Fair Lending Developments: Testing the Limits of Statistical Evidence

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INTRODUCTION

The past year saw the continuation of some past trends, and some new directions. Building on a pattern of prior enforcement actions based on statistical discrepancies in mortgage lending data, the U.S. Department of Justice (“DOJ”) brought an enforcement action where minority borrowers’ loans were only five to fourteen basis points higher than those of white borrowers, the smallest differential to date. The DOJ also brought redlining enforcement actions and an action involving handicapped borrowers. The Department of Housing and Urban Development (“HUD”) entered the fair lending arena with a couple of actions involving claims of discrimination against pregnant mortgage borrowers.

Private litigation featured significant use of statistical evidence to establish a basis for class certification and to deny summary judgment to a mortgage lender. In addition to the traditional use of the Fair Housing Act (“FHA”) and the Equal Credit Opportunity Act (“ECOA”) as vehicles for fair lending claims, such claims were also brought under the civil rights laws. After appearing to be on their last legs, municipal reverse redlining cases were given a new lease on life in a pair of decisions that found that the municipal plaintiffs had successfully stated fair lending claims.

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FEDERAL ENFORCEMENT DEVELOPMENTS

ENFORCEMENT ACTIONS BY THE DOJ

The DOJ settled five cases in the past year on a wide range of fair lending issues under the FHA, the ECOA, and the Americans with Disabilities Act (“ADA”). The enforcement action against PrimeLending, a wholly owned subsidiary of PlainsCapital Bank (“PrimeLending”), alleged race discrimination nationwide consisting of charging African-American borrowers higher interest rates than non-Hispanic white borrowers on mortgage loans. PrimeLending allegedly gave its loan officers wide discretion to raise or lower interest rates (overages or underages) and did not monitor their discretion for fair lending concerns. This allegedly resulted in African-American borrowers paying an extra five to fourteen basis points, which increased their costs by $100 to $280 per year, and could not be explained by non-race related factors.

The consent order required PrimeLending to implement policies and procedures designed to ensure that its pricing was nondiscriminatory. This included limiting overages to 100 basis points, with loan officers required to submit a written explanation for any overage or underage that exceeds 50 basis points. A manager also must review each explanation before funding to document a legitimate, nondiscriminatory reason for the overage or underage, and to ensure that discretionary loan pricing does not vary materially by race or ethnicity. PrimeLending was also required to deposit $2,000,000 to pay claims.

The enforcement action against Midwest BankCentre, a wholly owned subsidiary of Midwest BankCentre, Inc. (“Midwest”), alleged race discrimination in lending to predominantly African-American communities in the St. Louis metropolitan area in violation of the FHA and the ECOA. All of the bank’s full-service branches were located in majority-white census tracts, and none was located in a majority-black census tract. Midwest also allegedly had formed its Community

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7. Id. at 3–4.
8. Id. at 4. By contrast, earlier consent decrees involved alleged differentials of 20 to 150 basis points. See Fair Lending 2011, supra note 1, at 448–49; Fair Lending 2010, supra note 1, at 576–77.
10. Id. at 4.
12. Id. at 5–6.
13. Id. at 6.
14. Id. at 10.
16. Id. at 4.
Reinvestment Act (“CRA”) \(^{17}\) assessment area in a “virtual horseshoe” around the majority-black census tracts, while comparable lenders received almost four times more residential loan applications and secured more than three times as many residential loans from majority-black census tracts than Midwest. \(^{18}\)

The Midwest consent order required it to open or acquire at least one full-service branch office in a majority-black census tract; \(^{19}\) spend at least $250,000 on targeted advertising and marketing campaigns to residents in majority-black areas; \(^{20}\) invest a minimum of $900,000 in special mortgage financing programs; \(^{21}\) spend a minimum of $300,000 on consumer education and credit repair programs; \(^{22}\) and pay $25,000 to the group that brought the bank’s practices to the government’s attention. \(^{23}\)

A similar redlining case was brought against Citizens Republic Bancorp, Inc. and its subsidiary Citizens Bank (“Citizens”), alleging that it discriminated against African-Americans by engaging in a race-based pattern of locating or acquiring branch offices in the Detroit metropolitan area. \(^{24}\) Eight of its nine branches were located in majority-white census tracts, and its CRA assessment area also allegedly formed a “virtual horseshoe” around majority-black census tracts. \(^{25}\) The bank’s customer solicitation efforts allegedly failed to include print or radio advertising in Detroit. This allegedly resulted in favoring the credit needs of residents in majority-white census tracts over residents of majority-black neighborhoods. \(^{26}\)

The Citizens settlement agreement required it to revise its CRA assessment area to include all of Wayne County and the City of Detroit. \(^{27}\) The bank agreed to devote $1,625,000 to promote sustained home ownership in Detroit; \(^{28}\) open a loan production office in a majority-black census tract in Detroit; \(^{29}\) spend $400,000 on advertising and consumer education directed at residents of majority-black census tracts; \(^{30}\) and spend $1,500,000 on a special financing program for qualified mortgage applicants in majority-black census tracts in Wayne County. \(^{31}\)

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\(^{20}\) Id. at 11.

\(^{21}\) Id. at 14.

\(^{22}\) Id. at 17–18.

\(^{23}\) Id. at 20.


\(^{25}\) Id. at 7.

\(^{26}\) Id. at 9.


\(^{28}\) Id. at 4.

\(^{29}\) Id. at 7.

\(^{30}\) Id. at 10.

\(^{31}\) Id. at 10–11.
In a fourth case, the DOJ charged that Nixon State Bank (“Nixon”) violated the ECOA when it engaged in a pattern of lending discrimination on the basis of national origin in the pricing of unsecured consumer loans in the small rural community of Nixon, Texas.\(^{32}\) The DOJ alleged that Nixon charged higher interest rates to Hispanics than non-Hispanic whites as a result of its policy of giving its employees broad subjective discretion in setting interest rates without justification by legitimate business interests.\(^{33}\)

The settlement required Nixon to pay $91,600 to a compensation fund\(^ {34} \) and revise its pricing policies to include standards for collecting applications and a uniform loan pricing matrix.\(^ {35} \) Nixon must limit the amount by which the interest rate may deviate, specify the factors that may contribute to the deviation, maintain a written record of those factors in each loan file, and monitor loan data for potential disparities based on national origin.\(^ {36} \)

The DOJ entered into a settlement agreement with Wells Fargo & Company (“Wells Fargo”) based on allegations that it violated Title III of the ADA based on complaints by individuals who are deaf, hard of hearing, or have speech disabilities.\(^ {37} \) The DOJ alleged that Wells Fargo refused to accept some calls made using relay services and instead referred such callers to telephone numbers with a dedicated teletypewriter/telecommunications device for the deaf which did not result in equal access to services because callers were required to leave messages that went unanswered.\(^ {38} \)

The settlement agreement required Wells Fargo to continue to accept calls made using relay services\(^ {39} \) and ordered it to pay up to $16,000,000 to compensate individuals harmed by the ADA violations,\(^ {40} \) pay $1,000,000 to nonprofit organizations that assist disabled veterans,\(^ {41} \) and pay a $55,000 civil penalty.\(^ {42} \) Wells Fargo must also provide customers with sign language and oral interpreters when necessary during face-to-face communication.\(^ {43} \)

**Enforcement Actions by HUD**

One day after an article appeared in the *New York Times*,\(^ {44} \) HUD announced that it was initiating multiple investigations into whether lenders discriminated


\(^{33} \) Id. at 3.

\(^{34} \) Id. at 9.

\(^{35} \) Id. at 4–5.

\(^{36} \) Id. at 5–6.


\(^{38} \) Id. at 1–2.

\(^{39} \) Id. at 11.

\(^{40} \) Id. at 22.

\(^{41} \) Id. at 30.

\(^{42} \) Id. at 31.

\(^{43} \) Id. at 15.

against women borrowers who were on pregnancy leave. Two enforcement actions resulted in 2011. These were the first fair lending, as opposed to fair housing, enforcement actions that HUD has taken.

The first action was against Cornerstone Mortgage Company (“Cornerstone”), which allegedly changed the status of a mortgage loan application from a female physician after it learned that she was on paid maternity leave. During her leave, her income came from short-term maternity disability benefits that could not be considered for purposes of qualifying for a mortgage loan under Cornerstone’s policies. HUD charged that this violated the FHA by discriminating on the basis of sex or familial status. It entered into a conciliation agreement under which Cornerstone settled the physician’s claims for $15,000 and set up an escrow account of $750,000 to pay claims from other female borrowers.

The DOJ filed an enforcement action in federal district court for HUD on behalf of a female borrower and all others similarly situated against Mortgage Guaranty Insurance Corporation (“MGIC”) and two of its underwriters. The complainant filed an administrative complaint of discrimination with HUD charging that MGIC would not issue private mortgage insurance on her mortgage loan while she was out on paid maternity leave until she returned to work full time. The enforcement action resulted when the complainant elected to resolve the HUD charge of discrimination in a civil action.

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49. Cornerstone Agreement, supra note 47, at 2–3 (citing 42 U.S.C. §§ 3604(a), 3604(c), 3605).

50. Id. at 5.

51. Id. at 6.


53. See id. at 4–8.

54. Id. at 9. The case is still pending as of this writing.
LITIGATION DEVELOPMENTS
PRIVATE DISCRIMINATION CLAIMS

In contrast to the many fair lending decisions that have addressed only pleading issues, statistical evidence played a key role in several cases over the past year. For example, the plaintiffs in Ramirez v. GreenPoint Mortgage Funding, Inc. alleged that the defendant violated the ECOA and the FHA by giving its brokers discretion over the pricing of mortgage loans, which led to African-Americans and Hispanics being charged disproportionately high interest rates. On class certification, the court examined whether the plaintiffs' expert's statistical analysis of GreenPoint's data satisfied the class requirements of commonality, typicality, and predominance under a disparate impact theory.

The expert's regression analysis showed that the interest rates charged African-Americans and Hispanics were 9.4 basis points and 7.6 basis points higher, respectively, than those for similarly situated whites. GreenPoint did not challenge the expert's underlying methods, but rather introduced its own expert to demonstrate how other factors justified the price disparities. The court held that it could not decline to certify the class based on the possibility that the plaintiffs' theory of liability would not prevail since they did not have to prove that they would ultimately succeed on the merits.

With respect to typicality, the court rejected GreenPoint's "unclean hands" argument based on the plaintiffs allegedly providing false information in their loan applications, on the ground that such an equitable defense does not apply to ECOA and FHA claims. GreenPoint also challenged the plaintiffs' standing because their interest rates were lower than those of similarly situated whites, so they could not show a negative effect from the discretionary policy. However, the plaintiffs' expert contended that, absent discriminatory practices, their rates would have been even lower. The court again held that the argument went to the ultimate merits of the plaintiffs' claims, and since the methodology of the plaintiffs' expert was not being challenged, it could not choose between the conflicting expert evidence at this stage.

56. 268 F.R.D. 627 (N.D. Cal. 2010). This case was previously reported on in Fair Lending 2009, supra note 55, at 570–72.
58. Id. at 633–34, 638–39, 641. Many federal courts have recognized that disparate impact claims are cognizable under both the FHA and ECOA. See Fair Lending 2010, supra note 1, at 572–73.
60. Id. at 633–34.
61. Id. at 634–35 (citing Dukes v. Wal-Mart Stores, Inc., 603 F.3d 571, 587 (9th Cir. 2010) (en banc), rev’d, 131 S. Ct. 2541 (2011)).
62. Id. at 638.
63. Id.
64. Id.
65. Id. at 639 (citing Dukes, 603 F.3d at 591–92).
With respect to predominance, the court rejected GreenPoint’s argument that it would need to evaluate each individual loan transaction to ascertain whether its brokers’ commissions were fundamentally different when they dealt with minority borrowers.66 The court concluded that the question of whether the class as a whole suffered price discrimination predominated over any individual issues.67

The result was the same in Barrett v. H&R Block, Inc.68 based on similar claims about broker pricing discretion.69 The plaintiffs’ expert’s regression analysis showed that the interest rates for African-Americans were 0.086 percent higher than those of similarly situated whites, resulting in them paying $134 more per year.70 The defendants’ expert challenged the merits of that analysis, but the court found that a dispute about the experts’ statistical analyses was tantamount to a dispute about the merits of the case, and therefore could not be grounds for denying class certification for lack of commonality.71

As in GreenPoint, the defendants challenged typicality based on the plaintiffs’ lack of standing because they received more favorable loans than similarly situated whites. However, the court concluded that allegations that a common practice governed the pricing of all class members’ mortgages were sufficient to show typicality.72 The court also rejected an “unclean hands” defense based on allegedly false statements in mortgage applications, as in GreenPoint.73

With respect to whether common questions predominated, the court held that the key question was whether the alleged discretionary pricing policy had a disparate impact because it fell “more harshly on one group than another and cannot be justified by business necessity.”74 In such a case, the relevant evidence focuses on “statistical disparities, rather than specific incidents, and on competing explanations for those disparities.”75 Despite the defendant’s attacks on the merits of the plaintiffs’ expert’s conclusions, the court found that the plaintiffs carried their burden of showing predominance.76

Statistical evidence was also the key to denying summary judgment to the defendant bank in In re Wells Fargo Residential Mortgage Lending Discrimination Litigation.77 The plaintiffs alleged that Wells Fargo’s credit pricing system, which used both objective and subjective discretionary criteria, resulted in a discriminatory

66. Id. at 641.
67. Id. at 642.
69. Id. at *8–9.
70. Id. at *15.
71. Id. at *17–18. As in GreenPoint, the defendants did not contend that the plaintiffs’ statistics were “unreliable or based on an unaccepted method,” something that must be resolved at the certification stage. Id. at *18 n.6 (citing Dukes v. Wal-Mart Stores, Inc., 603 F.3d 571, 591–92 (9th Cir. 2010) (en banc), rev’d, 131 S. Ct. 2541 (2011)).
72. Id. at *20.
73. Id. at *21 (citing McKennon v. Nashville Banner Publ’g Co., 513 U.S. 352, 356–57, 360 (1995)).
74. Id. at *23–24 (citing Int’l Bhd. of Teamsters v. United States, 431 U.S. 324, 335 n.15 (1977)).
75. Id. at *24 (citing Watson v. Ft. Worth Bank & Trust, 487 U.S. 977, 987 (1988)).
76. Id.
77. No. 08-md-01930 MMC, 2010 U.S. Dist. LEXIS 122346 (N.D. Cal. Nov. 18, 2010).
impact on minorities in violation of the ECOA and the FHA.\footnote{78} The bank argued that the plaintiffs had to demonstrate individually that they paid more than a similarly situated non-minority borrower. Citing \textit{GreenPoint}, the court disagreed, holding that “[p]roof of disparate impact is based not on an examination of individual claims, but on a statistical analysis of the class as a whole,” because they are proven “by considering how a common policy collectively affects a group.”\footnote{79} The court found that the plaintiffs’ evidentiary showing that they were injured by Wells Fargo’s discretionary pricing policy was sufficient to create a fact question and deny summary judgment.\footnote{80}

Some courts found that fair lending claims may be brought under the civil rights laws as an alternative to claims under the ECOA and the FHA. The United States Court of Appeals for the Third Circuit held as a matter of first impression in \textit{Anderson v. Wachovia Mortgage Corp}.\footnote{81} that a fair lending claim can be brought under 42 U.S.C. § 1981. The plaintiffs claimed that Wachovia would only issue mortgage loans to them after it imposed several additional conditions that were racially motivated.\footnote{82} The district court granted summary judgment dismissing their claims. Finding that the plaintiffs had not presented direct evidence of discrimination,\footnote{83} the court applied the burden-shifting analysis of \textit{McDonnell Douglas Corp. v. Green}\footnote{84} to their claims. Under this analysis, if a plaintiff makes out a prima facie case, then the burden shifts to the defendant to offer some evidence of a legitimate reason for the complained of action. The burden then shifts back to the plaintiff to prove that the defendant’s proffered legitimate reason is only pretextual.\footnote{85} On the second and third prongs of this analysis, the court determined that Wachovia had proffered legitimate nondiscriminatory reasons for its actions and that the plaintiff had failed to rebut adequately those reasons as pretextual, and therefore affirmed.\footnote{86}

\begin{itemize}
\item \footnote{78}{Id. at *5–6.}
\item \footnote{79}{Id. at *9 (citing Ramirez v. Greenpoint Mortg. Funding, Inc., 268 F.R.D. 627, 641–42 (N.D. Cal. 2010)).}
\item \footnote{80}{Id. at *9–10. The court noted that Wells Fargo had challenged the admissibility of the plaintiffs’ statistical evidence under a separate motion to strike that had not yet been decided as of this writing. \textit{Id.} at *10 n.4 (citing Daubert v. Merrell Dow Pharms., Inc., 509 U.S. 579 (1993)). The court also stayed proceedings pending the U.S. Supreme Court’s decision in \textit{Wal-Mart Stores, Inc. v. Dukes}, 131 S. Ct. 2541 (2011). Stipulation and Order Staying Proceedings Except for Those Relating to Pending Motions to Strike and Setting Additional Briefing Schedule Re: Dukes, \textit{In re Wells Fargo Mortg. Lending Practices Litig.}, No. 3:08-md-01930 MMC (N.D. Cal. Apr. 20, 2011) (on file with \textit{The Business Lawyer}).}
\item \footnote{81}{621 F.3d 261, 264 (3d Cir. 2010).}
\item \footnote{82}{Id. at 264–65. Such conditions included requiring pre-closing repairs and increased down payments.}
\item \footnote{83}{Id. at 269–70. The court found that plaintiffs’ allegations of the defendants’ use of the phrase “you people” did not establish direct evidence of discrimination.}
\item \footnote{84}{411 U.S. 792 (1973).}
\item \footnote{85}{\textit{Anderson}, 621 F.3d at 270–71.}
\item \footnote{86}{Id. at 277–79.}
\end{itemize}
MUNICIPAL DISCRIMINATION CLAIMS

Unlike in previous years, two municipal reverse redlining cases survived motions to dismiss. In *Mayor & City Council of Baltimore v. Wells Fargo Bank, N.A.*, allegations of deliberately steering African-American borrowers away from prime loans that they could afford to pay to higher-cost subprime loans that they could not afford, resulting in defaults, foreclosures, and property vacancies, were found to “clearly provide the missing causal link” between the alleged steering and identified properties becoming vacant. The court also found that causation was shown for specific identified properties where unqualified borrowers were given refinanced mortgage loans or home equity loans that they could not afford to pay, likewise resulting in foreclosures and vacancies, although they would have remained in possession but for the unaffordable loans.

Memphis filed a similar reverse redlining case. As in the *Baltimore* case, the defendant bank moved to dismiss on the ground that the city lacked standing to sue because it failed to allege an injury that was causally connected to the alleged predatory loans. However, “concrete allegations” concerning fifty specific representative properties where reverse redlining allegedly caused foreclosures and vacancies, causing it injury due to increased government services and lost property tax revenue, showed that the city’s damages were “fairly traceable” to the bank’s alleged predatory lending practices in targeting African-American borrowers for mortgage loans that they could not afford to pay. The court distinguished other cases because such specificity was missing from those cases. The court also found that the city adequately stated the factual predicate for a disparate impact claim under the FHA by alleging that financial incentives to loan officers led them to steer minority borrowers to more expensive subprime loans in a statistically disproportionate way.

CONCLUSION

Both the DOJ and private litigants have tested the limits of statistical disparities in presenting evidence of disparate impact on racial minorities in fair lending.

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89. *Id.* at *9–10.
90. *Id.* at *10–11.
94. *Id.* at *31.
95. *Id.* at *45–51.
cases. The DOJ’s settlement with PrimeLending was based on a differential of only five to fourteen basis points between African-American and white borrowers. The statistical evidence presented in the Ramirez and Barrett cases also showed basis point differentials in the single-digit range. This suggests that cautions about the use of expanded data made available after 2002 under the Home Mortgage Disclosure Act\(^{96}\) and Regulation C,\(^{97}\) voiced by the Federal Reserve Board researchers who studied the data,\(^{98}\) have gone for naught, and that virtually any level of discrepancy is enough to form the basis for a claim of racial discrimination.

However, the United States Supreme Court’s decision in Wal-Mart Stores, Inc. v. Dukes\(^ {99}\) may change this picture. As noted above, the courts’ analysis of statistical evidence presented by the plaintiffs in Ramirez, Barrett, and Wells Fargo depended on the then-recent en banc decision of the United States Court of Appeals for the Ninth Circuit in Dukes, which the Supreme Court reversed. Focusing on the statistical evidence that the plaintiffs offered in Dukes to support class certification, the Supreme Court’s majority opinion takes a much more rigorous view of what “significant proof” of discrimination is needed to prove a class action claim,\(^{100}\) particularly where it is claimed that discrimination results from an exercise of discretion in decision making. It will be most interesting to see what impact Dukes will have on the quantum of proof in fair lending litigation.

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100. Dukes, 131 S. Ct. at 2553–56 (citing Gen. Tel. Co. v. Falcon, 457 U.S. 147 (1982)).