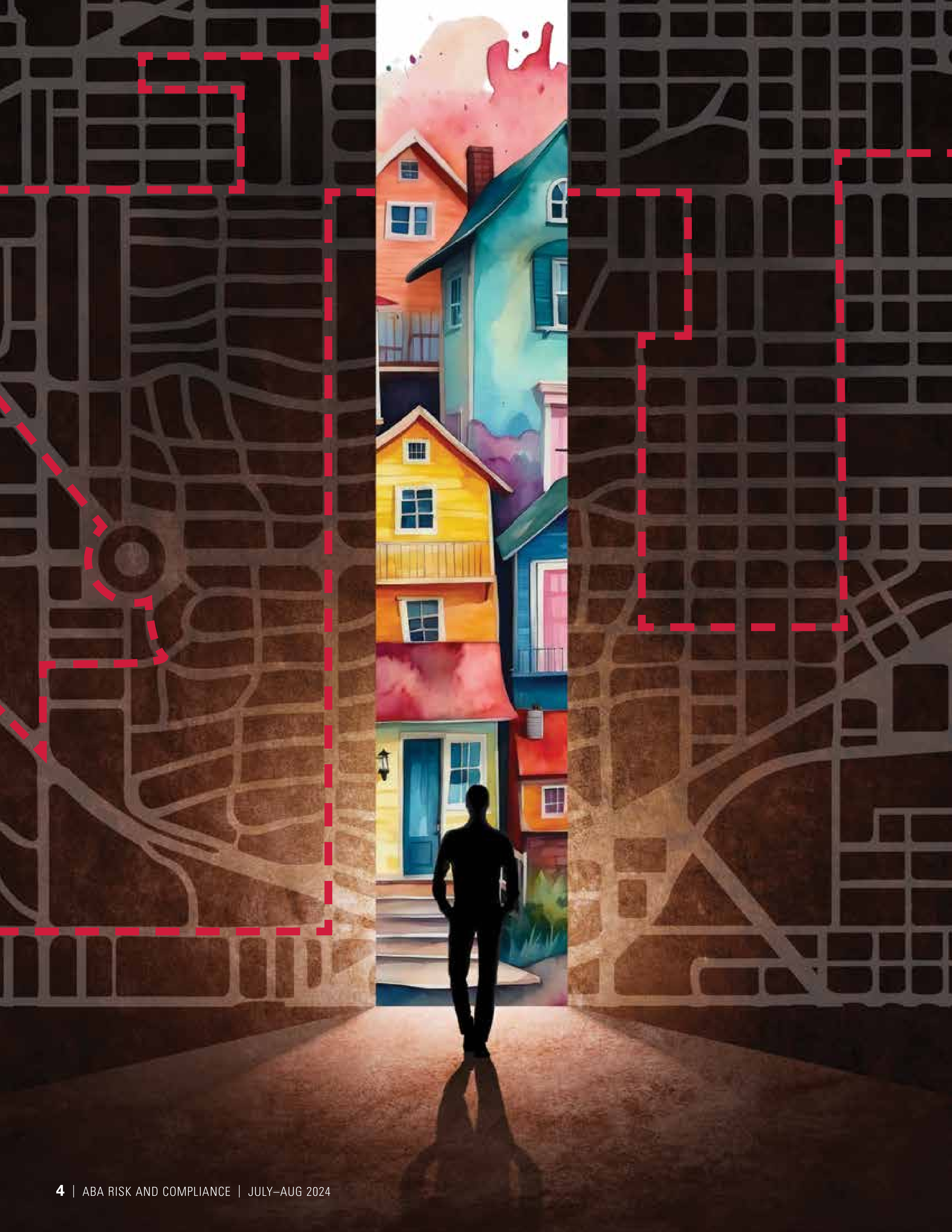

Lessons Learned from Redlining Examinations and the Initiative to Combat Redlining

BY ANDREA K. MITCHELL AND OLIVIA KELMAN

FEWER TOPICS GENERATE MORE CONVERSATION in bank consumer compliance today than redlining. Though redlining cases have been in the news since the 1990s, and regulators have been examining for redlining risk for decades, banks are taking notice of the fast and furious pace of examinations, investigations and settlements since the U.S. Department of Justice (DOJ) announced its Combating Redlining Initiative in October 2021.[1]

This article provides an overview of the current state of play in redlining enforcement and recent examples of practices that are treated as indicia of redlining. After exploring these topics, the article will offer suggestions for mitigating redlining risk and improving your institution's minority market lending performance.

Current State of Play in Redlining Enforcement

In the press event announcing the Combating Redlining Initiative, Attorney General Merrick B. Garland stated:

"Today, we are committing ourselves to addressing modern-day redlining by making far more robust use of our fair lending authorities. We will spare no resource to ensure that federal fair lending laws are vigorously enforced and that financial institutions provide equal opportunity for every American to obtain credit."[2]

Since the announcement, DOJ has publicly stated that it has two dozen open redlining investigations–most of which have been initiated by DOJ as opposed to the more common historical path of investigating referrals by federal bank regulators. The Attorney General's 2022 Annual Report to Congress on Fair Lending Enforcement identifies each agency's redlining referrals to DOJ for the first full year of the Combating Redlining Initiative. Redlining referral counts in 2022 were as follows:

- Federal Deposit Insurance Corporation (FDIC)(2)
- Office of the Comptroller of the Currency (OCC)(1)
- Federal Reserve Board (Fed) (0)
- Consumer Financial Protection Bureau (CFPB)(4)
- U.S. Department of Housing and Urban Development (HUD)(0)
- National Credit Union Administration(NCUA) (0)
- Federal Trade Commission (FTC)(0).[3]

Of those referrals, the DOJ opened investigations on the two FDIC cases, the OCC case, and one of the CFPB cases. This shows that the remainder of the open redlining investigations were DOJ-initiated investigations.

Since the Combating Redlining Initiative was launched, DOJ has filed 11 redlining complaints and has simultaneously entered into 12 redlining settlements that have resulted in $122 million in relief for affected communities. Consent orders have almost consistently included the same general provisions, which require:

- An injunction against future violations of fair lending laws;
- The opening of one or more full-service branches or loan production offices in the affected area;
- A community credit needs assessment;
- Substantial investments in a residential loan subsidy fund that must be allocated to borrowers in allegedly affected areas for specified purposes;
- Donations to community or government organizations that assist with homeownership;
- Increased budgets for targeted marketing and outreach in the allegedly affected area;
- Hiring a director of community lending;
- Fair lending training;
- Fair lending risk program assessment; and
- Financial education seminars for consumers and loan referral sources in the affected areas.

Most consent orders have a five-year term with annual reporting obligations. While the DOJ does not typically assess civil money penalties in redlining consent orders, the CFPB has a policy and practice of issuing penalties in all enforcement actions, including joint settlements with the DOJ. Prudential regulators also have authority to impose a civil money penalty even when they are not a party to the redlining settlement.

Developments in Redlining Examinations and Investigations

Aside from the frequency and volume of redlining enforcement actions over the past three and a half years, some new approaches have emerged in redlining examinations and investigations. These changes include expanded investigation targets, additional types of peer analyses, additional focus on other indicia of intent to avoid minority areas, heightened attention to fair lending compliance programs, and prior knowledge of disparities in minority-area lending.

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Expanded Investigation Targets

First, DOJ has historically directed its redlining focus on depository institutions ostensibly in part because of their obligation to publicly determine and disclose their Community Reinvestment Act (CRA) Assessment Areas, which obligate banks to serve all communities in the delineated areas and sometimes reveal exclusion of majority-minority census tracts from those areas.

However, the CFPB and DOJ have recently been investigating independent mortgage companies, which have been responsible for a growing percentage of the overall market share in HMDA reportable loans. In 2022, mortgage companies accounted for 72.1 percent of all first-lien, residential mortgage originations, up from 63.9 percent in 2021.[4] In light of this significant growth in market share, it is not surprising the CFPB and DOJ have both attempted to bring enforcement strategies into alignment with this new market reality by expanding their targets to include independent mortgage companies.[5] In addition to previously announced-public settlements and litigation, additional investigations of mortgage companies are in progress.

Another expansion in redlining investigations relates to regulators' scrutiny of banks that are relatively new entrants to the allegedly affected market. Gone are the days when banks were given a grace period to operate in a new market and build a presence before regulators expect the institution to receive applications from minority-area residents, sometimes referenced as "MMCT residents," at a level that statistically matches the level of applications received by longer-established peers.[6] This development may influence how banks evaluate the risks and rewards of mergers and acquisitions: if the acquirer or resultant bank is exposed to redlining risk from Legal Day One–or even before Legal Day One–meaningful due diligence of the surviving institution's redlining risk should now be a top-line issue for pre-transaction evaluation.

In addition, no bank is too small or too large to become the subject of a redlining investigation. While larger community banks and midsize banks tend to attract the most scrutiny, very large institutions have come under fire recently for poor performance in minority market lending, albeit outside the DOJ enforcement context. While large banks have historically avoided redlining settlements, activist groups and investigative journalists have used the media as a bully pulpit to prompt change from the largest mortgage lenders. Meanwhile, the regulators and DOJ have begun casting a wider net to capture small community banks in their redlining examinations and investigations, including ones with assets less than $1 billion.[7]

Additional Types of Geographic and Peer Analyses

In the past, regulators, enforcement agencies and civil rights organizations have generally focused on a lender's performance in majority-minority census tracts (MMCTs) relative to their performance in non-majority-minority census tracts (non-MMCTs), as compared to their peers, considering both application and origination volume. While this type of peer analysis focused on overall minority composition is still utilized as a measurement of minority market lending, DOJ has focused more recently on majority-Black and Hispanic census tract (MBHCT) lending. This shift in census tract demographic type may be a distinction without a difference in some markets due to the high Black and Hispanic population, and the resulting overlap between MMCTs and majority-Black and Hispanic census tracts.

However, the distinction between MMCTs and majority-Black and Hispanic census tracts could be very impactful in measuring a bank's performance in markets where MMCTs have a meaningful percentage of residents who are American Indian, Alaskan Native, Asian, Native Hawaiian or Other Pacific Islander. In those markets, an MMCT may not be an MBHCT, and strong performance in MMCTs may not shield a bank from allegations of redlining. If that bank is only monitoring its performance in MMCTs and is performing well in those tracts, that bank may unwittingly have redlining risk if a meaningful portion of those MMCTs are not also MBHCTs. Banks must ensure that statistical monitoring for redlining risk accurately reflects the racial and ethnic composition of the communities in which they operate and must stay attuned to changes in community demographics.

In some examinations, regulators have gone a step further to advise banks that they are under-performing in majority-Hispanic census tracts, majority-Black census tracts, or majority-Asian census tracts. The growing list of census tracts being used by the government to identify redlining risk creates a moving target for lenders to know which tracts to monitor. The most conservative option is to review all census tract types. Focusing on census tracts other than MMCTs may reduce the number of census tracts where a lender can generate sufficient application or loan volume to obtain statistically meaningful results.

In addition to the expanding list of demographic types of census tract being monitored, the government sometimes changes the geographical scope of its analyses and no longer confines its analyses to the Metropolitan Statistical Area (MSA) level. Some banks are being evaluated for potential redlining at the Metropolitan Division (MD) level. This level of granularity can be important insofar as some banks may find that they are lending at or near peer levels within an MSA but not within a particular MD in that MSA.

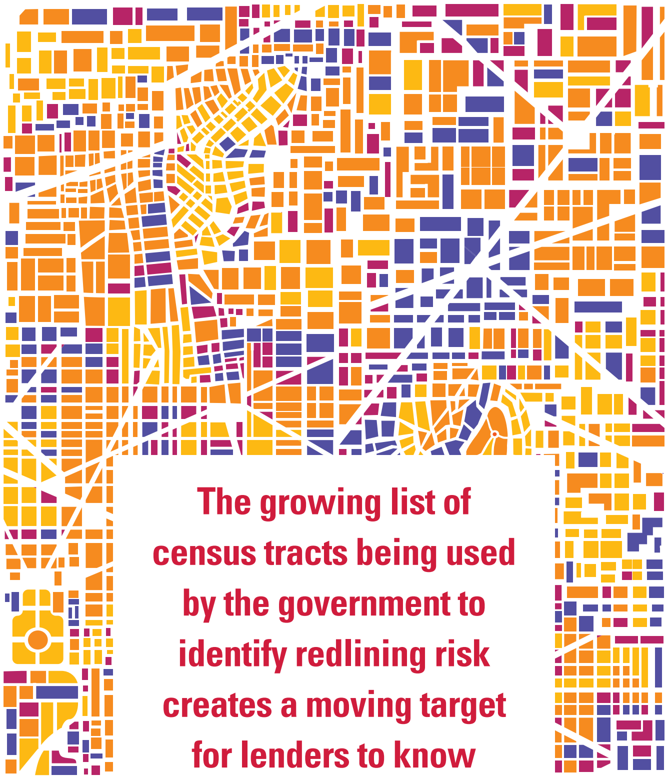
Conversely, the reverse might be true, and a bank that is lending in a manner similar to other lenders within a MD may find that the government's insistence on analyzing an entire MSA distorts the bank's true performance in minority areas. This approach to testing different geographic areas has caught some banks off-guard and without an explanation for why it is performing well at the MSA level but not the MD level or vice versa. That is why regulators encourage banks to conduct periodic analyses of their lending activity in their reasonably expected market area (REMA), otherwise known as a bank's service area, especially when their REMA is broader than their Assessment Area.

A few things have not changed in the context of "peer" analyses that compare a bank's performance in minority-area lending to the performance of other institutions operating in the same geography.

First, the government rarely adjusts the aggregate peer group beyond a filter for lenders with 50 to 200 percent of the HMDA volume as the lender at issue. While many reasons exist to include additional filters to identify true comparator institutions (e.g., asset size, exclusion of credit unions and non-depositories, exclusion of lenders with no brick-and-mortar in the market, to name just a few), regulators and DOJ generally do not accept additional adjustments to their volume-based peer group.

Second, the government does not accept a hand-picked peer group chosen by the lender when running an analysis. Preliminary findings letters have been critical of this practice.

Third, the government generally considers a lender's service area to cover the census tracts that it believes the lender should have had in its CRA Assessment Area during the relevant period, not the service area the lender delineated for itself. The significance of this practice is that a lender could run an analysis limited to its self-identified CRA Assessment Area only to



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find later that its minority market lending performance is being evaluated by the government in a much larger geographic area that has never been a focus of the lender.

Fourth, the government does not give lenders credit (in the fair lending enforcement context) for loans purchased on the secondary market, i.e., loans that have a HMDA Action Taken code of "6." While there was uncertainty on this issue prior to 2015, the industry was on notice of this position after DOJ's redlining settlement with Hudson City Bank.[8] Recent examination findings confirm that purchased loans are not included in a bank's MMCT loan count (or in the 50 to 200 percent formula utilized by the government for identifying the bank's peers).

Additional Indicia of Redlining

In the past, regulators and enforcement agencies generally focused redlining examinations and investigations on:

- Peer analyses;
- Assessment Area delineations;
- Branch locations and loan officer placement;
- Marketing and outreach efforts in minority markets;
- Community partnerships and engagement; and the
- Strength of the lender's fair lending compliance program.

In rare instances, the government relied upon evidence of intentionally discriminatory statements or overtly discriminatory policies to support redlining complaints. More recent examinations and investigations have expanded the scope of issues that are being evaluated, including referral sources, services offered to borrowers with limited English proficiency (LEP), and electronic communications that may reveal potential racial or ethnic bias by company employees, including emails and social media postings.

Referral Sources

DOJ investigations have become increasingly focused on referral sources, such as bank or loan officer relationships with realtors, builders or professional or civic organizations. The DOJ often probes deeply into referral sources at the institution level and loan officer level and will evaluate the geographic areas served by those referral sources. If a bank's referral sources focus extensively on or arise from non-MMCT areas, that is considered indicia of redlining. This is particularly so where there is no evidence that the bank encourages loan officers to develop relationships with referral sources in minority neighborhoods or other underserved areas.

Services Offered to Individuals with Limited English Proficiency (LEP)

In redlining examinations and investigations where the lender may have redlined in MMCTs or MBHCTs, the government often scrutinizes the lender for its lack of LEP services. For example, the government has been critical of banks with no Spanish-speaking loan officers or a web site that is not fully translated into Spanish. DOJ settlements have required the bank to:

Conduct homebuyer education classes in both English and Spanish;

- Market and advertise in English and Spanish;
- Provide point-of-distribution materials in English and Spanish;
- Translate portions of the company's website into Spanish;
- Create Spanish-language content for its digital application platform and other digital points of access to schedule an appointment with a Spanish-speaking employee; and to
- Provide language interpretation services with a live person, not artificial intelligence technology.[9]

Electronic Communications Revealing Potential Racial or Ethnic Bias

A new development since the launch of the Combating Redlining Initiative has been a request to search certain employees' electronic communications for racially or ethnically discriminatory words identified by DOJ. Electronic communications include emails, text messages, videoconference chats, Slack, and other similar forms of communications between employees. Employees for whom the DOJ seeks electronic communications typically include people with responsibility for determining branch locations, physical expansion strategies, Assessment Area delineations and mortgage loan officers in the allegedly affected area.

As a result of this new focus, emails have been cited in recent settlements as evidence of racial or ethnic bias that purportedly contributed to the company's lack of lending in MBHCTs.[10] Moreover, emails or text messages referenced in the government's complaints may not have been written by a bank employee; instead, a bank employee may have received the email or text from an external source and forwarded the message, without comment, to another person. DOJ attorneys take the position that any electronic communications from bank employees that reveal racial or ethnic bias support their claims that its personnel have intentionally avoided serving the lending needs of the allegedly affected area.

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This development has been the subject of extensive discussion in the industry and has prompted executives, Human Resources Departments and in-house counsel to explore whether to proactively implement email searches or use artificial intelligence to monitor employees' communications for discriminatory or biased comments in their work emails, texts or chats. Searching, collecting, and reviewing electronic communications can significantly increase the costs of a redlining investigation for a bank and given the prevalence of electronic communications, present a high level of risk that some needle might turn up in the haystack.

Heightened Attention to Fair Lending Compliance Programs

In addition to the indicia of redlining referenced above that are being investigated, regulators and enforcement agencies have increased their focus on the strength of the bank's fair lending program. A bank's failure to develop and maintain a robust fair lending program is considered indicia of redlining because it could reflect the institution's indifference to analyzing its MMCT or MBHCT lending performance and, as necessary, adopting appropriate controls to ensure that predominantly minority neighborhoods are being served as well as predominantly white non-Hispanic neighborhoods. For example, banks are expected to:

- Ensure the board, management, lending team, marketing team and other appropriate personnel receive regular fair lending training;
- Conduct peer analyses and other standard fair lending testing;
- Perform periodic Assessment Area analyses to ensure that its boundaries do not arbitrarily exclude MMCTs;
- Perform regular fair lending risk assessments;
- Maintain a process for ensuring that branches in or near MMCTs receive adequate loan officer staffing;
- Review marketing and advertising materials and the distribution of those materials, ensuring that such materials promote first-time homebuyer products or other products focused on affordability.

In addition, banks are expected to have a compliance department that has appropriate staffing, resources, and expertise to monitor redlining risk, and the practical ability to escalate risk to decision-makers where it is identified.

Even where lenders have a strong second line of defense, if the board and management team do not receive reporting on redlining or other fair lending risks, or they receive reporting and take no action to address persistent redlining issues, the strength of the fair lending program cannot compensate for the lender's failure to take corrective action over a prolonged period of time.

In fact, based on recent redlining examinations, regulators are taking a much heavier hand in directing banks through Matters Requiring Attention on how to perform peer analyses and fair lending risk assessments, how to incorporate fair lending oversight into marketing and advertising, and how to increase MMCT or MBHCT lending in markets where the bank is underperforming relative to peer. Moreover, there is an expectation that banks conduct a root cause analysis when they identify redlining risk. The reason for such root cause analyses is to prompt a deeper understanding of the institution's ability to achieve higher loan penetration in MMCTs or MBHCTs.

Suggestions for Mitigating Redlining Risk and Improving Minority Market Lending

The key to developing a fair lending compliance program that identifies and mitigates redlining risk is understanding all of the areas where a bank's lending, marketing and outreach activities influence how the institution engages with the community and engages in mortgage lending. Many banks learn too late that there were many missed opportunities to detect redlining risk earlier in the process. At a minimum, banks should:

- Conduct annual peer analyses and regular fair lending risk assessments–and when the institution is underperforming in minority areas, perform a root cause analysis;
- Understand the fair lending impact of any potential merger or acquisition, either by virtue of the combined entity branch locations or changes to the combined Assessment Areas, and consider making appropriate changes prior to any prompt from the government;
- Report any redlining risks to the appropriate management and Board committees;

DOJ attorneys take the position that any electronic communications from bank employees that reveal racial or ethnic bias support their claims that its personnel have intentionally avoided serving the lending needs of the allegedly affected area.

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- Develop and implement policies that ensure any branch or LPO opening or closing is evaluated for its impact on MMCTs or MBHCTs and that any expansions or contractions of an Assessment Area are subject to the same type of analysis;
- Create an inventory of the bank's referral sources to assess whether realtors, builders and other sources of business are adequately covering MMCT and MBHCT neighborhoods;
- Ensure that compensation plans and incentive programs are appropriately aligned with MMCT and MBHCT lending priorities;
- Develop appropriate controls around marketing, advertising and social media to ensure that the institution is reaching borrowers in minority markets as well as non-minority markets;
- Communicate with employees regularly about the bank's policies on fair and non-discriminatory treatment of customers and proper use of work email and social media; when needed, take disciplinary action against any employee who violates such policies; and
- Evaluate the institution's staffing of loan officers in branches in or adjacent to MMCTs or MBHCTs, including the availability of LEP services in locations where LEP borrowers reside or do business.

The most important tip for developing a minority market lending strategy is that there is no one-size-fits-all approach. What works in Los Angeles may not work in Chicago or Boston. And, what works for a small community bank may not work for a midsize bank or large bank. However, the following tactics are worth exploring regardless of market or bank size:

- Utilize internal or external resources to evaluate the residential lending needs of the MMCT or MBHCT residents in the market where the institution is underperforming, focusing specifically on local community and housing organizations or Community Development Financial Institutions that may have strong ties with minority communities;
- Ensure that the institution maintains a fair lending compliance program that has the appropriate resources and expertise needed for the size and risk profile of the bank;
- Develop outreach strategies for markets where the institution's branch network is not located in or near MMCTs or MBHCTs;
- Establish a management level committee that tracks MMCT and MBHCTs applications and originations and reports those results to senior management and Board committees;
- Evaluate the bank's mortgage and residential lending products to ensure that its suite of products adequately serve the lending needs of MMCT and MBHCT residents by, for example, offering products focused on first time homebuyers and affordability; where appropriate, consider offering a Special Purpose Credit Program; and
- Explore opportunities to expand foreign language services to LEP borrowers.

Key Take Aways

The clear message from regulators and enforcement agencies that enforce fair lending laws is that redlining appears to be on the main stage as a mechanism for closing the racial equity gap in homeownership. It is never too early to assess your institution's redlining risk and take steps to mitigate any identified risks. While banks cannot control what has transpired in prior years' mortgage lending activity, branching and community outreach, they can control what they do today and in the future to demonstrate their commitment to minority market lending and outreach. ■

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Endnotes

1. See Pres Release, U.S. Dep't of Justice, Justice Department Announces New Initiative to Combat Redlining (Oct. 22, 2021), https://www.justice.gov/opa/pr/justice-department-announces-new-initiative-combat-redlining
2. Id.
3. U.S. Dep't of Justice, Civil Rights Division, The Attorney General's 2022 Annual Report to Congress on Fair Lending Enforcement (2023).
4. Consumer Fin. Prot. Bureau, Summary of 2022 Data on Mortgage Lending (2023), available at https://www.consumerfinance.gov/data-research/hmda/summary-of-2022-data-on-mortgage-lending/.
5. See Memorandum Opinion and Order, Bureau of Consumer Fin. Prot. v. Townstone Fin., Inc., No. 20-4176, 2023 U.S. Dist. LEXIS 18405 (N.D. Ill. Feb. 3, 2023); Consumer Fin. Prot. Bureau v. Trident Mortg. Co., LLC, No. 22-2936 (Sept. 14, 2022), https://files.consumerfinance.gov/f/documents/cfpb_trident-consent-order_2022-09.pdf.
6. See U.S. v. First Nat'l Bank of Penn., No. 24-88 (Feb. 13, 2024), https://www.justice.gov/d9/2024-02/settle_fnb-final.pdf (settling redlining claims for time period that immediately preceded and followed bank's entry into market through the acquisition of a bank).
7. See, e.g., U.S. v. Am. Bank of Okla., No. 23-371 (Aug. 28, 2023), https://www.justice.gov/opa/file/1311976/dl?inline (settling redlining complaint).
8. See Consumer Fin. Prot. Bureau v. Hudson City Savings Bank, F.S.B., No. 15-7056 (Nov. 4, 2015), https://www.justice.gov/crt/case-document/file/791046/dl (settling joint redlining complaint of DOJ and CFPB).
9. See, e.g. U.S. v. First Nat'l Bank of Penn., No. 24-88 (Feb. 13, 2024), https://www.justice.gov/d9/2024-02/settle_fnb-final.pdf; U.S. v. The Wash. Trust Co., of Westerly, No. 23-399 (Sept. 27, 2023) (settling redlining complaint).
10. See Complaint at 10, Consumer Fin. Prot. Bureau v. Trident Mortg. Co., LLC, No. 22-2936 (July 27, 2022), https://files.consumerfinance.gov/f/documents/cfpb_trident_complaint_2022-07.pdf (noting emailed flyers contained "contained photos of Trident mortgage loan officers who were almost all white")]; see also Complaint at 17-19, U.S. v. Am. Bank of Okla., No. 23-371 (Aug. 28, 2023), https://www.justice.gov/d9/2023-10/complaint.pdf (describing bank employee emails containing allegedly racist descriptions of black persons).

ABA RESOURCES

ABA Webinar: Controlling Redlining Risks
aba.com/training-events/online-training/controlling-redlining-risks-how-to-impact-performance

ABA Training: Fair Lending
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