POST-RACIAL LENDING?

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I. INTRODUCTION

Should lenders have absolute discretion when setting mortgage loan prices regardless of the borrower's creditworthiness? How should a regulatory framework evaluate lending decisions for racial bias to determine if demographic or other variables are used as proxies for race? Congress enacted the Home Mortgage Disclosure Act in order to acquire data on mortgage lending patterns and to discourage geographical disinvestment.[1] Basic HMDA data indicates that mortgage loan applications from black and Hispanic households are more likely to be denied than are applications from whites. Loan denial rates for blacks, Hispanics, and Asians are higher than white applicants at all income levels.[2] The data also indicates that even after controlling for credit characteristics, minority homeowners are concentrated in the sub-prime sector.[3]

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1. ALLEN FISHBEIN & REN ESSENE, JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., THE HOME MORTGAGE DISCLOSURE ACT AT THIRTY-FIVE: PAST HISTORY, CURRENT ISSUES 1 (2010) ("The impetus for HMDA grew out of growing public concerns in the 1970s about mortgage "redlining" and the effects of disinvestment on the nation's older urban neighborhoods."); *Cf.* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-704, FAIR LENDING: DATA LIMITATIONS AND THE FRAGMENTED U.S. FINANCIAL REGULATORY STRUCTURE CHALLENGE FEDERAL OVERSIGHT AND ENFORCEMENT EFFORTS (Jul. 15, 2009) [hereinafter U.S. GOV'T ACCOUNTABILITY OFFICE] (identifying the limitations of HMDA data and discussing how those limitations and the fragmented financial regulatory system contribute to the ineffectiveness of fair lending enforcement).

2. STEPHEN ROSS & JOHN YINGER, THE COLOR OF CREDIT: MORTGAGE DISCRIMINATION, RESEARCH METHODOLOGY, AND FAIR-LENDING ENFORCEMENT 6 fig. 1.2 (2002).

3. DEBBIE G. BOCIAN ET AL., CTR. FOR RESPONSIBLE LENDING, UNFAIR LENDING: THE EFFECT OF RACE AND ETHNICITY ON THE PRICE OF SUBPRIME MORTGAGES 17 tbl. 6, 18 tbl. 7 (2006) (using controls and the 2004 HMDA data and credit scores controlling for mortgage product type, credit score, loan-to-value, and other variables, blacks were 6.1 percent to 34.3 percent more likely than whites to receive a higher rate subprime mortgage, and Latinos were 28.6 percent to 37.4 percent more likely to receive a higher rate mortgage).

Countrywide Financial Corporation was known for its aggressive growth strategy and was at its height the largest U.S. mortgage lender. In 2007 alone, it originated $408 billion in loans.[4] When it was ultimately acquired by Bank of America in 2009, it still managed 400,000 home loans.[5] Lax underwriting standards and discriminatory lending fueled this growth of loans.[6] Countywide made loans based on false or missing data about both borrowers and properties.[7] Furthermore, a Department of Justice investigation found that during the housing boom, Countrywide engaged in a pattern and practice of discrimination.[8] During the years 2004–2008, it discriminated against African-American and Hispanic borrowers by charging higher fees and rates to more than 200,000 minority borrowers across the country.[9] These borrowers posed the same credit risk as white borrowers with similar profiles.[10] By systematically charging higher discretionary fees and markups to minority borrowers, Countrywide[11] steered more than 10,000 minority borrowers into costly subprime mortgages when they were eligible for less expensive loan products.[12] Countrywide specifically targeted minority borrowers to sell them costly and defective loans that quickly went into foreclosure.[13]

Until recently, the regulatory scheme fully sanctioned Countrywide's practices and policies because it gave lenders the discretion to offer borrowers loan products without regard to costs, fees, the borrower's ability to repay, or the suitability of the particular product for the borrower.[14] Additionally,

4. Harold S. Bloomenthal, *The Mortgage Crisis and Mortgage-Backed Securities*, *in* 32 SEC. & FED. CORP. L. REP. 1, 1 (2010).

5. Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5, 91 (2009).

6. CTR. FOR RESPONSIBLE LENDING, UNSAFE AND UNSOUND, HOW COUNTRYWIDE'S IRRESPONSIBLE PRACTICES HAVE HARMED SHAREHOLDERS AND BORROWERS 3–4 (2008).

7. Bank of Am. Corp. v. Superior Court, 198 Cal. App. 4th 862, 865, 130 Cal. Rptr. 3d 504, 506 (2011).

8. Press Release, U.S. Dept. of Justice, Office of Pub. Affairs, Justice Department Reaches $335 Million Settlement to Resolve Allegations of Lending Discrimination by Countrywide Financial Corporation (Dec. 21, 2011), *available at* http://www.justice.gov/opa/pr/justice-department-reaches-335-million-settlement-resolve-allegations-lending-discrimination.

9. *Countrywide Financial Pays $335 Million to End Bias Case*, ANDREWS FIN. CRISIS LITIG. REP. (Jan. 10, 2012), *available at* 2012 WL 72288.

10. Linda E. Fisher, *Target Marketing of Subprime Loans: Racialized Consumer Fraud & Reverse Redlining*, 18 J.L. & POL'Y 121, 151 (2009).

11. John L. Ropiequet, *Assessing the Impact of* Wal-Mart Stores, Inc. v. Dukes *on Fair Lending Litigation*, 21 J. AFFORDABLE HOUSING & COMMUNITY DEV. L., 195, 218 (2012).

12. *See* Richard Moberly, *Sarbanes-Oxley's Whistleblower Provisions - Ten Years Later*, 64 S.C. L. REV. 1, 23 (2012).

13. Press Release, U.S. Dept. of Justice, Recent Fair Lending Cases (Dec. 28, 2011) (on file with author).

14. *Ability to Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z)*, CONSUMER FIN. PROT. BUREAU, *available at* http://www.consumerfinance.gov/regulations/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z/ (explaining that on January 10, 2013, the Consumer Financial Protection Bureau issued rules requiring creditors to make a reasonable, good faith determination of a consumer's ability to

borrowers are often unaware of which underwriting criteria lenders use, how brokers price loans, or the amount of their compensation.[15] The regulatory scheme operates in a lending climate ripe with unequal bargaining power that favors the lender and results in a *post-hoc* determination, at best, by regulators that the lender treated the borrower unfairly. Even with the recent changes, risk-based pricing involves unchecked lender discretion. Failing to monitor lender decision-making sanctions the vague regulatory standard as well as the stated law.[16]

The established rule is that lenders may not discriminate based on race.[17] Minority borrowers thus can presume that the nation's fair lending laws protect them from lending discrimination. Yet, racial disparities in lending remain.[18] These disparities are magnified in the risk-based pricing segment of mortgage lending. During the height of subprime crisis, minorities received almost forty percent of the higher-priced loans.[19] As discussed below, what is unclear in

repay any consumer credit transaction secured by a dwelling (excluding an open-end credit plan, timeshare plan, reverse mortgage, or temporary loan) and established certain protections from liability under this requirement for "qualified mortgages.").

15. Cassandra Jones Havard, *"Goin' Round in Circles" ... and Letting the Bad Loans Win: When Subprime Lending Fails Borrowers: The Need for Uniform Broker Regulation,* 86 NEB. L. REV. 738, 742, 786 (2008).

16. *See* discussion *infra* Part IV.

17. Since 1968, lenders have been subject to a panoply of fair lending laws. The fair lending statutes are comprised of the Civil Rights Act of 1968 (the Fair Housing Act), Pub. L. No. 90-284, Title VIII, 82 Stat. 81 (1968) (codified as amended at 42 U.S.C. §§ 3601–19, 3631 (1988 & Supp. VI 1994); Community Reinvestment Act, 12 U.S.C. §§ 2901–07 (1988 & Supp. VI 1994); Home Mortgage Disclosure Act, 12 U.S.C. §§ 2801–10 (1988 & Supp. VI 1994); Equal Credit Opportunity Act, 15 U.S.C. §§ 1691–1691(f) (1988 & Supp. VI 1994).

18. Brad Stone, *Banks Mine Data and Woo Troubled Borrowers*, N.Y. TIMES, Oct. 22, 2008 (critiquing marketing techniques targeting minority homeowners).

19. Because it does not include underwriting and pricing factors the HMDA data alone cannot indicate whether racial and ethnic pricing disparities reflect illegal discrimination. However, a 2008 Federal Reserve study used HMDA data to determine the percentage of subprime loans made by lenders. The incidence of higher-priced lending for minorities was 38.1 percent in 2007 and 14.2 percent in 2008, with the decline paralleling the collapse of the subprime market. Robert B. Avery, Neil Bhutta, Kenneth P. Beveroot, Glenn B. Canner & Christa N. Gibbs, *The 2008 HMDA Data: The Mortgage Market During a Turbulent Year*, FED. RES. BULL. A169, A189 (2010). In 1998, the subprime market was still a recent financial phenomenon, which gained a significant market share about five years earlier. HUD release a study of the subprime market that showed that subprime loans were three times more likely to be made in African American neighborhoods than in White neighborhoods. Additionally, homeowners in high-income African-American neighborhoods were twice as likely to receive subprime loans as residents in low-income White neighborhoods. Subprime loans accounted for 26 percent of total loans in 1998—compared with only 11 percent in moderate-income neighborhoods and just 7 percent in upper-income neighborhoods. DEP'T. OF HOUS. AND URBAN DEV., UNEQUAL BURDEN: INCOME & RACIAL DISPARITIES IN SUBPRIME LENDING IN AMERICA 2 (1998); *see also* Chris Mayer & Karen Pence, *Subprime Mortgages: What, Where and to Whom,* FIN. AND ECON. DISCUSSION SERIES 3 (2008-09) (concluding that "subprime loans are more concentrated in locations where credit is difficult to obtain"); *but see* Andrew Haughwout, Christopher Mayer & Joseph Tracy, *Subprime Mortgage Pricing: The Impact of Race, Ethnicity, and Gender on the Cost of Borrowing,* FED. RES. BANK OF N.Y. STAFF REPORTS no. 368, 22

risk-based pricing in general, and in mortgage lending specifically, is what warehouse lenders should do to comply with the anti-discrimination rules.

Mortgage lending discrimination is a persistent problem in minority communities.[20] The sub-prime lending crisis appears to be yet another manifestation of that problem because subprime and predatory lending tactics put many minority families in jeopardy of default and foreclosure.[21] The cause of this particular crisis is open to debate. Explanations include materialistic borrowers who choose to purchase more house than they can afford, lax underwriting by originators, inaccurate appraisals, and fraudulent practices by investment bankers.[22]

Most would agree in retrospect that the subprime financial crisis was an exemplar of market failure.[23] The lack of competition for mortgage credit in low and moderate income market segments provided an advantage to those lenders willing to lend.[24] Banks that formerly redlined neighborhoods provided access to mortgage credit that was unaffordable and destabilizing.[25]

(2009) ("Subprime lending [served] as a positive supply shock for credit in locations with high unemployment rates and minority residents.").

20. Wiley E. Rice, *Consumers*, 33 SAN DIEGO L. REV**.** 583, 584–99 (discussing the persistent problem of racial discrimination in home mortgage and insurance markets and positing that courts are ineffective in resolving the issues) (1996). *See e.g.*, LORRAINE HANSBERRY, A RAISIN IN THE SUN: A DRAMA IN THREE ACTS (1959) (demonstrating that barriers to obtaining a mortgage are legendary within communities of color and underlie the cultural distrust of traditional banks. *A Raisin in the Sun* is a classic play that puts a literary take on some of the issues minorities face in acquiring home ownership based on the use of restrictive covenants).

21. RAKESH KOCHHAR, RICHARD FRY & PAUL TAYLOR, PEW RESEARCH CTR., WEALTH GAPS RISE TO RECORD HIGHS BETWEEN WHITES, BLACKS AND HISPANICS 10, 19, 22 (2011) [hereinafter WEALTH GAPS RISE TO RECORD HIGHS].

22. Howard Husock, *The Financial Crisis and the CRA*, CITY J., Oct. 30, 2008, *available at* http://www.city-journal.org/2008/eon1030hh.html (discussing how HUD's mandated "affordable housing goals" introduced credit risk into the secondary market).

23. Diego Valiante, *The Market for Subprime Lending: A Law and Economics Analysis of Market Failures and Policy Responses* 4 (Ph.D. Thesis, LUISS University (Rome) and Centre for European Policy Studies (Brussels), Working Paper No. 1, 2008), *available at* http://ssrn.com/abstract=1956463, (describing the subprime mortgage crisis as a mix of "irrational and opportunistic behaviours, as well as a lack of regulation, supervision and in-efficient [sic] disclosure.").

24. Monopoly power is harmful to competition and to consumers. Companies that achieve monopoly power are able to charge supra-competitive prices because they control the market. *See* Dustin Sharpes, *Reintroducing Intent into Predatory Pricing Law*, 61 EMORY L.J. 903, 906 (2012) (discussing how monopoly power is harmful). Although the subprime market was not monopolized by any one lender, minority borrowers and neighborhoods felt the monopolistic effect of anti-competitive pricing.

25. John P. Segala, *Redlining*: *An Economic Analysis*, FED. RES. BANK OF RICHMOND ECON. REV. 3 (1980) (defining redlining as "… when lenders base any element of the mortgage decision, including whether or not to lend and the terms of the loan, on the geographic location of the property or on the characteristics of surrounding properties."; Ira Goldstein & Dan Urevick-Ackelsberg, *Subprime Lending, Mortgage Foreclosures And Race: How Far Have We Come And How Far Have We To Go?* THE REINVESTMENT FUND, 6 (2008) (discussing how minorities are targeted at a higher rate for subprime loans and the high incidence

In effect, subprime lenders were able to control prices in the market because it was anti-competitive.[26]

Although fair lending scholars continue to debate the value of the Home Mortgage Disclosure Act (HMDA), the broad consensus prevails that requiring lenders to report demographic characteristics and loan product information regarding home mortgage loans enhances the enforcement of lending discrimination laws.[27] Yet, the current regulatory regime contributes to the mortgage market's anti-competiveness, which results in inefficiency.[28] The risk-based price market is inefficient because it does not appropriately price risk for all borrowers. HMDA data is critical to regulatory efforts to monitor a lending institution's compliance with fair lending laws, which prohibit discrimination in residential real-estate related lending on the basis of specific factors, including race.[29] HMDA laws and regulations require most lenders to

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of failure among subprime loans).

26. *See* Kristin L. Perkins*, The Geography of Foreclosure in Contra Costa County, California,* 3 (N.Y.C. Dep't of Hous. Pres. and Dev., Working Paper 2009-03, 2009) (noting that subprime loans were concentrated in neighborhoods with high proportions of minority residents, lower-income households, and less educated households).

27. *See* George J. Benston, *Mortgage Redlining Research: A Review and Critical Analysis*, *in* THE REG. OF FIN. INSTS. 144, 162 (1979), *available at* http://www.bostonfed.org/economic/conf/conf21/conf21f.pdf ("It seems clear that the studies of the supply of mortgages to specific areas and groups by subsets of lenders are of very little value."); James R. Barth, Joseph J. Cordes & Anthony M. Yezer, *Financial Institution Regulations, Redlining and Mortgage Markets*, *in* THE REG. OF FIN. INSTS. 101, 102. (1979), *available at* http://www.bostonfed.org/economic/conf/conf21/conf21e.pdf (stating the HMDA and the Community Reinvestment Act restrict the ability of firms to make economically efficient lending decision); Jonathan R. Macey & Geoffrey P. Miller*, The Community Reinvestment Act: An Economic Analysis*, 79 VA. L. REV. 291, 313, 319–24 (1993) (arguing that the Community Reinvestment Act, HMDA's companion statute, reduces bank safety and soundness). Proponents of HMDA data argue that by collecting the data and examining tends in the housing finance market, the regulatory process is strengthened in terms of detecting discrimination. *See* George C. Galster, *Research on Discrimination in Housing and Mortgage Markets: Assessment and Future Directions*, 3 HOUSING POL'Y DEBATE, 639–83 (1992), *available at* http://www.knowledgeplex.org/kp/text_document_summary/scholarly_article/relfiles/hpd_0302_galster.pdf; Ronald E. Wienk, *Discrimination in Urban Credit Markets: What We Don't Know and Why We Don't Know It*, 3 HOUSING POL'Y DEBATE, 217–40 (1992), *available at* http://content.knowledgeplex.org/kp2/img/cache/sem/39569.pdf (suggesting that more research is needed on where in the lending process discrimination occurs in the housing market); *see also* Adam Rust, *A Principle-Based Redesign of HMDA and CRA Data*, 4 COMMUNITY DEV. INVESTMENT REV. 178, 178 (2009), *available at* http://www.frbsf.org/community-development/files/principlebased_redesign_hdma_cra_data.pdf (stating that HMDA databases did not keep pace with financial innovations and require reform); Mae A. Cavoli, *Fair Lending Laws: The Growing Tension*, 115 BANKING L. J. 604, 608 (1998), *available at* http://heinonline.org/HOL/Page?handle=hein.journals/blj115&div=55&g_sent=1&collection=journals.

28. *See* discussion *supra* notes 21–22 and accompanying text for how the current regulatory scheme contributes to the mortgage market's inefficiency.

29. The fair lending laws, the Equal Credit Opportunity Act (ECOA), 15 U.S.C. § 1691 and the Fair Housing Act (FHA), 42 U.S.C.A. §§ 3601–3631, prohibit discrimination in all phases of residential real estate lending. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) gave authority under ECOA to the CFPB and, with respect to

collect and report demographic information about their borrowers so that they and their regulators can analyze among other things how mortgage loans are priced, for potentially discriminatory patterns.[30] Lender's pricing of residential mortgages has become discriminatory because lenders used different standards in determining whether to extend credit or varied the terms of credit offered, including the amount, interest rate, duration, and type of loan.[31]

The warehouse line of credit is integral to the existing mortgage lending cycle because it provides short-term funding from the closing table to sale on the secondary market. Warehouse lenders make lines of credit available to a multiplicity of third-party originators, banks, correspondent lenders and brokers. These third-party originators in turn work directly with mortgage borrowers.[32] Discriminatory pricing disparities may occur because of the mix of these third-party originators or because the individual third parties negotiate different prices for the same products to different borrowers. As a result, a loan product that theoretically complies with the fair lending regulations may

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entities within its jurisdiction, granted authority to the CFPB to supervise for and enforce compliance with ECOA and its implementing regulations.

30. The CFPB announced proposed changes to HMDA in July 2014. The addition data includes property value, term of the loan, total points and fees as well as additional information on underwriting such as pricing such as debt-to-income ratios, interest ratios and total discount points. CONSUMER FIN. PROT. BUREAU, HMDA PROPOSAL, HOME MORTGAGE DISCLOSURE, REGULATION C (2014), *available at* http://files.consumerfinance.gov/f/201407_cfpb_proposed-rule_home-mortgage-disclosure_regulation-c.pdfes.

31. *See* discussion in text *infra* surrounding footnote 122.

32. Warehouse lending provides short-term loans to fund mortgages that mortgage brokers and banks originate. The warehouse loan is similar to a line of credit loan and is paid off when the loan is sold to a permanent investor, such as the secondary market. *See* Barry Epstein, *Mortgage Warehouse Lending is Safer Than Many Bankers Think*, AM. BANKER (May 1, 2012), http://www.americanbanker.com/bankthink/mortgage-warehouse-financing-asset-based-lending-1048891-1.html (discussing that warehouse lending provides short-term loans to fund mortgages that mortgage brokers and banks originate).

Title XIV of Dodd-Frank gave the CFPB authority to issue regulations restricting transactions involving mortgage brokers and imposing certain requirements and limitations on compensation and activities. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 1001–1100, 124 Stat. 1376, 1955–2113 (2010). In an effort to avoid these restrictions, mortgage brokers are converting to mini-correspondents. By setting up arrangements with wholesale lenders, the mortgage brokers will purport to act as mini-correspondent lenders. The mortgage broker appears to be the lender or creditor engaging in activities that lenders or creditors commonly engage in such as closing the loan in its own name, funding the loan from a warehouse line of credit, and receiving premium compensation for the sale of the loan to an investor. *See Consumer Financial Protection Bureau Issues Guidance Regarding Brokers Shifting To "Mini-Correspondent" Model*, Jul 11 2014, *available at* http://www.consumerfinance.gov/newsroom/consumer-financial-protection-bureau-issues-guidance-regarding-brokers-shifting-to-mini-correspondent-model. The CFPB issued a non-binding policy guidance to guide mortgage brokers making the transition. *See* BUREAU OF CONSUMER FIN. PROT., 4810-AM-P, POLICY GUIDANCE ON SUPERVISORY AND ENFORCEMENT CONSIDERATIONS RELEVANT TO MORTGAGE BROKERS TRANSITIONING TO MINI-CORRESPONDENT LENDERS 4–5, 13–14 (2014), *available at* http://files.consumerfinance.gov/f/201407_cfpb_guidance_mini-correspondent-lenders.pdf.

result in an unwarranted higher cost at the borrower level for the underlying mortgage origination.[33] Unchecked, this type of lending fosters the market's inefficiency because it allows warehouse lenders, indirectly, to make loans that are not priced similarly to other loans with the same level of risk. Counteracting this unchecked inefficiency and making HMDA more effective in detecting potential discrimination requires loan-pricing information from the warehouse lenders that fund mortgage originations through third parties.

The overall inquiry is whether lenders can show that the borrower's actual risk correlates with the interest rates and fees charged.[34] The industry challenge, and regulatory concern, is how to create competitive pressures in the mortgage markets that will increase efficiency and ensure that prices for mortgage credit are commensurate with risk.[35]

This Article intends to resolve whether HMDA's reporting requirements are fair and efficient in policing discriminatory lending. It focuses on risk-based pricing,[36] which is a practice that services many minority borrowers and expands their access to credit. Part II of this Article explains how HMDA's reporting requirements are a legislative response to excessive lender discretion. It calls into question the efficacy of HMDA reporting as a meaningful constraint on lenders' decision-making and raises the question of whether lenders, by using statistical discrimination, may be using race in screening and loan pricing under the guise of risk assessment.[37]

Part III is the centerpiece of the Article. It addresses the question of what constraint, if any, HMDA places on the capacity of lenders to comply with fair lending laws when making risk-based loans. It argues that given the changed nature of the home mortgage market, the current fair lending tests are

33. One study found that subprime lending occurred more with non-White Hispanic borrowers and upper income borrowers and argues that housing policy reforms should represent a perspective beyond race. *See* Maurice Jourdain-Earl, *The Demographic Impact of the Subprime Meltdown*, COMPLIANCE TECH., *available at* http://www.compliancetech.com/files/Demographic%20Impact%20of%20the%20Subprime%20Mortgage%20Meltdown.pdf (discussing a study that found that subprime lending occurred more with non-White Hispanic borrowers and upper income borrowers, and argues that housing policy reforms should represent a perspective beyond race).

34. *See* discussion *infra* Part IV.

35. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 1 (The call is for more synergistic integration of economic policy and legal rules. At the request of Financial Services Committee Chairman Barney Frank, (D-MA), the Government Accountability Office (GAO) conducted a "comprehensive review" of the current state of federal fair lending enforcement. The report, released in July 2009, found that data enhancement is needed to detect potential fair lending violations. It also suggested an overhaul of the financial regulatory structure to ensure "consistent and effective federal oversight" of fair lending laws).

36. Risk-based pricing allows lenders to assess the credit risk of borrowers and offer variability in pricing. Lenders charge a higher interest rate based on the estimated risk that the borrowers would not repay the loan. Patricia A. McCoy, *Rethinking Disclosure in a World of Risk-Based Pricing*, 44 HARV. J. ON LEGIS., 126–27 (2007).

37. *See* discussion *infra* Part IV.A.2.

ineffective in assessing the disparate impact of lenders' discretion. Specifically, it reviews the case law surrounding the recent decisions in *Wal-Mart Stores, Inc. v. Dukes* and *Ramirez v. GreenPoint Mortgage* and concludes that these rulings unnecessarily hinder a successful disparate impact claim based on discretionary pricing. The section ends with a critique of courts' evaluations of the business justification defense as a part of the disparate impact analysis and argues for a more scrutinizing evaluation of a lender's proffered claim of business necessity. It concludes that disparate impact should be viewed as a discretion-constraining rule.[38]

This Article posits that Congress' response to lending discrimination is inadequate. Congress presents Title VII's fair lending rules as effective against discriminatory lending practices and policies. However, Congress fails to appreciate that the present fair lending legal regime is inherently ineffective when applied to risk-based pricing's broadly discretionary method of decision-making. Lenders circumvented the existing legal constraints on discriminatory lending by making a higher incidence of risk-based loans to minorities regardless of creditworthiness. Regulators failed to develop an adequate compliance mechanism to detect this type of discriminatory lending. Warehouse lenders, or lenders who provide short-term financing to mortgage originators such as banks, correspondent lenders, and brokers, represent an unchecked link in the lending process. While these lenders may not be intentionally discriminating, they are not monitoring their "borrowers" for non-discrimination. Requiring warehouse lenders to monitor loan origination is an effective way of ferreting out whether there is a disparate impact in lending. Thus, Part IV argues that regulatory reform will serve as a check on originating lenders' discretion, a check for which HMDA presently serves an important though insufficient role.[39] Specifically, HMDA should place a more exacting duty on warehouse lenders to engage in on-going validation and monitoring of origination loan funds for non-discriminatory lending. This simple, but profound change will constrain the originating lender's discretion by limiting the ability to choose a loan product that is not competitive, affordable, sustainable, or correlated to borrower risk. This will also affect the loan originator's ability to improperly use the business judgment justification as a defense, thereby tailoring that doctrine to the actual lending process.

II. THE DUBIOUS VALUE OF HMDA

HMDA is a loan reporting statute.[40] From its inception, HMDA's ultimate goal was to further fairness and efficiency in the mortgage market and to

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38. *See* discussion *infra* Part III.

39. Originating lender is used here to describe a party that originates the loan, whether it is a mortgage broker, bank, or the mini-correspondents under the new Dodd-Frank rules.

40. FED. FIN. INSTS. EXAMINATION COUNCIL, A GUIDE TO HMDA REPORTING: GETTING IT RIGHT! 1, 1 (2013), *available at* http://www.ffiec.gov/hmda/pdf/2013guide.pdf.

encourage community investment.[41] It requires lenders to provide annual data on the applications they receive and the loans they make. To ultimately achieve its goal, however, HMDA's reporting requirements require ongoing scrutiny as markets expand, loan products develop, and new ways of assessing credit become available.

A. HMDA as a Market Corrector

HMDA data provides public information about lending patterns. Historically, it is best known as an anti-redlining measure.[42] HMDA data was integral to the identification of areas of communities where housing-credit needs were unmet and neighborhood disinvestment occurred.[43] Presently, HMDA enhances the enforcement of fair lending by identifying market disparities in credit availability and loan terms.[44] HMDA data exposed the market segmentation that reflected minorities having a greater incidence of higher-priced loans.[45] In this regard, HMDA prompts regulators to undertake a more careful examination of lenders' fair lending practices and encourages lenders to evaluate policies and procedures to ensure compliance with anti-discrimination statutes.

1. Legislating Reporting Requirements

Congress enacted the Home Mortgage Disclosure Act in 1975 to prevent lending discrimination.[46] By legislating reporting requirements, HMDA requires certain banks and other mortgage lending institutions to report information about mortgage applications, applicants, and the lender's decision on the application.[47] HMDA data is compiled annually and made available to

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41. Mark W. Olson, Governor, Remarks before Consumer Bankers Association 2005 Fair Lending Conference, Arlington, Va., A Look At Fair Lending Through The Lens Of The New HMDA Data, (Nov. 7, 2005) *available at* 2014 WL 1221358, (discussing the inherent limitations of HMDA's data in promoting market efficiency and legal compliance).

42. Richard D. Marsico, *Looking Back and Looking Ahead As the Home Mortgage Disclosure Act Turns Thirty-Five: The Role of Public Disclosure of Lending Data in A Time of Financial Crisis*, 29 REV. BANKING & FIN. L. 205, 206–08 (2009) (discussing HMDA's history and arguing that the subprime mortgage crisis is indicative of the need for HMDA reform).

43. Senator William Proxmire, one of the bill's sponsors, described HMDA as a "very gentle remedy." *Id*. at 213.

44. *Fair Lending and the Home Mortgage Disclosure Act,* Hearing before Subcomm. on Oversight and Investigations, H. Comm. on Fin. Servs. 110th Congr. (July 25, 2007) (testimony of Mark S. Olson, Governor, Fed. Reserve Bd.), *available at* http://www.federalreserve.gov/newsevents/testimony/olson20060613a.htm.

45. Gregory D. Squires, Derek S. Hyra & Robert N. Renner. *Segregation and the Subprime Lending Crisis* 3 (Econ. Pol. Inst., Briefing Paper #244, 2009), *available at* http://www.epi.org/files/page/-/pdf/110409-briefingpaper244.pdf.

46. 12 U.S.C. §§ 2801–2811 (1975). The CFPB implements HMDA through Regulation C.

47. HMDA requires lenders to report the amount and type of loan, the location of property, the race, sex and income of the applicant, and whether the application was approved or denied. FED. FIN. INSTS. EXAMINATION COUNCIL, HISTORY OF HMDA, *available at* http://www.ffiec.gov/hmda/history2.htm (last visited Sept. 26, 2014).

the public.[48] The Federal Reserve Board (Federal Reserve) is the regulatory agency that was initially responsible for implementing HMDA by writing the governing regulations.[49]

Congress' objectives when enacting HMDA were at least two-fold. First, Congress intended the HMDA data to assist in determining whether financial institutions were successfully meeting their communities' housing credit needs.[50] Second, the data disclosure was designed to attract lender investment to areas in need of community development.[51]

At its inception, HMDA required no more than simple statistical reporting.[52] Lenders were required to report the total number of loans made to individuals for home purchases, refinances, and improvements, as well as the final decision on the application. When Congress passed the Community Reinvestment Act (CRA)[53] two years later, HMDA's reporting requirements were viewed as complementary and were intended to deter redlining by identifying potentially discriminatory lending patterns.[54]

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48. Depository lending institutions, e.g., banks, credit unions, and savings associations, are required to file under HMDA if they mandated the annual reporting of information, by mortgage lending institutions with at least $10 million in assets, on the number and dollar amount of both home mortgage and home improvement loans, by census tract or county. *Id.* Under the CFPB's proposed rules, non-depository mortgage lenders may be required to report only if they make at least 100 loans in a year, with an exception around reverse mortgages. *See* CONSUMER FIN. PROT. BUREAU, HMDA PROPOSAL - HOME MORTGAGE DISCLOSURE, REGULATION C (2014), *available at* http://files.consumerfinance.gov/f/201407_cfpb_proposed-rule_home-mortgage-disclosure_regulation-c.pdf.

49. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) transferred HMDA rulemaking authority from the Federal Reserve Board (Federal Reserve) to the CFPB. Dodd-Frank also changed HMDA supervisory and enforcement authority to the CFPB from the various banking regulatory agencies, the Board of Governors of the Federal Reserve System (FRS), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the National Credit Union Administration (NCUA), and the Department of Housing and Urban Development (HUD). *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub.L. No. 111–203, 124 Stat. 1376 (2010). On Aug. 29, 2014, CFPB issued a proposed rule that added several new reporting requirements and clarified existing ones. The proposed rule does not address warehouse lenders. CONSUMER FIN. PROT. BUREAU, HMDA PROPOSAL, HOME MORTGAGE DISCLOSURE, REGULATION C (2014), *available at* http://files.consumerfinance.gov/f/201407_cfpb_proposed-rule_home-mortgage-disclosure_regulation-c.pdf.

50. FED. DEPOSIT INS. CORP., COMPLIANCE MANUAL § V–9.1 (2014), *available at* http://www.fdic.gov/regulations/compliance/manual/pdf/V-9.1.pdf.

51. KATHRYN PETTIT & AUDREY DROESCH, URBAN INST., A GUIDE TO HOME MORTGAGE DISCLOSURE ACT DATA 5 (2008), *available at* http://www.urban.org/uploadedpdf/1001247_hdma.pdf.

52. *See* Allen J. Fishbein, *The Ongoing Experiment with "Regulation from Below": Expanded Reporting Requirements for HMDA and CRA*, 3 HOUSING POL'Y DEBATE 601, 601–36 (1992).

53. Community Reinvestment Act of 1977, Pub. L. No. 95–128, 91 Stat. 1147 (codified as amended at 12 U.S.C. §§ 2901–09 (2006)).

54. *See* Cassandra J. Havard, *Synergy and Friction—The CRA, BHCs, SBA and Community Development Lending*, 86 KY. L.J. 617, 618–19 (1998).

Regulation C, which is the regulation implementing HMDA, has undergone a number of revisions. It requires that lenders report both the geographic location of originated loans and information about denied mortgage loan applications.[55] As of 1990, lenders also must report the race, sex and income of the applicant.[56] HMDA began requiring lenders to report price data in 2002, and by 2004 the price data began to show disturbing trends. African-American and Hispanic borrowers received more of the higher priced loans than whites.[57] Since the 2004 reporting year, lenders must report loan price information in the form of "rate spread."[58] A subsequent study by the Federal Reserve found that at least thirty percent of the disparity was left unexplained by factors such as income and loan size.[59]

HMDA identifies price disparities through loan pricing.[60] Lenders must report higher priced loans that exceed either certain price points or thresholds of the loan's adjusted annual percentage rates (APRs). This requirement applies only to loans with spreads above the pre-determined price points.[61]

55. The Federal Reserve uncovered lenders' discriminatory pricing policies by examining individual Metropolitan Statistical Areas (MSAs) in the distinct geographical markets in which lenders made loans to determine if the lender's pricing policies and product offerings were in violation. Testimony of Sandra F. Braunstein, Director, Div. of Consumer and Cmty. Affairs, Fed. Reserve Bd., Hearing on *Fair Lending and the Home Mortgage Disclosure Act, Hearing before Subcomm. on Oversight and Investigations, H. Comm. on Fin. Servs*. 110th Cong. (July 25, 2007) (testimony of Sandra F. Braunstein, Director, Div. of Consumer and Cmty. Affairs, Fed. Reserve Bd.), *available at,* http://www.federalreserve.gov/newsevents/testimony/Braunstein20070725a.htm. ("… HMDA data are most helpful as a fair lending tool when they are used in conjunction with other risk factors and supervisory information to identify institutions that warrant closer review.").

56. Financial Institutions Reform, Recovery, and Enforcement Act of 1989, § 1211, 103 Stat. 183, 525–26 (codified at 12 U.S.C. § 2803); Jason Dietrich, *Missing Race Data in HMDA and the Implications for the Monitoring of Fair Lending Compliance* 3 (Office of the Comptroller of the Currency Econ. and Policy Analysis, Working Paper No. 2001–1, 2001).

57. Robert Avery, Glen Canner & Robert Cook, *New Information Reported under HMDA and Its Application in Fair Lending Enforcement,* FED. RESERVE BD. (2004), *available at* http://www.federalreserve.gov/pubs/bulletin/2005/summer05_hmda.pdf.

58. DARRYL E. GETTER, CONG. RESEARCH SERV., REPORTING ISSUES UNDER THE HOME MORTGAGE DISCLOSURE ACT, RL34720, GOV'T & FIN. DIV. 3 (2008). Institutions must report the rate spread between the annual percentage rate (APR) and the average prime offer for a comparative transaction as of the date the interest rate is set. *See* Federal Financial Institutions Examination Council, A Guide to HMDA Reporting (2003), http://www.ffiec.gov/hmda/pdf/2004guide.pdf.

59. Alan M. White, *Borrowing While Black: Applying Fair Lending Laws to Risk-Based Mortgage Pricing*, 60 S.C. L. REV. 677, 683–86 (2009); *see also* Judith A. Giles & Marsha J. Courchane, *Stratified Sample Design for Fair Lending Binary Logit Models* 4 (Econometrics, Working Paper No. EWP0007, 2000), *available at* http://www.uvic.ca/socialsciences/economics/assets/docs/econometrics/ewp0007.pdf (positing that logistic regressions are commonly used inaccurately to assess for fair lending across groups of loan applications).

60. *See generally id. at* 2–4 (2008) (analyzing HMDA reporting requirements).

61. *HMDA Glossary,* FED. FIN. INSTS. EXAMINATION COUNCIL, http://www.ffiec.gov/hmda/glossary.htm#R (last modified Sept. 27, 2014) ("The price data take the form of a "rate spread." Lenders must report the spread (difference) between the annual percentage rate (APR) on a loan and the rate on Treasury securities of comparable maturity — but only for loans with

Loans that are designated as having status under the Home Ownership and Equity Protection Act, or "HOEPA status," provide further insight into a lender's practices and may signal the need for a regulatory fair lending examination based on possible discrimination.[62] Loans above the pre-determined price points signal pricing disparities.[63] Moreover, the disparities are also tied to the lender offering the loan product.[64]

Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) in 2010.[65] This massive piece of legislation was Congress' reaction to the 2007 financial crisis. Articles X and XIV present significant changes regarding the regulation of the mortgage origination process and mortgage loan products. The Dodd-Frank amendments to HMDA identified additional data needed to uncover indicates pricing disparities.[66]

Article X of Dodd-Frank amends HMDA by requiring additional data collection about borrowers.[67] The amendments facilitate fair lending litigation by requiring compilation of more detailed borrower characteristics. In addition to race, ethnicity, sex, and income, lenders are now required to record and report the age and credit score of the borrower, the census tract of the mortgaged property, the value of the property pledged as collateral for the loan, and a clear description of the loan product sold.[68] The goal is to make it easier to statistically compare borrowers and determine which borrowers received subprime loans. Article X also imposes new reporting requirements on loans. Lenders must report more detailed information about the proposed loan product, including: the total points and fees payable at origination; the

spreads above designated thresholds. So, rate spreads are reported for some, but not all, reported home loans. The rate spread, along with Lien Status and HOEPA help interpret the pricing data.").

62. Further, lenders are required to identify loans that are subject to the HOEPA. *See* Regulation Z, 12 C.F.R. § 226.32 (2008) (stating requirements for types of closed-end home mortgages.) Dodd-Frank also amended several HOEPA provisions. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, §§ 1001–1100, 124 Stat. 1376, 1955–2113 (2010) (codified as amended at 12 U.S.C. §§ 1431–33).

63. Robert B. Avery, Neil Bhutta, Kenneth P. Beveroot, Glenn B. Canner & Christa N. Gibbs, *The 2008 HMDA Data: The Mortgage Market During a Turbulent Year,* FED. RES. BULL., A169, A177 (2010), *available at* http://www.federalreserve.gov/pubs/Bulletin/2010/pdf/hmda08final.pdf. Subprime loans nearly doubled from 2004–2005. They accounted for 15.5 percent of all approved mortgages in 2004. In 2005 and 2006, they were 26.2 percent and 28.7 percent, respectively. *Id.*at A184. That percentage declined to 18.3 percent by 2007. *Id.*

64. *See* John L. Ropiequet, Nathan O. Lundby, Kenneth J. Rojc & Sara B. Lubezny, *Update on ECOA and Fair Lending Developments*, 63 BUS. LAW. 663, 666 (2008) ("FRB researchers who studied the expanded HMDA data have emphasized that the data is insufficient, by itself, to establish [Equal Credit Opportunity Act] violations by lenders.").

65. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§1001–1100, 124 Stat. 1376, 1955–2113 (2010).

66. *Id*. § 1094.

67. *See id.*

68. *Id*.

term of the loan; and, the "channel through which application was made, including retail, broker."[69]

Article XIV defines several key factors in the mortgage process that protect consumers. Specifically, it defines the qualified mortgage product[70] and requires that each loan be evaluated for the borrower's ability to repay.[71] This provision serves as a prohibition against those subprime loan products that are so inferior that they are not sustainable. The definition of a mortgage originator is also significant. The broad definition includes any person who receives compensation for taking a loan application, assists a consumer in obtaining a loan, prepares loan packages, collects information on available loans for a consumer, or negotiates loan offers or terms for a consumer.[72] Finally, Article XIV limits the compensation that mortgage originators can receive, which removes the incentive for originators to steer consumers towards more onerous loan products.[73]

2. The Persistent Concerns over HMDA and Fair Lending Enforcement

The initial value of the HMDA data is that it provides a point of comparison for loan performance and a lender's denial rate for both minority and white applicants. Subsequent revisions to the statute and its regulations have proven responsive to the changing dynamics of the mortgage market and evidence of perceived discrimination. [74]

Congress has changed HMDA to improve its accuracy. It expanded both the group of mortgage lenders required to report and the reporting of borrower and applicant demographics.[75] In response to the rise of subprime and

69. *Id.* Other identifying information about the loan product includes: the loan APR as compared to all loans by the lender; any prepayment penalties associated with the loan; the number of months after which the interest rate may change; payments other than fully amortizing payments during any portion of the loan term.

70. *Id.* § 1412. A "qualified mortgage" is a residential mortgage loan. The regular periodic payments for the loan cannot increase the principal balance or allow the consumer to defer repayment of principal. *Id.* § 1412(A)(i). The loan has points and fees that total less than 3 percent of the total loan amount. *Id.* § 1412(A)(vii).

71. *Id.* § 1402.

72. *See id.* § 1401(cc)(2).

73. *See id.* § 1403(c)(1).

74. A 1988 Pulitzer-Prize winning series in the Atlanta Journal-Constitution*, The Color of Money*, documented the flow of funds into Atlanta's black neighborhoods and is credited indirectly with focusing national attention on mortgage lending discrimination again. The patterns of discriminatory lending in Atlanta prompted a Justice Department investigation into the mortgage lending practices of Atlanta banks and a change in HMDA's reporting requirements. *See Justice Department Launches Probe of Discrimination among Dozens of Atlanta Banks and S&Ls*, 52 BANKING REP. (BNA) 945 (May 1, 1989); *see also* Financial Institutions Reform, Recover, and Enforcement Act of 1989, Pub. L. No. 101-73 § 1211, 103 Stat. 183, 524 (1989); 12 U.S.C. § 2803 (2011) (HMDA reporting requirements amended to require greater disclosure of financial institutions' lending practices by income level, race, and gender).

75. 12 C.F.R. § 203.4(a) (2009).

predatory lending, the Federal Reserve expanded the information reported under HMDA to include pricing.[76] Specifically, lenders were required to collect and publicly disclose information about mortgages with APRs above certain designated thresholds.[77] The Federal Reserve used the information on high-priced loans to run statistical analyses that compared loans made to minorities with loans made to non-Hispanic whites. These analyses calculated the disparities in rate spread by race, ethnicity, and the incidence of higher priced loans, and ultimately developed an 'outlier list.'[78] Even with the changes, the HMDA data did not provide a full picture of the subprime market.[79] The HMDA data ignores potential discrimination in the prime and government-guaranteed mortgage markets because it focuses on assessing mortgage pricing disparities among subprime lenders to the exclusion of lenders that may offer prime, conventional mortgages or government-guaranteed mortgages.[80]

HMDA data has proven useful in identifying the geographic patterns and continuous incidences of risk-based loans. The data is also key in determining who the market participants are—e.g., banks, affiliates and independents—and loan dispersion.[81] However, the geographic information that HMDA provides can be misleading for several reasons. First, HMDA does not require depositary institutions located in non-metropolitan areas to report loan information.[82] Second, the mortgage lending information may be incomplete

76. The FRB justified expanding the reporting requirements to include pricing data because they dominate the sub-subprime market. The comment from community and civil rights groups advocated for the change hoping that data availability would increase fair lending enforcement. *See generally* Robert B. Avery, Glenn B. Canner, and Robert E. Cook, *New Information Reported under HMDA and Its Application in Fair Lending Enforcement*, 91 FED. RES. BULL. 344, 391–94 (2005), *available at* http://www.federalreserve.gov/pubs/bulletin/2005/summer05_hmda.pdf (discussing the limitations of using the enhanced HMDA data requirements requiring loan pricing as a basis for uncovering unfair lending while noting preliminary indications that minorities are more likely to obtain credit from institutions in the higher-priced market segment).

77. KATHRYN L.S. PETTIT & AUDREY E. DROESCH, THE URBAN INST., A GUIDE TO HOME MORTGAGE DISCLOSURE ACT DATA 13 (2008), *available at* http://www.urban.org/uploadedpdf/1001247_hdma.pdf.

78. The Federal Reserve shares this information with other state and federal regulators. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 1, at 14–16 (discussing the fair lending examination process for the federal financial institution regulatory agencies).

[77] PETTIT & DROESCH, *supra* note 75, at 9 ("The number of subprime loans, however, can be approximated by calculating the number of loans originated by lenders identified by the U.S. Department of Housing and Urban Development (HUD) as subprime specialists. Because these subprime specialists might also offer traditional prime-market loans…").

80. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 1, at 18–19.

81. Ropiequet, Lundby, Roic & Lubezny, *supra* note 62, at 666. There is also an inconsistency in the regulatory framework between HMDA requirements and the Equal Credit Opportunity Act (ECOA). ECOA prohibits lenders from collecting personal characteristics, such as race, ethnicity, and sex. The decision not to require such reporting hinders federal oversight and academic research. *See* discussion *supra* note 60.

82. PETTIT & DROESCH, *supra* note 75, at 6; *see also* 12 C.F.R. § 1003.3 (2011).

when institutions that are not required to file under HDMA make mortgages.[83] Non-depository institutions do not have to report the census tract location of loans made in non-metropolitan areas.[84]

The criticisms of HMDA data surround its use and dispute whether it can accurately prove the existence of lending discrimination. While it is generally accepted that the data alone is insufficient to control for all of the relevant differences between borrowers, it does highlight lenders who should be subject to further investigation.[85] Because HMDA data does not include underwriting information, it is difficult to determine from the data alone why lenders may charge certain borrowers higher interest rates or fees.[86] Additionally, much of the criticism of HMDA centers around the way that community groups and housing activists use HMDA data. Community organizations and concerned citizens successfully used HMDA data as a tool to increase bank reinvestment lending.[87] This information is crucial when banks apply to regulators for mergers. The HMDA data assist regulators in determining whether banks have been meeting the lending needs of the community under the CRA.[88] During the CRA examination process and when a bank files a regulatory expansion application, community groups may submit written comments on the bank's community reinvestment performance.[89] This type of advocacy makes lenders

83. It is particularly problematic to rely on HMDA data to show disparities in non-metropolitan and low-homeownership areas. PETTIT & DROESCH, *supra* note 75, at 6. Institutions are only required to enter property location information for loans originated within the metropolitan areas in which they have a branch. 12 C.F.R. § 1003.5(3)(i) (2011). Institutions do not have to identify the census tract for properties located in counties with populations of less than 30,000 people. PETTIT & DROESCH, *supra* note 75, at 6. HMDA data also has limitations when considering the changes in neighborhoods that have low demographics of home ownership rates. *Id.* These are neighborhoods comprised of multi-family units. *Id.* The demographic and economic changes in these neighborhoods are ambiguous because the multi-family market does not specifically identify the number of units in a building. *Id.*

84. CFPB's recently amended HMDA regulations would require all institutions that make 25 loans to report. CONSUMER FIN. PROT. BUREAU, 79 Fed. Reg. 51732 (Aug. 29, 2014) (to be codified at CFPB-2014-0019).

85. MARGERY AUSTIN TURNER & FELICITY SKIDMORE, MORTGAGE LENDING DISCRIMINATION: A REVIEW OF EXISTING EVIDENCE 9 (1999) ("Even though HMDA data now include borrowers' race and income, they do not include critical information on the wealth and debt levels of loan applicants, their credit histories, the characteristics of properties serving as collateral, the terms of loans for which applications were submitted, or the underwriting criteria used to determine eligibility").

86. *See Frequently Asked Questions about HMDA*, WELLS FARGO, https://www08.wellsfargomedia.com/downloads/pdf/about/hmda_faq.pdf (last visited Sept. 27, 2014).

87. *See* Lee v. Bd. of Governors of the Fed. Reserve Sys., 118 F.3d 905, 908–09 (2d Cir. 1997) (where community groups sought to overturn Federal Reserve Board's merger approvals based on the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods).

88. Community Reinvestment Act of 1977 §§ 804(a)(1)–(2), 12 U.S.C. §§ 2903(a)(1)–(2) (2008).

89. *See* Michael E. Schrader, *Competition and Convenience: The Emerging Role of Community Reinvestment,* 67 IND. L.J. 331, 344 (1992) (discussing CRA financial commitments that financial institutions make when community groups protest a bank merger).

accountable, and is exactly what Congress had in mind when the statute was passed.[90]

Dodd-Frank is pro-consumer regarding litigation to enforce the fair lending laws. The statute implicitly approves the disparate impact theory by forbidding any lending practice that promotes "disparities among consumers of equal credit worthiness but of different race, ethnicity, gender or age."[91] It also creates a new private right of action for violation of laws against steering and predatory lending and also awards the successful litigant treble damages, costs, and attorney's fees associated with the action.[92] Borrowers who face foreclosure proceedings have the right to bring an ability to repay action against the lender and to seek a recoupment or offset for the damages of such a violation.[93]

As discussed below, even with these changes, the issue of discretionary pricing has not been abated. More reforms are needed if borrowers and the home finance market are to operate efficiently and fairly.

B. The Changed Mortgage Market and Lender Discretion

The mortgage market has changed dramatically in the last two decades and now delivers more diverse product offerings, including risk-based pricing. Consequently, a wider group of borrowers receive mortgage approvals. In order to understand whether and to what extent lenders can exercise discretion in risk-based loans, this section first considers the changed mortgage market. It explains how the present funding structure creates lending discretion. Then the discussion turns to how lenders use statistical analysis in lending, which is an issue underlying the proposed changes to HMDA data discussed in Part IV.

1. Price Variability and Loan Channels

Risk-based pricing has led to more granularity or variance and divisibility in pricing. Prior to the development of a wide, risk-based product market, lenders had less than five mortgage products and operated in local or regional markets.[94] Most lenders chose between offering prime or sub-prime loans, but rarely offered both. Brokers rarely originated loans. Borrowers with impaired credit were simply denied loans.[95]

90. Active community involvement in HMDA enforcement along with changes to the regulatory process have played a significant role in making lenders accountable. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 1, at 19–20.

91. *See* Dodd-Frank Act, *supra* note 65, § 1403(c)(3)(C).

92. *Id.* § 1404.

93. *See id.*

94. *See generally* K.S. Gerardi, H. S. Rosen & P. S. Willen, *The Impact of Deregulation and Financial Innovation on Consumers: The Case of the Mortgage Market*, 65 J. OF FIN. 333, 333–360 (2010).

95. *Id.*

The mortgage market is today national in scope and offers scores of products. Lenders operate in both the prime and sub-prime markets, have multiple origination channels, and choose to offer borrowers a high-rate product rather than deny the loan.[96] The increased access to credit for credit-impaired borrowers gives lenders significant discretion in pricing and creates pricing variability.[97]

Pricing variability creates more opportunities to service a more diverse population of borrowers. It also offers more opportunities for prices to vary significantly and for fair lending disparities to exist. The solution is to encourage transparent reporting of variances. The lender's data then provides a basis for evaluating the pricing for fair lending disparities.[98] Variable pricing can lead to fair lending disparities, however, when cost-based or competition-based discretion is allowed and not fully documented.[99]

The traditional method of retail lending involved a loan officer at a bank.[100] The bank originated, funded, and serviced the loan. Mortgage funding today may involve multiple layers of financial mediation.[101] The mortgage loan originates through one of three channels: retail, mortgage broker, or correspondent.[102] All three of these loan originators are independent contractors who use warehouse credit lines to fund mortgage loans.[103]

96. B.J. Keys, T. Mukherjee, A. Seru & V. Vig, *Did Securitization Lead To Lax Screening? Evidence from Subprime Loans*, 125 Q. J. OF ECON. 307, 307–62 (2010) (positing that in the subprime market securitization lowered the screening incentives of loan originators for subprime borrowers).

97. Price variability is also known as risk-based pricing. *See* WILLIAM C. APGAR & ALLEGRA CALDER, *The Dual Mortgage Market: The Persistence of Discrimination in Mortgage Lending*, *in* THE GEOGRAPHY OF OPPORTUNITY: RACE AND HOUSING CHOICE IN METROPOLITAN AMERICA 116–17 (Xavier de Souza Briggs ed., Dec. 2005), *available at* http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w05-11.pdf.

98. Known factors can normalize prices, which can be expressed as overages. Jack M. Guttentag, *What is a Mortgage "Overage?"*, THE MORTGAGE PROFESSOR (last updated Jan. 19, 2011), http://www.mtgprofessor.com/a%20-%20shopping%20for%20a%20mortgage/what_is_an_overage.htm.

99. *See* Avery, Canner & Cook, *supra* note 57, at 369–70.

100. *See id.* at 349. Correspondent lending is a combination of retail, channel, and wholesale channel lending. CONSUMER FIN. PROT. BUREAU, MORTGAGE ORIGINATION EXAMINATION PROCEDURES 7 (2014), http://files.consumerfinance.gov/f/201401_cfpb_mortgage-origination-exam-procedures.pdf. Correspondent lenders may fund mortgages from warehouse lines of credit or other funds. *Id.*

101. Financial intermediation is the process of indirectly transferring funds between lenders and borrowers. Mark P. Gergen, *Subchapter K and Passive Financial Intermediation*, 51 SMU L. REV. 37, 37–38 (1997).

102. *See* WILLIAM APGAR, AMAL BENDIMERAD & REN S. ESSENE, JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., MORTGAGE MARKET CHANNELS AND FAIR LENDING: AN ANALYSIS OF HMDA DATA 7 (2007), *available at* http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/mm07-2_mortgage_market_channels.pdf.

103. Cassandra Jones Havard, *"Goin' Round in Circles" ... and Letting the Bad Loans Win: When Subprime Lending Fails Borrowers: The Need for Uniform Mortgage Broker Regulation*, 86 NEB. L. REV. 737, 781 (2008).

Correspondents, however, may either fund mortgage loans themselves on a short-term basis or match mortgage brokers with wholesale lenders, who then provide the funds.[104] However in none of these situations are the loan originators agents of the ultimate mortgage funder.

The warehouse or wholesale lender is a final mortgage funder. The warehouse lender sets the underwriting standards and provides an advance commitment on price.[105] Wholesale lenders enter into contractual agreements with the originating lender, retail bank, mortgage broker or correspondent to fund loans. In the wholesale channel, a bank or mortgage broker actually solicits the loan and takes the application from the consumer.[106] As independent contractors, the loan originators (mortgage brokers, banks, correspondents) are not employees of the wholesale lender.[107] The status of loan originator also has limitations. The wholesale lender, not the originating lender, makes the underwriting decisions and reviews the documentation to accept or reject the loan before actually releasing funds.[108]

The link between the source of the funds, pricing variability, and pricing disparity becomes apparent given how lending involves statistical analysis and model-based approaches to evaluate profit.[109] Variable pricing allows the lenders, both originating and wholesale, to define the market and the profit expectations of that market. The increase in sub-prime lending has a direct correlation to both the secondary market demands for more of these loans as well as the ability to price risk differently.[110] When the pricing moves from

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104. *Id.* at 749–51 (discussing how the broker models makes mortgage lenders more efficient and responsive to changing market conditions).

105. *See* discussion *infra* in text surrounding note 173.

106. CONSUMER FIN. PROT. BUREAU, MORTGAGE ORIGINATION EXAMINATION PROCEDURES 6–7 (2014), *available at* http://files.consumerfinance.gov/f/201401_cfpb_mortgage-origination-exam-procedures.pdf. Throughout the remainder of this article, the term "originating lender" refers to banks, mortgage brokers and correspondent lenders who use warehouse loans to fund mortgages.

107. *Id.*; *see also* REN S. ESSENE & WILLIAM C. APGAR, JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., UNDERSTANDING MORTGAGE MARKET BEHAVIOR: CREATING GOOD MORTGAGE OPTIONS FOR ALL AMERICANS 7, 29 (2007), *available at* http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/mm071_mortgage_market_behavior.pdf. Mortgage brokers usually have relationships with multiple mortgage lenders and offer different mortgage loan products from these lenders. The advent of mortgage brokers raised the issue of suitability and whether the broker was indeed making the correct recommendation of loan product to the buyer. *Id.* at 7.

108. *See* APGAR, BENDIMERAD & ESSENE, *supra* note 102, at 7–8. By 2005, wholesale lending operations funded 56 percent of all prime loans and 78 percent of all non-prime loans.

109. Mortgage loans have an objective and a subjective price component. The objective component is derived from risk-based factors, such as credit scores. Essentially, the objective component is based on the customer's creditworthiness. The subjective component consists of fees imposed by the lenders. These fees are discretionary charges such as overages or yield spread premiums. Richard R. Pace & Lawrence B. Norland, *Monitoring Loan Pricing for Fair Lending Compliance,* A.B.A. BANK COMPLIANCE, Sept.–Oct. 2000, at 32, 36–40, *available at* https://www.pwc.com/en_US/us/financial-services/fair-lending-compliance-services/lessons_learned.pdf.

110. Robert G. Schwemm & Jeffrey L. Taren, *Discretionary Pricing, Mortgage*

objective indictors of creditworthiness to subjective pricing that includes unjustifiable discretionary fees, price variability becomes pricing disparity.

Discrimination in credit markets is statistically significant enough to have a negative effect on loan approvals and rates.[111] In the risk-based mortgage market, loan channels segment borrowers based on individual and group characteristics and geographical considerations.[112] There are a multiplicity of loan products available to credit-impaired borrowers.[113] Evidence shows that mortgage originators may presumptively offer minority borrowers who are not credit-impaired higher priced loans before first validating cost-based differences between the loan products.[114] Lenders who discriminate against minority borrowers that are as equally qualified as white borrowers may be justifying decision-making on the "lower or more variable future earned-income levels."[115] These circumstances all raise critical issues of regulatory impact and policy.

As an integral part of the mortgage financing process, warehouse lenders have control over a substantial flow of the funds. The regulatory concern regarding wholesale lenders is whether they allow too much discretionary decision-making when providing funds. Originating lenders are not agents of the wholesale lenders and in that regard do not expose the wholesale lender to liability. Yet, the warehouse lender's failure to inform and monitor the

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Discrimination, and the Fair Housing Act, 45 HARV. C.R.-C.L. L. REV. 375, 379–80 (2010). *See generally* Gretchen Morgensen, *Home Loans: A Nightmare Grows Darker*, N.Y. TIMES, Apr. 8, 2007, at BU1, *available at* http://www.nytimes.com/2007/04/08/business/yourmoney/08gret.html?pagewanted=all&_r=0.

111. Gary A. Dymski, *Is Discrimination Disappearing? Residential Credit Market Evidence, 1992–98*, 28 INT'L J. SOC. ECON. 1025, 1031 (2001).

112. Alan M. White, *Subprime Mortgage and Discriminatory Lending: Borrowing While Black: Applying Fair Lending Laws to Risk-Based Mortgage Pricing*, 60 S.C. L. REV. 677, 687 (2009); Jared Ruiz Bybee, *Fair Lending 2.0: A Borrower-Based Solution to Discrimination in Mortgage Lending*, 39 U. MICH. J.L. REFORM 113, 125 (2011) (stating that most minority borrowers choose to use higher-priced mortgage brokers instead of federally regulated banks).

113. Cassandra Jones Havard, *"Goin' Round in Circles" ... and Letting the Bad Loans Win—When Subprime Lending Fails Borrowers: The Need for Uniform Mortgage Broker Regulation*, 86 NEB. L. REV. 737, 751, 753 (2008).

114. Maya Sen, *Quantifying Discrimination: The Role of Race and Gender in the Awarding of Subprime Mortgage Loans,* 3 (Harvard Univ. Dept. of Gov., Working Paper, 2010) (defining individual discrimination as individual lenders discriminating against identically situated borrowers) *available at* http://www.gov.harvard.edu/files/uploads/sen.subprime_0.pdf; *see also* ROBERT J. GARY-BOBO, SOPHIE LARRIBEAU, University of Cergy-Pontoise, THEMA A STRUCTURAL MODEL OF DISCRIMINATION IN MORTGAGE LENDING, WITH SOME EVIDENCE ON NEUTRAL GROUND 3 (1999) (positing that detecting discrimination in mortgage markets is made more complex by the discrimination present in other markets, such as the labor and housing markets) *available at* http://dev3.cepr.org/meets/wkcn/3/3510/papers/bobo.pdf; *see also* Devah Pager & Hana Shepherd, *The Sociology of Discrimination: Racial Discrimination in Employment, Housing, Credit, and Consumer Markets,* 34 ANN. REV. OF SOC. 181–209 (2008).

115. Gary A. Dymski, *Discrimination in the Credit and Housing Markets: Findings and Challenges*, *in* HANDBOOK ON THE ECONOMICS OF DISCRIMINATION 215, 222 (William M. Rodgers III ed., 2006), *available at* http://economics.ucr.edu/papers/papers02/02-18.pdf.

originating lenders for discriminatory lending is a non-delegable duty.[116] The uneven access to sustainable, affordable financial services results in the disadvantageous, predatory products and services that constitute subprime lending.[117] The implications of efficient, robust pricing variability are that warehouse lenders must exercise greater effort to monitor lenders' policies and practices for fair lending. This need to monitor is arguably more stringent in the wholesale lending channel, which has a broad reach, but arguably is devoid of direct oversight authority.[118]

Creating a synergy between fair lending and safety and soundness can provide access to credit in fair and equitable ways. Policy changes regarding access to credit in minority economic communities must recognize the base inequality that structural discrimination invariably creates.[119] The recent Department of Justice (DOJ) fair lending settlements resulted in such an inquiry of lenders.

116. The Federal Housing Administration's (FHA) prohibitions extend to warehouse lenders because the statute explicitly prohibits "any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race, color, religion, sex, handicap, familial status, or national origin." 42 U.S.C. § 3605(a) (2006). "Residential real estate-related transaction" includes "the making or purchasing of loans . . . for purchasing, constructing, improving, repairing, or maintaining a dwelling" or loans that are "secured by residential real estate." 42 U.S.C. § 3605(b). *See generally* Joshua W. Dixon, *The Case Against A Nondelegable Duty on Owners to Prevent Fair Housing Act Violations,* 69 U. CHI. L. REV. 1293, 1318 (2002).

117. Economic clusters developed primarily due are the public policies and private industry practices that created inequities in housing and housing finance. These policies and practices created the racial and economic structure of neighborhoods and consequently of the country's housing market. The uneven access to financial services results in disadvantageous products and services of subprime lending. Squires identifies some structural inequity factors affecting access to financial services as (1) intimidation and violence by neighborhood "improvement" societies to maintain the "character" of communities; (2) explicit discriminatory policies that virtually excluded non-whites from FHA and other government insured loan programs in the 1930s to the 1960s and fueled suburban development at the expense of central cities; (3) refusal of real estate and rental agents to provide similar levels of service to white and non-white clients, including steering of clients to communities based on their race and that of the neighborhoods; (4) redlining by financial institutions (including the refusal to provide financing for many years and predatory lending more recently); (5) concentration of public housing complexes in inner city ghettos and barrios; and (6) exclusionary zoning ordinances existing in most suburbs that limit or prohibit multi-family housing and other affordable housing units. Gregory D. Squires, *Urban Development and Unequal Access to Housing Finance Services*, 53 N.Y.L. SCH. L. REV. 255, 263–64 (2008–2009).

118. Several DOJ settlements involved wholesale lenders, but these loans are not subject to the same direct regulatory review as loans made through traditional origination channels. *See* discussion *infra* note 114.

119. The borrower's financial condition is a critical factor that may limit the lender's causation. *See* Ramona L. Paetzold & Steven L. Willborn, *Deconstructing Disparate Impact: A View of the Model Through New Lenses*, 74 N.C. L. REV. 325, 354 (1996) (discussing disparate impact and causation in employer context).

2. Lenders' Discretion and Anti-Discrimination

Despite the fair lending laws, which ought to restrain lenders' conduct, widespread concern persists over the abuse of lender discretion in the context of risk-based pricing.[120] The most widely cited and well-documented concerns are the high incidence of subprime, equity-stripping loans that lenders make to minority borrowers who are otherwise qualified for prime loans.[121] The extent to which lenders appear to engage in this type of discrimination without regulatory scrutiny of lending practices that are, at least presumptively, illegal is difficult to reconcile with the intent of the law.[122]

From 2010-2012, pricing discretion became one of the theories used to establish mortgage lenders' violations of fair lending laws. The DOJ alleged that warehouse lenders failed to monitor loan originations and failed to prohibit loan officers and brokers from adding fees and interest rate mark-ups that increased their own compensation.[123] Using HMDA data, the complaints also

120. *See* Carol Necole Brown, *Intent and Empirics: Race to the Subprime*, 93 MARQ. L. REV. 907, 920, 951 (2010) (arguing that the cultural affinity hypothesis explains how "lenders discriminate against borrowers with whom they do not have a cultural affinity," and therefore lenders have no meaningful context to evaluate a borrower's creditworthiness).

121. According to a study conducted by the Center for Responsible Lending, African-American borrowers were anywhere from 6 percent to 34 percent more likely to receive a higher-rate loan than white borrowers with similar qualifications; and Latino borrowers were 29 percent to 142 percent more likely to receive a higher loan rate than white borrowers with similar qualifications. Debbie Gruenstein Bocian, Keith S. Ernst & Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, CTR. FOR RESPONSIBLE LENDING 19–20 (May 31, 2006), http://www.responsiblelending.org/mortgage-lending/research-analysis/rr011-Unfair_Lending-0506.pdf. The authors based this study on a proprietary subprime loan data set, which supplemented HDMA data. This racial disparity in subprime lending is evident regardless of borrowers' income-levels or risk-related credit factors. *Id.* at 3. The study breaks the data down by Loan To Value (LTV), Fair Issacs Company (FICO) credit score range, and race. The data indicates that that of the borrowers with the best credit histories, i.e., the lowest risk categories—LTV below 80 percent and FICO score above 680—African Americans were 65 percent more likely to receive subprime loans than their similarly situated white counterparts for purchasing a home and 124 percent more likely when refinancing. *Id.* at 11–12 tbls. 2–3.

122. *See* WILLIAM C. APGAR & ALLEGRA CALDER, *The Dual Mortgage Market: The Persistence of Discrimination in Mortgage Lending*, *in* THE GEOGRAPHY OF OPPORTUNITY: RACE AND HOUSING CHOICE IN METROPOLITAN AMERICA 101, 111–12 (Xavier de Souza Briggs ed., 2005) (describing discrimination in housing and mortgage markets as "more subtle"), *available at* http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w05-11.pdf. This point is hard to reconcile with the advances in the market that, in effect, kept the regulatory structure at least one step behind the advances in products offered in the marketplace. *Id.* at 118.

123. *See, e.g.*, Complaint at 3, United States v. AIG Fed. Sav. Bank, No. 1:10CV178 (D. Del. Mar. 4, 2010) [hereinafter AIG Complaint] (wholesale lender charged with failure to supervise mortgage brokers), *available at* www.justice.gov/crt/about/hce/documents/aigcomp.pdf; Complaint at 3, United States v. Countrywide Fin., No. CV11 10540 PSG (AJWx) (C.D. Cal. Dec. 28, 2011) [hereinafter Countrywide Complaint] (wholesale lender charged with failure to supervise its employees and brokers), *available at* www.justice.gov/crt/about/hce/documents/countrywidecomp.pdf; Complaint at 3-5, United States v. Wells Fargo, No. 12-520 (JDB) (D.D.C July 12, 2012) [hereinafter Wells Fargo complaint] (wholesale lender charged with failure to supervise loan originations), *available at* www.justice.gov/crt/about/hce/documents/wellsfargo

identified the pricing differentials between minority and white borrowers.[124] The lenders, as in most of the fair lending enforcement cases, resolved the litigation with the entry of a contemporaneous or nearly contemporaneous consent decree.[125] What is significant about the consent decrees that DOJ entered into is that the remedial action sought is to reduce or eliminate discretionary pricing. Specifically, the lenders consented to DOJ's ongoing supervision of the fair lending programs, implementation of pricing and monitoring programs and policies, close supervision by senior management including, providing written explanations whenever a pricing differential deviates from the bank's interest rate sheets, and documenting a specific, legitimate nondiscriminatory reason for the rate differential.[126]

These settlements made fair lending laws more meaningful by imposing limits on lenders' discretionary actions.[127] Using statistical disparities as a way

comp.pdf;Complaint at 3 United States v. Southport, No. Case No. 13-CV-1086-JPS (E.D. Wis. Sept. 26, 2013) [hereinafter Southport complaint] (charged higher broker fees on wholesale mortgage loans made to African-American and Hispanic borrowers as compared to non-Hispanic white borrowers), *available at* http://www.justice.gov/crt/about/hce/documents/southport/sp_complaint_2013-09-26.pdf; Complaint at 3, United States v. Plaza Home, No. 13-C-1086 (E.D. Wis. Sept. 26, 2013) [hereinafter Plaza Home complaint], *available at* www.justice.gov/crt/about/hce/documents/plazahomecomp.pdf.

124. *See, e.g.*, AIG Complaint at ¶ 15; Countrywide Complaint at ¶¶ 38–41; Wells Fargo Complaint at ¶¶ 66–74; Southport Complaint at ¶¶ 17, 19; Plaza Home Complaint at ¶¶ 16, 18, 20, 22.

125. *See, e.g.*, Consent Order, United States v. AIG Fed. Sav. Bank, No. 1:10CV178 (D. Del. Mar. 24 2010) [hereinafter AIG Consent Order], *available at* http://www.justice.gov/crt/about/hce/documents/countrywidesettle.pdf; Consent Order, United States v. Countrywide Fin., No. CV11 10540 PSG (AJW) (C.D. Cal. Dec. 28, 2011) [hereinafter Countrywide Consent Order], *available at* http://www.justice.gov/crt/about/hce/documents/countrywidesettle.pdf; Consent Order, United States v. Wells Fargo, No. 12-520 (JDB) (D.D.C. July 12, 2012) [hereinafter Wells Fargo Consent Order], *available at* http://www.justice.gov/crt/about/hce/documents/wellsfargosettle.pdf; Consent Order, United States v. Southport, No. 13-CV-1086-JPS (E.D. Wis. Sept. 26, 2013); Consent Order, United States v. Plaza Home, No. 13-C-1086 (E.D. Wis. Oct. 1, 2013) [hereinafter Plaza Home Consent Order], *available at* http://www.justice.gov/crt/about/hce/documents/plazahome/ph_settle.pdf.

126. The settlements required lenders continuing in operation to implement specific policies and procedures to avoid discrimination, including employee training. *See* AIG Consent Order, at ¶¶ 4–9 (lending pricing and procedures), ¶ 8 (monitoring), ¶¶ 11–13 (employee and broker training); Wells Fargo Consent Order at ¶¶ 4–8 (lending policies and procedures), ¶¶ 9–11 (monitoring), ¶¶ 13–16 (employee and broker training), ¶¶ 39–40 (evaluating and monitoring); Plaza Home Consent Order, *supra* note 125, at ¶¶ 3–7 (lending policies and procedures), ¶ 8 (monitoring), ¶¶ 11–14 (employee and broker training); United States v. Plaza Home, No. 13-C-1086 (E.D. Wis. Sept. 26, 2013). AIG no longer makes warehouse loans, but agreed to implement policies and procedures eliminating discretionary pricing by employees and brokers if it re-enters the wholesale lending business. *See, e.g.,* AIG Consent Order (Intro.).

Countrywide and Southport are no longer operational. These institutions agreed to injunctive relief to prevent the recurrence of the alleged unlawful lending practices in the event they re-enter the residential mortgage lending business. Countrywide Consent Order at ¶ 2; United States v. Southport, Case No. 13-CV-1086-JPS (E.D. Wis. Sept. 26, 2013).

127. *See generally* discussion surrounding note 133.

to determine either the lack of monitoring or a failure to take action, DOJ established that lenders were failing to examine their credit operations for potential disparate impact.[128] Fair lending rules, while antithetical to arbitrary and discriminatory pricing, are ineffective at *preempting* risk-based, or any other, pricing that is discriminatory. An inherent conflict exists between the legality of rational discrimination and the protections borrowers deserve from lenders making decisions that result in either disparate treatment or disparate impact.[129]

The success of the DOJ fair lending settlements hinged on the government being able to fashion a remedy that both monitors and eliminates pricing disparities.[130] The HMDA data was critically important in showing a pattern and practice of discriminatory conduct. However, two things are significant about the use of that data. First, as intended by HMDA, the data is a *post-hoc* evaluation of lending discrimination and therefore only deters future lending violations. Second, the evidentiary basis for establishing a specific policy in some cases is difficult to sustain when the lender's policy is to allow discretion in decision-making. Nonetheless, the impressive outcome resulting in liability against wholesale lending abuses begs the question of HMDA's efficacy in preventing discriminatory pricing. How existing fair lending case law interferes with HMDA as a preemptive measure in thwarting lending abuse is discussed below.[131]

III. THE RELATIONSHIP BETWEEN HMDA, LENDER DISCRETION AND FAIR LENDING

In order to understand whether and to what extent risk-based pricing delegates to lenders excessive discretion in loan pricing, this section first considers how courts generally have interpreted discretionary policies under Title VII. It then discusses the business justification doctrine and how that rule may be flawed in the context of risk-based pricing. This discussion of fair lending enforcement reveals a disconnect between fair lending rules and their enforcement. The breakdown occurs in two ways. First, plaintiffs alleging discrimination cannot meet the required evidentiary burden when the court

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128. *See, e.g.*, AIG Complaint at ¶ 17; Countrywide Complaint at ¶ 93; Wells Fargo Complaint at ¶ 77; Southport Complaint at ¶ 24; Plaza Home Complaint at ¶ 27.

129. Economists who support statistical discrimination argue it is validly based on a statistical analysis of accurate information regarding borrowers. *See generally* Edmund S. Phelps, *The Statistical Theory of Racism and Sexism*, 62 AM. ECON. REV. 659, 659 (1972) (positing a theory of statistical discrimination).

130. Many of the fair lending settlements were based on allegations of discriminatory pricing or steering and the lenders' lack of effective fair lending monitoring or corrective action. In some cases, potential liability can go as far back as 2004. *See* discussion *supra* notes 123–24.

131. *See generally* John L. Ropiequet, *Assessing the Impact of* Wal-Mart Stores, Inc. v. Dukes *on Fair Lending Litigation*, 21 J. OF AFFORDABLE HOUSING 195, 215–21 (2012), [hereinafter Ropiequet, *Assessing the Impact of* Wal-Mart Stores] (discussing the advances in using statistical evidence to prove disparate impact in fair lending litigation).

finds that subjective, discretionary decision-making lacks the specificity required to support a lending discrimination claim. Second, the court's evaluation of the lender's business justification is not properly tailored to an inquiry into reasonable business conduct.

A. Disparate Impact Doctrine

Disparate impact occurs "when a lender applies a racially or otherwise neutral policy or practice equally to all credit applicants, but the policy or practice disproportionately excludes or burdens certain persons on a prohibited basis."[132] As a theory of liability, it has often been used to challenge lender's mortgage decision-making.[133]

An analysis of disparate impact as a legal theory begins with the rule set out in *Griggs v. Duke Power*.[134] Griggs challenged the use of a written employment test for hiring under Title VII of the Civil Rights Act of 1964, which prohibits discriminatory employment practices. Ruling that intent was not necessary to establish discrimination in hiring practices, the Court determined that practices with a disparate impact must be justified by a business necessity.[135] Commentators roundly criticized *Griggs*.[136] In response to subsequent court rulings narrowing the concept, Congress codified the standard in the 1991 Civil Rights Act amendments.[137]

Fair lending's disparate impact test, also known as the "effects test," is

132. OFFICE OF THE COMPTROLLER OF THE CURRENCY, FED. DEPOSIT INS. CORP., FED. RESERVE BD., OFFICE OF THRIFT SUPERVISION & NAT'L CREDIT UNION ADMIN., INTERAGENCY FAIR LENDING EXAMINATION PROCEDURES iv (2009), *available at* http://www.ffiec.gov/PDF/fairlend.pdf.

133. HUD recently adopted a disparate impact rule—24 C.F.R. § 100.500 (2013). The Consumer Financial Protection Board issued statements regarding their intended use of the disparate impact theory. CONSUMER FIN. PROT. BUREAU BULLETIN 2012–04 (Fair Lending) (Apr. 18, 2010).

134. Griggs v. Duke Power Co., 401 U.S. 424, 436 (1971).

135. *Id.* at 431–32.

136. *See* Alfred W. Blumrosen, *The Legacy of Griggs: Social Progress and Subjective Judgments*, 63 CHI.-KENT. L. REV. 1, 1–2, 20–22 (1987); *see generally* Elaine W. Shoben, *The Use of Statistics to Prove Intentional Employment Discrimination*, 46 L. & CONTEMP. PROBS. 221, 221–23 (1983) ("The difference between 'intentional' and 'effect' discrimination still poses a question today in the area of subjective interviews.").

137. In February 2013, HUD issued a final rule making the existing ECOA disparate impact rule applicable to the FHA. In June 2013, the Supreme Court granted certiorari in *Twp. of Mt. Holly v. Mt. Holly Gardens Citizens in Action*, 133 S. Ct. 2824, 2824 (2013), to consider the scope of disparate impact under the FHA, but the case settled before oral argument. *See generally* Stacy E. Seicshnaydre, *Is Disparate Impact Having Any Impact? An Appellate Analysis of Forty Years of Disparate Impact Claims under the Fair Housing Act*, 63 AM. U. L. REV. 357, 374, 403–08, 410 (2013), *available at* http://digitalcommons.wcl.american.edu/cgi/viewcontent.cgi?article=1906&context=aulr (questioning why the Supreme Court of the United States chose "to assess disparate impact theory in housing cases after allowing the theory to rest undisturbed for so many decades").

found in Regulation B.[138] In litigation, plaintiffs use Title VII's burden-shifting standard, which is similar to the test in *Griggs*. To prove discriminatory effects, the plaintiff must make a *prima facie* showing of disparate impact. The burden then shifts to the defendant to justify its actions. Finally, the burden shifts back to the plaintiff to prove the existence of a less discriminatory alternative.[139] This method of proof is the same proof as Title VII employment discrimination actions.[140] That is, they defer to the defendant's justifications.[141] What has become apparent is that the defendant's justifications regarding mortgage-lending decisions are made even more complicated by this country's residential segregation and racial income disparities. Thus, the lenders' justification of its policies and practices must be viewed through the prism of race.

B. Discretion and Vagueness in Fair Lending

Plaintiffs relying on the disparate impact theory must show: 1) a specific policy or practice, 2) a disparate impact, and 3) facts raising a sufficient inference of causation.[142] Recent developments in employment law regarding the disparate impact theory may impede fair lending plaintiffs who are challenging a warehouse lender's practice of allowing individual loan officers or mortgage brokers to exercise discretion in pricing.[143]

1. Discretion as a Bar to Fair Lending Enforcement

Wal-Mart Stores, Inc. v. Dukes[144] is a noteworthy decision regarding

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138. *See generally* Equal Credit Opportunity (Regulation B), 76 Fed. Reg. 79,422 (Dec. 21, 2011) (to be codified at 12 C.F.R. pt. 1002 (2011)) ("The legislative history of the Act indicates that the Congress intended an 'effects test' concept, as outlined in the employment field by the Supreme Court in . . . *Griggs v. Duke Power Co.* . . . to be applicable to a creditor's determination of creditworthiness.").

139. Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541, 2561 (2011).

140. Title VII requires a plaintiff to show that employer's stated reason for complainant's rejection was in fact a pretext. McDonnell Douglas Corp. v. Green, 411 U.S. 792 (1973) (holding modified by Hazen Paper Co. v. Biggins, 507 U.S. 604 (1993)).

141. The standard is difficult as well because it has changed over time. Before the Supreme Court's ruling in *Wards Cove Packing Co. v. Atonio*, the standard was "business necessity." 490 U.S. 642 (1989). The defendant bore the burden of proving that no reasonable alternatives to the challenged practice were available. See Kirby v. Colony Furniture Co., 613 F.2d 696 (8th Cir. 1980). After *Wards Cove*, "business justification" standard places the burden of proving reasonable alternatives on the plaintiff. *See* Wards Cove, 490 U.S. at 659.

142. Watson v. Fort Worth Bank, 487 U.S. 977, 994–95 (1988) (proving employment discrimination based on statistical evidence).

143. After *Wal-Mart Stores, Inc. v. Dukes*, disaggregated discretionary decision-making may not be an acceptable way of proving racial disparities in lending based on HMDA data. *See* Ropiequet, *Assessing the Impact of* Wal-Mart Stores, *supra* note 131, at 197.

144. *Wal-Mart Stores*, 131 S. Ct. at 2547. The complaint alleged that Wal-Mart discriminated against 1,500,000 current or former female employees in its 3,400 stores across the county with respect to pay and promotion decisions in violation of Title VII. *Id.*

disparate impact and discretion in employment discrimination.[145] One commentator describes the decision as a "tangled doctrinal web."[146]

The issue of class certification became entwined with the merits of plaintiffs' evidentiary burden of proving employment discrimination.[147] Plaintiffs alleging a pattern and practice of discrimination proffered as a basis for class certification evidence of statistical disparity and expert testimony on implicit bias. Specifically, as proof of gender discrimination plaintiffs aggregated national statistics for all Wal-Mart stores on female pay and promotions. They also presented expert testimony on a gender-biased corporate culture.[148]

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145. Scholars studying the *Wal-Mart Stores, Inc. v. Dukes* opinion see its implications having a far-reaching effect on employment discrimination cases. Professor Judith Resnik discussed the case in light of the equality rights of litigants who otherwise would not have access to courts. Judith Resnik, *Fairness in Numbers: A Comment on* AT&T v. Concepcion*,* Wal-Mart v. Dukes*, and* Turner v. Rogers, 125 HARV. L. REV. 78, 135–36, 153–54 (2011) (discussing aggregate techniques that mix substantive and procedural rights and criticizing the Court's decision as providing protection for the property rights of individuals from group-based litigation while limiting the equality rights of groups with common interests). Professor Suzette Malveaux viewed the Court's decisions as not just discouraging class actions but also ignoring the common employment practice of employers' delegating discretionary decision-making to supervisors as a way of escaping liability for disparate impact and disparate treatment. Suzette M. Malveaux, *How Goliath Won: The Future Implications of* Dukes v. Wal-Mart, 106 NW. U. L. REV. 34, 44 (2011) (arguing that the Court's ruling on class certification requirements for Title VII is significant on employment discrimination cases because employees have a more difficult time acting collectively to challenge systemic discrimination). Professor Melissa Hart characterized the decision as one with many theoretical and doctrinal flaws, including the decision's rejection of statistical modeling as indicative of employment discrimination. Melissa Hart, *Working Group on the Future of Systemic Disparate Treatment Law: Civil Rights and Systemic Wrongs*, 32 BERKELEY J. EMP. & LAB. L 455, 468–75 (2011) (arguing that the court's rejection of statistical modeling does not justify its conclusion that individuals should engage in remedial hearings instead of bringing class actions, and it ignores the modern workplace with its decentralized management structures and "highly subjective criteria for employee evaluation"). Professor Natalie Pedersen posited that the case drew the linkage between social psychology and the practices of the employer that possibly indicates bias in decision-making. Natalie Bucciarelli Pedersen, *The Hazards of Dukes: The Substantive Consequences of a Procedural Decision*, 44 U. TOL. L. REV. 123, 141 (2012) (discussing how *Wal-Mart Stores, Inc. v. Dukes* may have changed the social framework theory previously used in employment discrimination cases). *See also* Elizabeth Chamblee Burch, *Introduction: Dukes v. Wal-Mart Stores, Inc.*, 63 VAND. L. REV. EN BANC 91, 93 ("*Dukes v. Wal-Mart Stores, Inc.* straddles the substance-procedure divide at nearly every turn."); Stephanie S. Silk, *More Decentralization, Less Liability: The Future of Systemic Disparate Treatment Claims in the Wake of* Wal-Mart v. Dukes, 67 U. MIAMI L. REV. 637, 640 (2013) ("the Court's opinion sheds light on the difficulty that disparate treatment claimants now face"); Jessica L. Martens, *Thinking Outside the Big Box: Applying a Structural Theory of Discrimination to* Wal-Mart Stores Inc. v. Dukes, 51 WASHBURN L.J. 411, 413 (2012) (arguing that the Supreme Court's approach impeded the recovery of potential victims of workplace discrimination and that a structural approach to class certification would recognize gender stereotyping resulting in employment discrimination).

146. Burch, *supra* note 145, at 93.

147. Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541, 2551–52 (2011).

148. *Id.* at 2552.

The Court rejected as insufficient proof of discrimination the statistical evidence and the expert testimony.[149] The Court characterized the evidence as "only evidence of a general policy of discrimination" and "worlds away" from meeting the "significant proof" standard.[150] Wal-Mart's corporate policy prohibited discrimination in employment decisions and allowed local managers' discretion to make promotions and increase pay.[151] The Court determined that plaintiffs alleging a pattern and practice of discrimination under Title VII and seeking class certification are expected to identify a specific policy that shows a company procedure that has resulted in biased decision-making.[152] Absent that, plaintiffs must show that the company operated under a general policy of discrimination affecting all members of the class, which required strong inferences of discriminatory conduct at the regional and national level.[153]

The absence of an identifiable policy in the *Wal-Mart* case led the Court to conclude that the statistically significant differences in pay and promotion were not based on gender discrimination.[154] It was significant to the Court's ruling that the corporate policy was to give individual store managers discretion on pay and promotion issues, thus establishing the *lack* of a uniform policy.[155] Because individual managers could make independent decisions under the policy, the corporate policy lacked the nexus required to establish causation for class certification.[156]

What the decision seems to overlook is that subjective decision-making is the root cause of unconscious and implicit bias in the workplace. How to ameliorate continued discrimination without taking into account the restrictive effects of stereotypes and implicit bias constrains the analysis.[157] The *Dukes* decision thus becomes germane to fair lending issues. The decision calls into question favorable decisions allowing fair lending class actions to proceed based on the disparate impact theory.

In *Ramirez v. GreenPoint Mortgage Funding, Inc.,* plaintiffs challenged the discretion that wholesale lenders gave mortgage brokers to price mortgage loans.[158] African American and Hispanic borrowers alleged that GreenPoint charged disproportionately high interest rates and used statistical analysis to

149. *Id.* at 2555.
150. *Id.* at 2545.
151. *Id.* at 2554.
152. *Id.* at 2553.
153. Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541, 2553 (2011).
154. The Court specifically rejected the plaintiffs' proffer of a "social framework analysis" and regression analysis given the absence of a uniform corporate policy. *Id.* at 2555.
155. *Id.* at 2554.
156. *Id.* at 2556.
157. Melissa Hart, *Civil Rights and Systemic Wrongs*, 32 BERKELEY J. EMP. & LAB. L. 455, 468–75 (2011).
158. Ramirez v. GreenPoint Mortg. Funding, Inc., 268 F.R.D. 627, 630 (N.D. Cal. 2010).

establish disparate impact.[159] Relying on the favorable Ninth Circuit decision in *Wal-Mart v. Dukes*, the court affirmed that for class certification purposes, the plaintiff's statistical analysis of the lender's discriminatory conduct did not have to prove that it would win on the merits of the case.[160]

Ramirez is a good illustration of how the warehouse lending operation works. GreenPoint originated nearly ninety-three percent of its mortgages through wholesale channels, relying on "tens of thousands of authorized brokers."[161] After funding the mortgages, GreenPoint sold them into the secondary market where they were packaged into mortgage-backed securities.[162]

Plaintiffs' allegations regarding discriminatory lending related to GreenPoint's discretionary pricing policy, which governed brokers' compensation for their services. "GreenPoint paid brokers a 'yield spread premium' or 'rebate' when they set the interest rate" above par, and allowed them to impose higher rates and fees at their discretion.[163] GreenPoint capped broker commission at five percent of the loan amount and monitored the fees for compliance with its policies.[164] Arguably GreenPoint's written guidelines and monitoring of the brokers' fees would satisfy the *Dukes* Court. Although the *Dukes* factual predicate is based on class action certification, the Court's dicta on the commonality of claims is useful in understanding how to evaluate management discretion.[165] The Court clearly disfavored dispersed decision-making within a corporation ad meeting the evidentiary standard for proving gender discrimination.[166] The absence of corporate directives, policies or guidelines on how managers and supervisors were to make promotion and

159. *Id.* at 631.

160. *Ramirez s*ettled before the Supreme Court's decision in *Wal-Mart Stores, Inc. v. Dukes*. *See* Order, No. 3:08-CV-0369-TEH (N.D. Cal. Apr. 12, 2011). *Cf.* Barrett v. H&R Block, No. 08-10157-RWZ, 2011 U.S. Dist. LEXIS 30713, at *18 (D. Mass. Mar. 21, 2011) (plaintiffs' expert's regression analysis are not grounds for denying class certification). The exercise of discretion by numerous loan officers was the basis for denying class certification in several cases. In these cases, the courts found there was no common mode of exercising discretion as required for class certification and thus denied the class action. *See In re* Wells Fargo Residential Mortg. Lending Discrimination Litig., No. 08-md-01930 MMC, 2011 U.S. Dist. LEXIS 99830, at *18 (N.D. Cal. Sept. 6, 2011) (stating that plaintiffs in *Wal-Mart Stores* had not shown that defendants "exercise[d] their discretion in a common way"); Rodriguez v. Nat'l City Bank, No. 08-2059, 2011 WL 4018028, at *155 (E.D. Pa. Sept. 8, 2011) ("Plaintiffs would likely have to show the disparate impact and analysis for each loan officer or at a minimum each group of loan officers working for a specific supervisor."); *In re* Countrywide Fin. Mortg. Lending Practices Litig., No. 08-MD-1974, 2011 U.S. Dist. LEXIS 118695, at *15 (W.D. Ky. Oct. 11, 2011) (finding that plaintiffs' statistical analysis did not meet the commonality requirement required for class certification).

161. *Ramirez*, 268 F.R.D. at 630.

162. *Id*.

163. *Id.* at 630–31.

164. *Id.* at 631.

165. Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541, 2552.

166. *Id.* at 2254–55.

wage decisions was critical. With no company guidance, no stated policy of non-discrimination and sole delegation to store management, the *Dukes* Court could not identify a uniform policy of discrimination that would justify the commonality necessary to support class claims of gender disparity in management.[167] However, unlike *Dukes*, in *GreenPoint,* the mortgage brokers were subject to a written policy, monitoring and review regarding compliance with that policy. The presence of an established policy on compensation and limits on third party discretion makes even a limited application of *Dukes* inapposite.

The final element of a disparate impact claim is causation. *Miller v. Countrywide Bank, N.A*. provides a familiar defense often used to justify discrimination, in general. To support the use of discretionary pricing resulting in racial lending disparities, *Countrywide* justified the disparities in the competitive market.[168]

African-American borrowers alleged that under Countrywide's discretionary pricing policy they were three times more likely than white borrowers to receive a high-interest loan.[169] The defense countered that the causation factor was not met because plaintiffs failed to show a correlation between the alleged disparities and how the discretionary pricing policy caused the disparity.[170] Rejecting this argument, the court found that the plaintiffs' proof was adequate because not only did Countrywide authorize both brokers and employers to engage in discretionary pricing, but also the plaintiff's complaint alleged Countrywide did so as policy and the complaint cites "reports observing that granting markup discretion to brokers and/or employees in other mortgage companies often leads to discriminatory results."[171]

Countrywide put forth a "market forces" defense that implicitly acknowledges disparities.[172] Countrywide argued that the negotiated terms were the result of competitive market forces, and thus could not "yield to disparate impact analysis."[173] The presumption underlying the argument is that the market self-corrects, therefore making the determined loan rates even, although the rates may be "higher than the par rate."[174] Indeed, the court found that the supposed 'self-correction' was, in effect, a "practice" that amounts to a

167. *Id.* at 2553.

168. Miller v. Countrywide Bank, 571 F. Supp. 2d 251, 257 (D. Mass. 2008).

169. *Id.* at 253.

170. *Id.* at 259.

171. The court found that authorization from Countrywide sufficient to deny the motion to dismiss, while explicitly recognizing that it may or may not meet the evidentiary burden of proving discriminatory lending practices at trial. *Id.*

172. *Id.* at 257–58.

173. *Id.*

174. Miller v. Countrywide Bank, 571 F. Supp. 2d 251, 257–58 (D. Mass. 2008).

policy and had become an effective way of discriminating.[175]

Miller would not survive a challenge to class certification under *Dukes* because the statistical analysis did not identify a common mode of exercising discretion.[176] But its "market defense" belies a corporate culture uninfected by racial stereotypes. What is problematic, and what law and policy must address, is how to check subjective decision-making in order to stop continued discrimination in lending. Lending, like employment, is susceptible to unconscious bias and subtle stereotyping. When that notion is unchecked, pricing disparities become acceptable, in spite of legal prohibitions.

The pricing disparities revealed by the HMDA data provide a basis for challenging lending discrimination. However, the disparate impact's method of proof is fairly stringent, and requires more than just reliance on HMDA data.[177] As the discussion above indicates, the requirement of identifying a specific policy or practice is difficult when warehouse lenders use originating lenders. By allowing wide discretion among originating lenders, a court may find that there is no specific policy from the warehouse lender or a unified practice among the brokers and lenders. This discretionary void, as the *Miller* court indicates, insulates the decision-making.[178] Proof of disparate impact causation is complex. The expert testimony must present sufficient statistical proof and analysis to show common harm, characteristic terms, and frequency of incidence. Further, the discriminatory loan pricing must be linked to the pricing differentials and shown along racial lines. The plaintiff must show that the identified brokers and loan officers on a sustained basis used race as a determinant. Even with this burden met, the defense is allowed to show a business justification for the decisions. The question becomes when deference to the lender's justification is appropriate.

2. The Flawed Legitimate Business Rationale

The complexity of race and segregated housing patterns, fueled by government policies and practices, intersect with the legitimacy of racial disparities in lending.[179] Recognizing private market concerns and the potential for regulatory intervention to restrict markets must be balanced, however, with structural discrimination in lending.

HMDA, with its public information disclosure requirements, incentivizes lenders to consider whether they are making loans in a racially biased way. Similarly, it requires them to consider how to mitigate disparate impact

175. *Id.* at 258.

176. Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541, 2554 (2011).

177. John L. Ropiequet & Christopher Naveja, *A Curious Dichotomy: Fair Lending Litigation and Enforcement Actions Following* Wal-Mart Stores, Inc. v. Dukes, 32 BANKING & FIN. SERVS. POL'Y REP. 1, 2 (2013).

178. Miller v. Countrywide Bank, N.A., 571 F. Supp. 2d 251, 255–56 (D. Mass. 2008) (quoting Watson v. Fort Worth Bank & Trust, 487 U.S. 977, 990–91 (1988)).

179. *See* discussion *infra* at Part IV, A. 4.

through examination and evaluation of alternatives. Yet, in the fair lending context, there is an unintended limitation to disparate impact's business justification. An individual lending decision intersects with private decision-making, law, and government policy. This results from the complexity associated with its numerous variables and qualifiers, market segments, origination sources, and the geographic location of the property.

The traditional disparate impact analysis is concerned primarily with proving fairness and negating arbitrary, subjective decision-making. There also must be concern about the way in which lending policies exacerbate racial inequality in communities. The high incidence of subprime lending in minority neighborhoods resulted in massive foreclosures. The foreclosures prompted the regulatory enforcement actions discussed above to correct the racial disparities in lending.[180] Moreover, there are limits on the business justification test that the *Griggs* burden-shifting test alone cannot ameliorate.[181] Disparate impact's burden shifting may be limited to underscoring the disparity-producing action, e.g., discouraging the adoption of a lending policy that relates only to minority borrowers. Indeed, the limits of the fair lending disparate impact regime are shown when it is unable to circumvent the structural practices and embedded racial inequalities.

Eliminating discriminatory mortgage practices requires examining more closely the operation of the modern mortgage markets.[182] Today's mortgage finance transaction has many stages ripe with opportunities to treat unsuspecting borrowers unfairly. How a court evaluates the business justification the lender offers is critical to enforcement of fair lending laws. Using the business justification under the disparate impact analysis should be viewed as a discretion-constraining rule.[183] Business justification was not intended to be a specific rule regarding conduct.[184] Indeed, a more specific disparate impact rule will not limit originating lenders' discretion. The disparate impact rule is needed to require lenders, and others subject to Title VII, to evaluate policies and decision-making for unintended consequences resulting in racial bias. The discretion-constraining effect of disparate impact,

180. *See* discussion *supra* at Part II, B. 2.

181. Olatunde C.A. Johnson, *Disparity Rules*, 107 COLUM. L. REV. 374, 396 (2007).

182. The modern mortgage market involves numerous loan products, different loan channels, and the originate-to-distribute model of mortgage financing. REN S. ESSENE & WILLIAM C. APGAR, JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., UNDERSTANDING MORTGAGE MARKET BEHAVIOR: CREATING GOOD MORTGAGE OPTIONS FOR ALL AMERICANS 1 (2007), *available at* http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/mm071_mortgage_market_behavior.pdf.

183. Antonin Scalia, *The Rule of Law as a Law of Rules*, 56 U. CHI. L. REV. 1175, 1177–79 (1989) (discussing federalism and arguing that judicial opinions should establish broad discretion-constraining rules of law).

184. *See* Griggs v. Duke Power Co., 401 U.S. 424, 431 (1971) ("The Act proscribes not only overt discrimination but also practices that are fair in form, but discriminatory in operation.").

however, depends on identifying the limits of, in this case, the originating lenders' options. Those limits could be placed appropriately on the scope of activities that may be discriminatory by imposing specific rules.

Another option is to constrain the discretion or the authority of managers to under-enforce the rules. To have a rule of business justification that that ignores how managers are able to skirt the applicability of the fair lending rules limits the use of the rule. An absence of limits on what constitutes a viable defense in the fair lending context results in both discriminatory conduct and supra-competitive profits. This is an absolute disregard for this rule of law. Disparate impact is an ineffective theory if it does not constraint this delegation of discretion. There should be limits on what conduct lenders may legally undertake to practice fair lending. Similarly, what business justification requires lenders to take into account should be defined. Otherwise, disparate impact as applied to fair lending only constrains the rationale that supports a lender's discretion, not the degree of discretion they can exercise.

IV. REFORM AND POLICY IMPLICATIONS

According to the foregoing analysis, warehouse lenders are able to delegate limitless discretion through originating lenders to use warehouse loans in a discriminatory manner. HMDA's monitoring functions are inadequate to deter these actions. This delegation, embedded within the funding process, essentially absolves the warehouse lender of the duty to avoid discrimination. The duty to not discriminate should be non-delegable. Allowing warehouse lenders to "turn a blind eye" negates the fair lending laws. Section A considers some strategies regulators might employ to both monitor the warehouse lender's duty and reduce the discretion that the warehouse lender delegates to the originating lender. Section B considers the societal policy mandates and social norms that support implementing these reforms.

There are three limitations to these suggestions. First, these suggestions, based on the considerations discussed above, do not propose an exclusive, or even singular approach to limit warehouse lenders' delegation of the fair lending duty or originating lender's discretion. Instead, it is my objective to identify integral ways that HMDA can effectively monitor discrimination in real-time and lead to the design of better monitoring measures. Second, this discussion is neither an effort to engage directly in the ongoing debate about the role of the sub-prime credit in either the private or public capital markets. It also is not an effort to value or oppose the prominence of short-term funding, such as warehouse lending, or of securitization in the mortgage finance market. Finally, the suggested reforms are not an attempt to explicitly or implicitly decide who bears responsibility for the financial crisis.[185] Difficult questions

185. *See generally* U.S. FIN. INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT

remain about how the public and private capital markets that fund the housing market were and should be regulated.[186] My purpose is fairly narrow and limited to the accepted notion that Congress enacted HMDA to monitor discriminatory lending in both its original and contemporary versions and that constraining originating lender discretion within acceptable limits is within the statute's regulatory scope.

A. Reforms

1. Fair Lending and Warehouse Lending Incentives

Left unaddressed in Dodd-Frank was the relationship between fair lending and warehouse funding. As discussed above, Dodd-Frank restrains lender discretion by generally reforming origination standards and qualified mortgages. But, it fails to identify other reforms that are needed to create an affordable, inclusive housing finance market.[187] Understanding how warehouse lending can incentivize fair lending is critical. The crux of any reform lays in evaluating what role warehouse lenders must play in fair lending risk management.[188]

Fair lending laws are concerned with the discrimination in which private lenders engage, and the disparities that result. In the regulatory context, laws can have both a prohibitive and a deterrent effect.[189] HMDA, as a statutory complement to CRA, is a deterrent statute.[190] Because it is meant to deter, its objective is distinguishable from the fault-based concept of intentional discrimination.[191] Instead, HMDA encourages private decision-making by

(2011), *available at* http://cybercemetery.unt.edu/archive/fcic/20110310173545/http://c0182732.cdn1.cloudfiles.rackspacecloud.com/fcic_final_report_full.pdf (discussing The Financial Inquiry Commission which is tasked with the responsibility of delving into and uncovering the myriad causes of the 2008 financial crisis and making recommendations for future policy).

186. *See generally* David Reiss, *Fannie Mae and Freddie Mac and the Future of Federal Housing Finance Policy: A Study of Regulatory Privilege*, 61 ALA. L. REV. 907 (2010).

187. Brian Honea, *GSE Reform Not Expected In the Near Term,* DS NEWS (Aug. 12, 2014), http://dsnews.com/news/08-12-2014/gse-reform-expected-least-2016 (discussing several proposals to reform the secondary housing market finance system and the—now bankrupt—government-sponsored entities Fannie Mae and Freddie Mac, and discussing how many commentators do not expect any reform before 2015 or 2016.)

188. Megan Haberle, *Finishing What Dodd-Frank started: Why Housing Finance Reform Still Matters*, ALTERNET (June 30, 2011, 10:38 AM), http://www.alternet.org/speakeasy/2011/06/30/finishing-what-dodd-frank-started-why-housing-finance-reform-still-matters?page=entire%2C0.

189. Regulated entities must comply with administrative rules or face sanctions for failing to do so. *See generally* Timothy F. Malloy, *Regulating By Incentives: Myths, Models, and Micromarkets,* 80 TEX. L. REV. 531, 600–604 (2002) (suggesting tailored environmental regulation as a "supplement" to direct regulation or incentive-based regulation).

190. *See* discussion *supra* in text surrounding notes 51–52.

191. *See* Implementation of the Fair Housing Act's Discriminatory Effects Standard, 78 Fed. Reg. 11,460 (Feb. 15, 2013) (to be codified at 24 C.F.R. pt. 100) (discussing how disparate impact in fair lending is often criticized for its lack of explicit regulatory guidelines and HUD recently

giving more attention to reporting, which may include racial disparities, with the purpose of limiting racial inequality in mortgage lending. In this regard, HMDA can incentivize lenders to change their practices if they result in mortgage discrimination. HMDA is also typical of conduct deterring standards because its remedies are enforced at the administrative level only.[192] Thus, changes to HMDA will make it particularly well suited to address structural discrimination in lending. A focused inquiry, therefore, becomes how HMDA can more effectively discourage disparate impact in mortgage lending, and thereby encourage private lenders to address racial disparities.

The broad scope of disparate impact in fair lending makes its application troubling for the courts. Plaintiffs are often unable to establish that the lender had a policy that supports a particular pattern of discriminatory lending.[193] Lenders, in turn, have supposedly adopted policies that encourage fair lending without specifically identifying what the policy encompasses or what practices are employed. Yet, the immediate goal of HMDA is to encourage private lenders to address the complexity of racial inequality that exists in lending. It is difficult for most lenders to adopt a mechanism for monitoring disparate impact when they claim that either there is not a discrete policy capable of producing the disparity or that failure to implement the policy at issue caused significant competitive disadvantage.[194]

Moreover, a more robust and uniform regulatory approach uses disparate impact as its foundation. Consistent with HMDA's objectives, the regulations should affirmatively require that all lenders, including warehouse lenders, take steps to reduce the lending disparities within their own portfolios when making lending decisions. In this way, HMDA becomes a mechanism that does more than simply prompt questions about what an institution's actual performance in

implemented disparate impact regulations outlining burden of proof required.).

192. Alexander v. Sandoval, 532 U.S. 275, 290 (2001) (indicating private right of action is not available to enforce Title VI's effects regulation).

193. Mayor of Baltimore v. Wells Fargo Bank, 677 F. Supp. 2d 847, 850 (D. Md. 2010) (alleging that Wells Fargo's predatory and discriminatory lending practices led to foreclosures that harmed the City. Wells Fargo filed a Motion to Dismiss, challenging the City's standing and contending that its complaint failed to state a cognizable FHA violation under either a disparate treatment or disparate impact theory. The Motion to Dismiss was granted, but allowed an opportunity for the City to file a second amended complaint.).

194. *See, e.g.*, Noland v. Commerce Mortg. Corp., 122 F.3d 551, 553 (8th Cir. 1997) (describing bank's decision to reject borrower's loan application because the borrower did not have cash needed for closing upheld); *see also* Rowe v. Union Planters Bank of Se. Missouri, 289 F.3d 533, 535 (8th Cir. 2002) (describing lender's business justification upheld because plaintiff did not qualify for either loans applied for- FmHA-guaranteed or a commercial loan); *see also* Boykin v. Bank of Am. Corp., 162 F. App'x 837, 840 (11th Cir. 2005) (describing how a lender's business justification was upheld because loan was "high cost" under New York law and prohibited under bank's written policies). Individual trial judges have found the disparate impact theory a viable approach in several class action mortgage discrimination cases. The cases have all settled before the defendant-lenders could use a competitive disadvantage as a business justification. Robert G. Schwemm & Jeffrey L. Taren, *Discretionary Pricing, Mortgage Discrimination, and the Fair Housing Act,* 45 HARV. C.R.-C.L. L. REV. 375, 423 (2010).

mortgage lending is; it will also direct all lending segments to identify which policies and practices justifiably perpetuate racial inequities. It is time to acknowledge explicitly that HMDA seeks to eradicate racial bias and requires lenders to not simply adopt and implement a policy of non-discrimination, but to also to identify ways in which implicit bias can be countered. In this way, lenders become obligated to understand how racial disparity is generated in mortgage lending system and then develop appropriate remedies.

2. Fair Lending Risk Management

The warehouse lending settlements provide a strong expectation of what should be done to assess risk exposure and to control and monitor fair lending price risk.[195] Effective fair lending management requires reducing disparities at every step in the lending process. As discussed above, the new rules of Dodd-Frank will help to curb lending abuse and provide more protection for consumers. The Dodd-Frank changes, however, do not eliminate the risk of unfair lending in discretionary pricing or the duty to monitor discriminatory pricing. Consistent with this duty, the warehouse lender should require appropriate disciplinary actions for non-compliance.[196]

Statistical analysis of the risk of unfair lending will allow lenders to ferret out the unintended differences in lending outcomes among demographic groups. Monitoring can also lead to early corrective actions. This duty is consistent with the responsibility that all lenders have to reduce the potential for fair lending issues. Warehouse lenders are in a unique position to exercise leverage over third party mortgage brokers, mortgage bankers and correspondent lenders that they fund. By requiring warehouse lenders to monitor the third parties with whom they deal, warehouse lenders can prohibit the third party's discriminatory conduct. It will require that all lenders proactively develop policy rules and decision criteria that correlate with race, ethnicity, gender, or other prohibited bases. Moreover, warehouse lenders are the only parties that have relevant information regarding all borrowers. Only they can evaluate differences in outcomes among borrowers who have similar credit characteristics. It is appropriate that lenders throughout the process maintain that duty. In so doing, lenders are solely exercising the due diligence that is an integral part of any lending process.[197]

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195. *See* Plaza Home Consent Order, *supra* note 125.

196. By using the reforms proposed, warehouse lenders should be able to determine which broker or correspondent lender is driving the disparities and take appropriate steps, which might include counseling, mandating fair lending training, capping compensation, or ceasing to do business together. Melanie Hibbs Brody & Richard R. Pace, *Managing Fair Lending Risk in Wholesale Mortgage Pricing*, ABA BANK COMPLIANCE, Mar.–Apr. 2010, at 1, 10, *available at* http://www.klgates.com/files/Publication/0da7f98f-3df8-4682-bbb9-14d756617915/Presentation/PublicationAttachment/bd4ed574-c0d8-449b-b1fd-19744feb7e2f/WholesalePricing_WhitePaper.pdf.

197. *See generally* Marsha J. Courchane & David Skanderson, *Fair Lending Risk Management Lessons from Recent Settlements*, CRA INSIGHTS: FINANCIAL ECONOMICS, Nov.

Given the changed lending environment, a more effective HMDA requirement would be to explicitly require warehouse lenders to monitor warehouse loans.[198] A contractual provision in the funding agreement between the warehouse lender and the originating lender would require the originating lender to certify that she is subject to the monitoring program. The provision should also give the warehouse lender the sole discretion to terminate the funding arrangement with the originating lender if the originating lender violates the policy.[199] Monitoring wholesale prices, albeit complicated, speaks to the crux of lending pricing disparities. While some may argue that wholesale lenders are not liable for broker and correspondent pricing, it is difficult to prevent the third party conduct that may lead to pricing disparities without requiring the nexus between the warehouse lender and the third party.[200] As the source of the funding, warehouse lenders are in a unique and critical position to exercise leverage over discretionary pricing decisions and incentivize the brokers and correspondents that they fund.[201] Additionally, they are in the best position to control, manage, and monitor pricing discretion regarding product offerings and pricing outcomes. What is imperative is that there is documentation for the business rationale for discretionary pricing adjustments and corrective action taken as necessary.

Warehouse lenders should design specific policies and procedures to avoid discrimination, such as defined standards for discretionary pricing, pre-funding review that loans comply with these policies, and a prohibition on funding loans that do not comply. Warehouse lenders should require brokers to observe these standards. Furthermore, warehouse lenders should be required to have statistical monitoring programs for lending disparities in order to

2012, *available at* http://www.crai.com/uploadedFiles/Publications/FE-Insights-Fair-Lending-Risk-Management-1112.pdf.

198. *See* Brody & Pace, *supra* note 196, at 3.

199. Settlement Agreement and Order Thereon, United States v. Long Beach Mortg. Co., No. 96-6159 (C.D. Cal. Sept. 5, 1996), *available at* http://www.justice.gov/crt/about/hce/documents/longbeachsettle.php. The bank operated in what the lending industry calls the "B/C" credit market, which is subprime because borrowers have impaired credit and pay higher prices to compensate for increased risk to the lender. *Id.* The parties agreed that to avoid costly litigation, the controversy should be resolved voluntarily. *Id.* Both parties agreed that Long Beach Bank, its officials, employees, agents, as well as successors, will not engage in any act or practice that discriminates on the basis of age, sex, race or national origin in the pricing of mortgage loans as prohibited by the FHA and the ECOA. *Id.* The agreement required Long Beach Bank to implement personnel training, accurate risk classifications, a retail mortgage loan monitoring system, and a consumer education program. *Id.*

200. *See generally* Brody & Pace, *supra* note 196.

201. The Dodd-Frank Act placed limits on loan origination fees, which has changed the funding relationships, making many mortgage brokers "mini-correspondents" in order to avoid the statutory restrictions on fees that mortgage brokers can earn. *See* BUREAU OF CONSUMER FIN. PROT., 4810-AM-P, POLICY GUIDANCE ON SUPERVISORY AND ENFORCEMENT CONSIDERATIONS RELEVANT TO MORTGAGE BROKERS TRANSITIONING TO MINI-CORRESPONDENT LENDERS 1 (2014), *available at* http://files.consumerfinance.gov/f/201407_cfpb_guidance_mini-correspondent-lenders.pdf.

identify the causes of the disparities.[202] In this way, the warehouse lender can develop "demographically-neutral loan prices" for each loan that can be compared for "similarly situated" borrowers, and, as necessary, take corrective action such as cutting funds to the particular broker or correspondent that fails to comply. The lender can also take appropriate action against the originating lender, whether that be withdrawing the line of credit or terminating the relationship with the offending party.

3. HMDA Reform and Existing Fair Lending Law

Finally, a regulatory-enforced disparate impact rule for warehouse lenders addresses the concerns that courts recognize already limit fair lending enforcement. First, the suggested reform is consistent with *Dukes*. *Dukes* requires a specific policy and practice as a predicate for a disparate impact case.[203] It is both an old and wrong-headed notion that a failure to address where and how bias may enter into decision-making should absolve the decision-maker. While the *Duke*s Court may have been correct in not granting class certification based on lack of commonality, the underlying rule that allows lenders to circumvent judicial scrutiny should be shored up. Lenders cannot be allowed to develop a "safe harbor" by having rules or criteria available for regulatory evaluation that are protective of their intent to not comply with the recognized rules. Such a practice in and of itself is a violation of the spirit of the law.

Implementing fair lending should involve all parties who share in the profitable enterprise of funding home mortgages. This change is necessary to further accountability. The proposed reform requires a specific policy and practice be put in place rather than continuing to protect the void of discretionary decision-making that can make disparate impact claims non-actionable. It is consistent with HMDA's objective of providing a valid, reasonable measure for detecting discriminatory conduct. It also mitigates racial impacts through examination and evaluation of alternatives. The objective is to hold all lenders in the mortgage funding process accountable for fair lending decision-making. Concomitantly, all consumers should receive an affordable, sustainable mortgage loan.

Second, the reform is also consistent with the court's findings in *Ramirez* regarding the use of statistical analysis to prove disparate impact. In *Ramirez,* the statistical analysis provides a factual basis for class commonality—

202. This requirement would be similar to the Securities and Exchange Commission's recently adopted regarding third party issued credit ratings of asset-backed securities. The SEC regulation requires a credit rating agency to exercise internal controls over the ratings process, transparency of certain ratings performance, and a requirement for third parties retained for the purpose of conducting due diligence related to asset-backed securities to provide a certification containing specified information. *See* 17 C.F.R. § 240.17g-10 (effective Nov. 14, 2014).

203. Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541, (2011) (stating Title VII liability under a disparate-impact theory requires the plaintiff first identify the specific employment practice that is challenged).

determining whether there are common characteristics and claims among the class of plaintiffs. Requiring the warehouse lender to present a statistical analysis would be very similar. A statistical analysis of the mortgages that the warehouse lender funds begins to answer the question of whether there is discrimination in lending. The warehouse lender determines the underwriting criteria for borrowers. The statistical analysis will determine whether its criteria and policies resulted in a disparate impact on minority borrowers or in minority neighborhoods. As with other data collected under HMDA, the warehouse lender's loan data would not be determinative of whether there is discrimination. What the data does is provide a basis for regulators to study and assess whether there are areas of concern.[204]

Lenders who make risk-based loans either predominately to minority borrowers or in minority neighborhoods should have to justify their practices in comparison to other lenders in the same area.[205] Instead of simply asserting that the borrower's creditworthiness justifies a higher interest rate, lenders must identify and document how the loan is consistent with other loans in the same area. File review, data mining, and statistical regression modeling provide adequate analysis to determine whether product placement is fair. This also provides a rationale by which the court can measure the lender's decision-making and the profitability of the loan to determine if it is reasonable or exorbitant.

As argued above, HMDA is not an indicator of lending discrimination, but

204. For example, if the warehouse lender makes similar loans to all minority borrowers or all borrowers in a majority-minority neighborhood, the statistical analysis should trigger further review. The additional review should compare the underwriting criteria, e,g, credit scores, debt to income ratio, etc., to assess similarity among borrowers and then compare the lender's profits with comparable loans by other lenders. This would be a check on the discretion of originating and warehouse lenders. One study has suggested that a measure of whether banks are providing a fair share of mortgage loans to communities of color is whether the home purchase and loan finance portfolio to reflect the regional distribution of homeowners and the actual mix of household income in each neighborhood. For example in the Twin Cities area of Minnesota, a lender that had a high concentration of subprime loans during the subprime crisis now has a disproportionately low rate of prime loans in the same area. *See* INST. OF METRO. OPPORTUNITY, UNIV. OF MINN. SCH. OF LAW, TWIN CITIES IN CRISIS: UNEQUAL TREATMENT OF COMMUNITIES OF COLOR IN MORTGAGE LENDING 10 (2014), *available at* http://www.law.umn.edu/uploads/ef/be/efbe0b8fda7508c925b74c7add571f41/IMO-Twin-Cities-Lending-Report-2014-Final.pdf. A comparative analysis such as this uses the community's actual demographics as a basis for a fair lending evaluation. This method could have a significant deterrent effect on discriminatory lending because lenders have access to the demographic information and are able to readily project the calculate whether a lender lending decision would be in compliance.

205. *See* Sewin Chan, Michael Gedal, Vicki Been & Andrew Haughwout, *The Role of Neighborhood Characteristics in Mortgage Default Risk: Evidence from New York City* 15 (Furman Ctr. for Real Estate and Urban Policy, Working Paper, 2011), *available at* http://furmancenter.org/files/publications/Pathways_1_Newest_with_Figures_Working_Paper.pdf (concluding that for borrowers in census tracts that are over 80 percent black, "the default hazard is over 25 percent higher than that of borrowers in tracts with fewer than 20 percent black residents. . . .").

is an indicator of the need for additional investigation. HMDA data can provide an "external view" to show whether there are observed pricing disparities that are either adverse to a protected class, are statistically significant, or are relatively large in magnitude.[206]

Specifically, to reduce pricing disparities, warehouse lenders should monitor for comparison and compliance and report on two components of the borrower's loan package: the APR, and total broker fees.[207] Lenders should conduct periodic statistical monitoring.[208]

A fundamental issue relates to how federal courts should scrutinize the lender's legitimate business rationale. Originating lenders defend the higher interest rates given to minority borrowers based on either creditworthiness or the geographic location of the property. What those same lenders, who are charged with discriminatory conduct, are not required to do is to prove that they have received a reasonable, rather than exorbitant profit margin.[209] Similarly, they are not required to demonstrate or report the statistical frequency of risk-based pricing in a geographical location. Why pricing concessions are required and the frequency with which they occur should be evaluated in comparison to competitors. Only by requiring such data in response to the legitimate business justification defense can a court adequately evaluate whether the limits on the originating lender's discretion are reasonable or in effect an excuse for discriminatory conduct.[210]

Warehouse lenders' monitoring of the originating lender will also reduce its exposure to liability for the conduct of the originating lender who is its borrower. Similarly, warehouse lenders should want to insulate themselves from poor and discriminatory decision-making by an originating lender. By failing to monitor the loan fund disbursements, the warehouse lender is essentially delegating its duty to make loans that are not discriminatory. The originating lender then becomes the warehouse lender's agent, implicitly or explicitly, and the warehouse lender is then liable for its conduct.

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206. Brody & Pace, *supra* note 196, at 3.

207. *Id.* at 4–5. The APR "captures the effect of discretionary lender-based pricing differences — such as price exceptions, lender fee waivers, etc." *Id.* at 5. The total broker fees capture the additional fees that borrowers pay up front. *Id.* at 4. Dodd-Frank reduced the amount of total fees that mortgage brokers can receive and eliminated yield spread premiums, a common way that brokers added to the cost of a loan. 12 U.S.C. § 1403 (amending section 129B of the Truth in Lending Act (as added by section 1402(a)) .

208. FED. DEPOSIT INS. CORP., RISK MANAGEMENT MANUAL OF EXAMINATION POLICIES SECTION 3.2-1 LOANS 47 (2005) ("A lending policy should not be a static document, but must be reviewed in a light of changing circumstances surrounding the borrowing needs of the bank's customers as well as changes that may occur within the bank itself.").

209. *See* Cassandra Jones Havard, "*On the Take": The Black Box of Credit Scoring and Mortgage Discrimination*, 20 B.U. PUB. INT. L.J. 241, 247 (2011).

210. Courchane & Skanderson, *supra* note 197, at 1, 5 (suggesting that if a significant number of loans need pricing concessions, it may indicate a need to adjusting rate sheet pricing to eliminate discretionary pricing).

The warehouse lender's regression analysis and disparity pricing studies should have a qualified privilege because it provides regulators with needed information to assess fair lending compliance.[211] Additionally, regulators should be granted some discretion in declaring penalties, as long as violations are within a specified range of default.

Finally, as the *Miller* court posited, fair lending laws are a response to markets that cannot self-correct or stop discrimination.[212] What is needed is both an effective market and regulatory response to the originating lenders' exercise of discretion in pricing. This discretion is a product of markets that do not self-correct. The present structure of the housing finance market allows originating lenders to select the appropriate loan product and loan channel for the buyer. Constraints on lender discretion could involve limitations of lenders' choices in making these decisions.[213] Alternatively, originating lenders can be constrained by defining the warehouse lender's regulatory obligations in a way that requires more stringent enforcement by regulators and the courts.[214]

This approach is justified not only because markets are not self-correcting, but also because failure to do so reinforces the public perception that this lending discrimination is private, harmless decision-making. The public is largely indifferent to fair lending, assessing violations as based on individual choice, while regulators are unaccountable for under-enforcement due to the invisibility of non-enforcement. The public indifference towards what appears to be the private, harmless decision-making provides no incentive for the lender to reform outside of the regulatory structure. Conversely, lenders have strong incentives to exploit non-compliance with fair lending laws in ways that actually disguise the conduct that justifies regulatory enforcement.

Implementing any of the foregoing strategies requires balancing the interests of lenders and consumers. If our nation is to protect the fair lending values that the Title VII reflects, and upon which the disparate impact doctrine is premised, there must constraints on delegation of pricing discretion. This limitation is integral to ensuring that creditworthy borrowers have access to sustainable, affordable homeownership.[215]

211. Currently there is a qualified privilege for producing such data. If a creditor conducts or authorizes a voluntary self-test, the data is privileged if the creditor has also taken appropriate corrective action. *See* 12 C.F.R. § 1002.15.

212. Miller v. Countrywide Bank, 571 F. Supp. 2d 251, 258 (D. Mass. 2008).

213. This addresses and may even eliminate steering: deliberately, intentionally, making predatory loans that violate fair lending standards because it is difficult to assess as such and significantly under-enforced.

214. *See* Ian Ayres, *Market Power and Inequality: A Competitive Conduct Standard for Assessing When Disparate Impacts are Unjustified*, 95 CALIF. L. REV. 669, 700 (2007).

215. *See* KOCHHAR, FRY & TAYLOR, *supra* note 21, at 5 (finding that Latinos lost an estimated two-thirds of their net worth and Asian and African American wealth has fallen by more than half due to the economic recession in the U.S).

4. The Policy Implications

Home ownership is the cornerstone of the American Dream.[216] It represents opportunity, prosperity and a better future for the "next generation." Home ownership has always been tied to other rights.[217] It also provides financial and social benefits. In addition to the tax deduction for property taxes and mortgage interest payments, the house appreciates in value and becomes a source of collateral for borrowing.[218] Home ownership makes the homeowner vested in the neighborhood and its surroundings.[219] There are also spillover effects, which include impacts on children, security of neighborhoods and improved social services that benefit communities as a whole.[220]

There are also spillover effects when home ownership ceases. Such was the case with the subprime crisis. The 2007 financial crisis combined risky loans, weak underwriting – sometimes even based on fraudulent information, the securitization of loans on the secondary markets, and a lax regulatory environment.[221] Many groups played a part in this, including borrowers who did not understand loan products, investors who placed heavy reliance on appraisals and ratings, and mortgage originators who added exorbitant fees and costs to borrowers' loans.[222] Each of these groups presents complex conflicts of interest and requires collective action to resolve the economic consequences. There are also particular challenges and spillover effects that require policy intervention to mediate. For example, there is the occurrence of negative equity, which leaves many homeowners "underwater," or owing more on a home than it is worth.[223] Homeowners in need of loan modifications found

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216. Robert G. Schwemm & Jeffrey L. Taren*, Discretionary Pricing, Mortgage Discrimination, and the Fair Housing A*ct, 45 HARV. C.R.-C.L. L. REV. 375, 433 (2010) ("mortgage lending has always been the gateway to the American Dream of homeownership.").

217. Historically, property ownership gave citizens the right to vote. *See generally*, Glenn P. Smith, Note, *Interest Exceptions to One-Resident, One-Vote: Better Results From The Voting Rights Act?*, 1996 74 TEX. L. REV. 1153 (1996).

218. TAMAR FRANKEL & MARK FAGAN, LAW AND THE FINANCIAL SYSTEM – SECURITIZATION AND ASSET BACKED SECURITIES 433 (2009).

219. *See generally* Joseph M. Harkness and Sandra J. Newman, *Effects of Homeownership on Children: The Role of Neighborhood Characteristics and Family Income*, FED. RES. BANK OF NEW YORK ECON. POL'Y REV. (June 2003) (an increase in property also increases home ownership); William M. Rohe, Leslie, S. Stewart, *Home Ownership and Neighborhood Stability,* 7 HOUSING POL'Y DEBATE 37 (1996) (study concluding that home ownership has beneficial effects on children, and thereby on society).

220. Donald R. Haurin, Toby L. Parcel & R. Jean Haurin, *The Impact of Homeownership on Child Outcomes* 15 (Joint Ctr. for Hous. Studies of Harvard Univ., Working Paper No. LIHO-01.14, 2001), *available at* http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/liho01-14.pdf.

221. Christopher L. Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185, 2213–24 (2007) (discussing how the secondary market funded predatory loans).

222. FIN. CRISIS INQUIRY COMM'N, FED. BANKING L. REP. ¶ 97–488 (CCH) (Jan. 27, 2011).

223. *9.1 Million U.S. Residential Properties Seriously Underwater in First Quarter, Lowest Level in Two Years,* REALTY TRAC (Apr. 15, 2014), http://www.realtytrac.com/content/foreclosure-market-report/q1-2014-home-equity-and-underwater-report-8037. RealtyTrac began reporting the number of properties underwater or the negative equity in homes in 2012. The U.S.

negotiating difficult because their interests were not aligned with those of investors who had an expected rate of return.[224] The health of the financial system and the economic toll for American families presents challenges as well.[225]

The economic toll on American families is arguably the most damaging spillover effect. One way to measure this effect is by the number of homes foreclosed.[226] As a consequence of the subprime crisis, between 2004 and 2008, 2.7 million homes were foreclosed.[227] For each home foreclosed in a neighborhood, the surrounding homes reduced in value an average of $5,000.[228] This loss was greater in low-income neighborhoods.[229] Additionally, the wealth of families and communities of color was significantly impacted.[230] Home ownership rates for blacks and Hispanic/Latino families dropped to a range of forty to forty-two percent.[231] This represented a return to the home ownership rates of fifteen years ago.[232] The foreclosures following the subprime crisis also pointed out another flaw in the American homeownership model. Most of the foreclosures occurred in socially and

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Home Equity & Underwater Report reports on property where the combined loan amount secured by the property is at least 25 percent higher than the property's estimated market value. During the second quarter of 2012, negative equity affected 12.8 million U.S. residential properties representing 29 percent of all properties with a mortgage. In the first quarter of 2013, 10.9 million residential properties representing 26 percent of all properties with a mortgage were seriously underwater. In the fourth quarter of 2013, 9.3 million residential properties representing 19 percent of all properties with a mortgage were seriously underwater. *Id.* For the first quarter of 2014, 9.1 million U.S. residential properties were seriously underwater. *Id.*

224. Bank of America's settlement with several state attorney generals ran into problems with those who invested in the allegedly predatory loans. The investors of Countrywide Financial, Bank of America's predecessor, protested Bank of America's home-loan-modification program as against their interests. Ruth Simon, *Investors Hit BofA Loan Modifications*, WALL ST. J., (Nov. 18, 2008), http://online.wsj.com/news/articles/SB122696804303735525?mg=reno64-wsj.

225. Amy J. Sepinwall, *Justice, Rights, and Bailouts: Responsibility, Repair and Redistribution in the Wake of the Financial Crisis,* 11 GEO. J.L. & PUB. POL'Y 301, 310–12 (2013) (discussing the shared responsibility among Americans for the subprime crisis).

226. Debbie Gruenstein Bocian, Wei Li, Carolina Reid & Roberto G. Quercia, *Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures,* CTR. FOR RESPONSIBLE LENDING, 14–30 (2011).

227. *Subprime Spillover: Foreclosures Cost Neighbors $202 Billion; 40.6 Million Homes Lose $5,000 on Average*, CTR. FOR RESPONSIBLE LENDING, 4 (Jan. 18, 2008), http://www.responsiblelending.org/mortgage-lending/research-analysis/subprime-spillover.pdf [hereinafter *Subprime Spillover*].

228. *Id*. at 1.

229. *Id*.

230. KOCHHAR, FRY & TAYLOR, *supra* note 21, at 14.

231. Robert G. Schwemm & Jeffrey L. Taren*, Discretionary Pricing, Mortgage Discrimination, and the Fair Housing A*ct, 45 HARV. C.R.-C.L. L. REV. 375, 381 (2010).

232. JAMES H. CARR & KATRIN B. ANACKER, NAT'L COMMUNITY REINVESTMENT COALITION, THE STATE OF HOUSING IN BLACK AMERICA, 3 (2012)*, available at* http://issuu.com/jhcarr/docs/state_of_housing_in_black_america/1.

economically isolated and disinvested areas.[233] Loans made by subprime lenders were not only unsustainable, but also increased segregation.[234] Again, the failure of fair lending laws is evident in the manner in which home financing was provided.

Ironically, the racial wealth gap is now greater than it was two decades ago and the laws implemented to give minorities more economic opportunities are skirted.[235] The effect is that low—and moderate—income minorities may be more economically marginalized than they were when the laws that ensured fair access to credit were passed. Changes in the housing finance market that caused the securitization of loans to shift the risk of loss, explains why credit exploded in long-neglected minority neighborhoods.[236] Lenders leveraged these short-term gains against minorities in a way that has decimated the wealth in communities of color.[237] For law to not be responsive to this phenomenon both legally sanctions and worsens economic inequality.

V. CONCLUSION

Will reforming HMDA reduce originating and warehouse lenders' discretion and thereby reinforce fair lending laws? Changing HMDA has the effect of making transparent, and therefore more consistent, the determination of whether a lender's risk-based lending violates the fair lending rules. Risk-based pricing is difficult to monitor for discriminatory motives. The regulatory void created by the ineffective fair lending examinations makes the regulatory

233. *Subprime Spillover, supra* note 227, at 4.

234. CHRISTY ROGERS, SUBPRIME LOANS, FORECLOSURE, AND THE CREDIT CRISIS 12 (2008). As a result of the Subprime Crisis, several major cities, including Baltimore, Cleveland, Los Angeles, and Miami, brought lawsuits against lenders. *Wells Fargo Settlement: A Predatory Lender Pays Up,* BALT. SUN, July 15, 2012, *available at* http://articles.baltimoresun.com/2012-07-15/news/bs-ed-wells-fargo-20120715_1_subprime-mortgages-minority-borrowers-mortgage-brokers; Henry J. Gomez, *Federal Judge Dismisses Lawsuit Blaming Banks For Foreclosure Mess In Cleveland,* PLAIN DEALER REP., May 19, 2009, *available at* http://www.cleveland.com/cityhall/index.ssf/2009/05/federal_judge_dismisses_clevel.html; *but see* John Caniglia, *Wells Fargo Settlement Could Pour Millions of Dollars Into Greater Cleveland,* THE PLAIN DEALER, July 12, 2012 (discussing the Justice Department settlement with Wells Fargo for discriminatory lending violations in Cleveland); Mariah Blake, *Miami and Los Angeles Sue Banking Giants Over the Sub-Prime Mortgage Debacle*, MOTHERJONES, Dec. 23, 2013, *available at* http://www.motherjones.com/mojo/2013/12/cities-sue-banking-giants-over-sub-prime-mortgage-debacle.

235. CARR & ANACKER, *supra* note 232, at 4.

236. From its inception, HMDA data has been vital to showing patterns of lending in minority neighborhoods. Ira Goldstein & Dan Urevick-Ackelsberg, *Subprime Lending, Mortgage Foreclosures And Race: How Far Have We Come And How Far Have We To Go?* THE REINVESTMENT FUND, 2 (2008) (positing that early HMDA studies, though flawed showed that a lack of credit flow into neighborhoods in which the majority of the residents were of members of racial and ethnic minorities.

237. Gary A. Dymski, Jesus Hernandez & Lisa Mohanty, *Race, Power, and the Subprime/Foreclosure Crisis: A Mesoanalysis, in* THE LEVY ECONOMIC INSTITUTE WORKING PAPER COLLECTION 31–32 (Levy Econ. Inst. of Bard Coll., Working Paper No. 669, 2011).

arena an unrealistic check on lender's conduct when lending is motivated by race or other illegitimate factors. To the extent that loan originators believe that race and geographic location are predictive of creditworthiness, it is unrealistic to assume that the lenders will not act on their biased assumptions when there is no threat of accountability. To expect that court enforcement only through the disparate impact doctrine will control the problem is unfounded.

This Article explored whether the relationship between HMDA, lender discretion, and fair lending enforcement is properly balanced. The regulatory enforcement scheme also vests a broad amount of discretion in the agencies and regulators charged with their enforcement. The recent discretionary pricing settlements bolster the conclusion that the present broad delegation of discretion leads to significant under-enforcement. If, however, all risk-based pricing becomes suspect and subject to unwarranted regulatory scrutiny, then amending HMDA would effectively drive risk-based lenders out of the market. Provided that a reformed HMDA does not create an automatic sanction, it will limit lender discretion by inviting more scrutiny of originating lenders whose conduct is clearly outside the norm. In addition, if changing HMDA scrutinizes decision-making more by lenders, it will also result in more self-compliance among lenders and more pressure to enforce fair lending law. It also may also persuade regulators to more clearly recognize violations of the law. Requiring warehouse lenders to monitor loans by originating lenders is an effective way of ferreting out whether there is a disparate impact in lending. Monitoring also protects the warehouse lenders and places the onus on the originating lenders who are the parties actually responsible for determining how the loan funds are used.

Completely restraining discretion and consequently shrinking the market could create market failure. Yet the regulatory scheme should be responsible for preserving the expectation of fairness in loan pricing that risk-based borrowers, indeed all borrowers, presume exists when they enter into a mortgage transaction. The predictable result is that lenders at every stage of the transaction will be more likely to comply with the fair lending laws in an informed, objective, rational, and non-discriminatory manner. Presently, the regulatory constraints are ineffective in stopping originating lenders from exercising unfettered discretion to set unreasonable high interest rates for risk-based borrowers under the guise of probable borrower default. Warehouse lenders are complicit in discriminatory pricing discretion because they do not monitor the use of the mortgage funds that they provide to originating lenders.

This Article suggests, in the context of HMDA, that monitoring needs to be put in place to reduce the degree of discretion delegated through risk-based pricing. Even with recent reforms, risk-based pricing remains broadly discretionary. Effectively constraining discretion in risk-based pricing requires amending HMDA and then increasing enforcement of fair lending rules. The current regulatory response—allowing the market to discipline risk-based lenders making risk-based loans—is fatally flawed. The strongest argument for the proposed amendment of HMDA is found in the legislative intent of the fair lending laws. Congress premised the fair lending laws on the artificial barriers that unjustly denied economic opportunities. Those artificial barriers still exist because that lenders use criteria and policies that disparately impact minority communities. And, lenders continue to justify those decisions by arguing that the results are unintentional and have a business justification. Congress and regulators must do more to ensure fair, affordable, sustainable mortgage finance.