Client Alert

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CFPB Brings Long-Anticipated First Redlining Enforcement Action – New Approach to Redlining Analysis Is Put into Action

By Joe Rodriguez

On September 24, 2015, the CFPB and DOJ announced a joint action against Hudson City Savings Bank for allegedly discriminatory redlining practices from 2009 through 2013 in certain neighborhoods in New York, New Jersey, Connecticut, and Pennsylvania in violation of the Equal Credit Opportunity Act and the Fair Housing Act. Over the past few months, officials from both the Bureau and DOJ have spoken publicly about redlining concerns, noting that they have seen a resurgence in the practice. Accordingly, we have anticipated the announcement of a significant enforcement action from the agencies.

Digging into the complaint reveals that the case against Hudson City was largely premised on the CFPB's peer-based redlining analysis, focusing on applications rather than originations, and identifying the following statistically significant disparities:

- In the NY/NJ Metropolitan Statistical Area (MSA) only 4.8% of Hudson City's applications were for properties in majority African-American or Hispanic census tracts,[1] while its peers generated 13.2% of their applications from such majority tracts, nearly 3x that of Hudson City.
- In so-called "high" African-American and Hispanic census tracts[2] in the NY/NJ MSA, Hudson City drew only 1.5% of its applications, while its peers drew 6.6% of their applications from such majority tracts, 4.5x that of the Bank.
- In the Camden, NJ MSA only 0.8% of Hudson City's applications were for properties in majority African-American or Hispanic census tracts, while its peers generated 8.3% of their applications from such majority tracts, nearly 10x that of Hudson City.
- In high African-American and Hispanic census tracts in the Camden MSA, Hudson City drew only 0.1% of its applications, while its peers drew 4.4% of their applications, approximately 31x that of the Bank.
- In the Bridgeport, CT MSA only 1.6% of Hudson City's applications were for properties in majority African-American or Hispanic census tracts, while its peers generated 7.6% of their applications from such majority tracts, approximately 4.5x that of Hudson City.
- In high African-American and Hispanic census tracts in the Bridgeport MSA, Hudson City drew only 0.2% of its applications, while its peers drew 2.0% of their applications, approximately 8x that of the Bank.

[1] According to the complaint, the Bureau defines a majority minority census tract as one where greater than 50% of the population is either African-American or Hispanic.

[2] According to the complaint, the Bureau defines a high minority census tract as one where greater than 80% of the population is either African-American or Hispanic.

In addition to these statistical concerns, the complaint alleged other matters that in totality significantly furthered the narrative set out in the peer analysis. During the relevant time period, Hudson City generated approximately 80% of its mortgage applications through brokers and approximately 20% through its retail branches. According to the complaint, based on 2010 census data, only 12 of 162 brokers (7.4%) utilized by Hudson City in the NY/NJ MSA are headquartered in majority African-American or Hispanic census tracts, and none of the 47 brokers utilized by the Bank in the Camden, NJ MSA were headquartered in majority African-American or Hispanic census tracts. Between 2011 and 2013, only 3.7% of the applications generated by Hudson City's brokers came from majority African-American or Hispanic census tracts, and, of those, only 18.2% were from applications that were noted in the Home Mortgage Disclosure Act data as actually being an African-American or Hispanic applicant. This means that only 0.67% of applications generated by Hudson City's brokers were from African-American or Hispanic applicants.

Moreover, within the Bank's retail branch network similar issues were noted. According to the complaint, between 2004 and 2010 Hudson City embarked on a branch expansion strategy in which it opened or acquired 54 branches. Of those branches, only four were located within a majority African-American or Hispanic census tract, and Hudson City did not accept first mortgage applications at most of its branches; instead, it referred customers to one of seven retail loan officers located in areas of New York, New Jersey, and Connecticut that had low African-American and Hispanic populations.

In addition, Hudson City's Community Reinvestment Act (CRA) assessment areas were drawn such that they excluded a significant percentage of the majority African-American and Hispanic neighborhoods. In the NY/NJ MSA, the Bank's CRA assessment area forms a clear doughnut hole around the 4 counties with the highest proportion of majority African-American and Hispanic neighborhoods. Moreover, the assessment area in the Camden MSA excludes all of the majority African-American and Hispanic census tracts.[3] While Hudson City would accept applications from the excluded areas, residents of these areas were not eligible for benefits others received such as discounted home improvement loans that the Bank generally offered to borrowers with low-to-moderate income.

Finally, the complaint also alleged that Hudson City's fair lending compliance management system was inadequate. The Bank's fair lending policy consisted solely of a statement asserting that it is an equal opportunity lender, and it had no written policies or procedures to monitor for compliance with its fair lending obligations. The Bank further failed to conduct any internal redlining analyses, even after being told it should do so by the Bureau in 2012.

In light of these facts, Hudson City agreed to a consent order that will require it spend $25 million on a loan subsidy program designed to provide affordable mortgage credit to residents in majority African-American and Hispanic neighborhoods in New York, New Jersey, Connecticut, and Pennsylvania. The Bank must further spend $2.25 million on advertising, local partnerships, and consumer education for residents of these neighborhoods. Hudson City must also open two new branches in majority African-American and Hispanic neighborhoods, expand its CRA assessment areas to include all of New York City and Philadelphia, and develop a fair lending compliance and training plan. The Bank must also pay a $5.5 million civil penalty to the CFPB.

[3] Hudson City's marketing was also noted as a concern. While the Bank doesn't much marketing, the little it did do was focused on Suffolk County, NY, which has the lowest proportion of majority African-American and Hispanic neighborhoods than any county in New York City and Long Island.

KEY TAKEAWAYS

This case appears to be a perfect storm of poor statistical results, branching and broker relationship decisions gone awry, inartful CRA assessment designations, and an inadequate compliance management system. The key question is whether this is the first of many actions to come or whether similar to indirect automobile lending, the Bureau will choose to file one or two actions to serve as a deterrent to others. Regardless, in order to avoid becoming the next lender subject to such an action, clients may want to consider the following lessons from the Hudson City case:

- **The CFPB has a New Approach:** While it remains true that a lender's CRA assessment area should not look like a breakfast food (e.g., the classic doughnut hole in Hudson City's NY/NJ assessment area), lenders cannot simply rely on setting a broad and inclusive assessment area in hopes of avoiding trouble. The Bureau's analyses are based on peers, meaning that regardless of a lender's good intentions to comply with the fair lending laws, they should be concerned if others are attracting applications and making loans in majority and high-minority areas at a significantly greater rate. The Bureau will view that as evidence that there were applicants seeking mortgage loans in such areas and may further assume, unless persuaded otherwise, that there is no legitimate non-discriminatory reason to draw relatively few applications from these areas.

- **Carefully Define Your Competition:** Because the CFPB's statistical analyses are based on peers, determining exactly which institutions should be in an institution's peer group is critically important. It's not enough to simply compare to the market as a whole rather the analysis should be focused on those lenders who have similar business models. Lenders also may want to consider various approaches to their redlining analyses, including holistic models that take more than just mortgage applications into account.

- **Fair Lending Compliance Management is Front and Center:** At a minimum, lenders must employ a robust fair lending compliance management system that includes policies and procedures, as well as details regarding front-end controls and back-end monitoring to mitigate any fair lending risk in their business. That compliance management program should also include regular redlining analyses to determine whether any statistically and practically significant disparities exist.

- **Branching and Relationships Still Matter in the Digital Age:** Even though banking is increasingly done through online and mobile platforms, traditional branch locations still matter. Locations of mortgage loan officers, as well as the brokers or correspondents you do business with are also relevant considerations. While decisions, of course, shouldn't be made solely for fair lending reasons, it is important for the fair lending professionals on staff to have a "seat at the table" whenever branching and other relationship decisions are being made.

Contact:

Joe Rodriguez
(202) 778-1610
jrodriguez@mofo.com

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