

Discrimination With A Smile: Strategies to Uncover Subtle Forms of Housing Discrimination

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U.S. Department of Housing & Urban Development

National Fair Housing Training Conference

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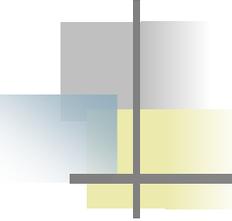
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- “Despite substantial progress made in eliminating discrimination in housing, we must continue to address the unfair practices that keep millions of American families from owning their own homes. The doors to homeownership should not be shut on anyone because of skin color or their current place of residence”

- *Congressman Elijah E. Cummings (D-Maryland),
Chairman, Congressional Black Caucus*

NCRC Overview

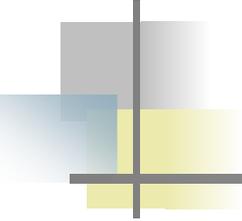


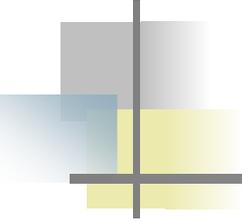
- National Community Based Membership
- Publications & Research; Policy Papers
- Consumer Rescue Fund - NCRC has identified numerous issues - role of broker, risk & pricing, servicing, increase in predatory lending to first time homebuyers, consumer loan origination issues
- Sub-Prime Fair Lending Mystery Shopping - NCRC Six Metro Area Audit Results
- Advocacy & Litigation
- Best Practices - Can North Carolina, New Mexico & NJ Laws serve as discussion point for a responsible national standard?
- Financial Literacy & MBDC, & Community Express Programs

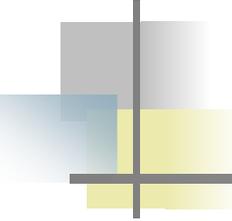


Impediments to Fair Housing Choice

- National real estate & financial service conglomerates
- One stop shopping - lender, appraiser, realtor, insurer - RICO & ethics issues
- “Affinity” relationships
- Internet
- Telemarketing
- Appraisal
- Corporate responsibility and social justice.
- Community viability & fair housing planning
- Economic justice & dismantling racism
- CRA modernization
- Government services, tax equity & environmental racism

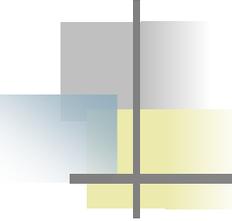
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- Risk based pricing & equal access to products & services - Reg C
 - Using consumer protection & civil rights statutes
 - Growth of product add-ons
 - Role of servicing & securitization
 - Reverse redlining
 - Tangible net benefit tests
 - Traditional forms of discrimination – steering, availability, pricing & terms, reasonable accommodation, accessibility
 - Realtor listing testing
 - Insurance products, homeowners & tenants insurance

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- New products marketed to emerging populations in rural, suburban and urban areas – contract to deed,
 - Source of Income discrimination in Section 8 & Rental Markets
 - Mobility demonstration programs
 - Occupancy Standards
 - Quality of life (services) in apartment complexes occupied by protected classes & Terms & conditions
 - HELOC, tax refund loans, home improvement



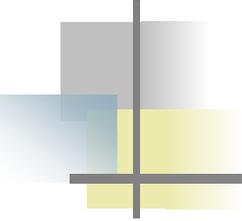
objective testing

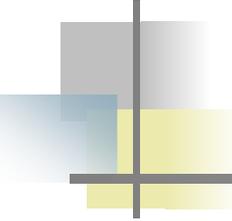
- Systemic Testing – National, Regional and/or Metro Area
- Focus on identifiable civil rights issues or impediment
- Innovative & newsworthy audits, investigations
- Impact on public policy by leveraging resources
- Augment Fair Housing Planning Process
- Establish mechanisms that assist protected classes, communities, outreach that produces economic justice
- Impact on corporate best practices by being a “private” or “public” attorney general or informed advocate



NCRC Luntz/Lazlo National Survey of American's Perceptions of Financial Institutions

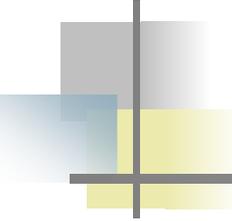
- 76 % of Americans believed that steering creditworthy minorities and women to costly loan products was a significant problem.
- 47 percent of the survey respondents believed that a white man would be more likely than an African-American man with the same credit history to be approved for a loan.

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- Only 10 percent of the respondents believed that the African-American would be more likely to be approved for a loan.
 - Among African-American survey respondents, 74 percent thought the white man would be approved, and only 3.6 percent thought that a similarly qualified African-American would be approved over the white man.
 - NCRC & it's members complaint intake, testing and research verifies that these perceptions of discriminatory treatment are reality in too many instances.



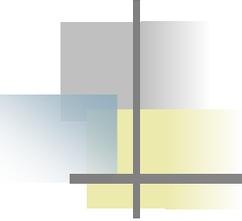
NCRC Equal Access to Credit Report

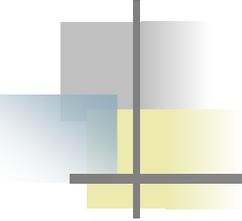
- “The Broken Credit System: Discrimination and Unequal Access to Affordable Loans by Race and Age” – November, 2003
- Sub-prime lending in ten large metropolitan areas
- Report available on PDF at www.NCRC.org

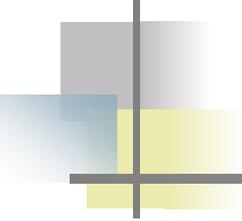


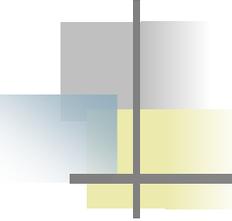
NCRC Research & Analysis

- NCRC finds that African-American and predominantly elderly communities receive a considerably higher level of high cost sub-prime loans than is justified based on the credit risk of neighborhood residents.
- President Bush has declared an Administration's goal of 5.5 million new minority homeowners by the end of the decade. The widespread evidence of price discrimination, however, threatens the possibility of creating sustainable and affordable homeownership opportunities for residents of traditionally underserved neighborhoods.

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- Sadly, it is still the case in America that the lending marketplace is a dual marketplace, segmented by race and age.
 - If a consumer lives in a predominantly minority community, he or she is much more likely to receive a high cost and discriminatory loan than a similarly qualified borrower in a white community.

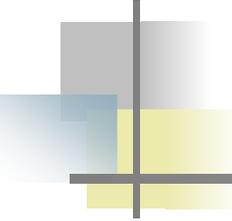
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- At the same time, the elderly, who have often built up substantial amounts of equity and wealth in their homes, are much more likely to receive a high cost refinance loan than a similarly qualified younger borrower.

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- The disproportionate amount of sub-prime refinance lending in predominantly elderly neighborhoods imperils the stability of long-term wealth in communities and the possibilities of the elderly passing their wealth to the next generation.



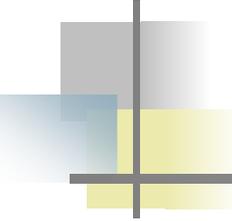
Economic Justice Begins At Home

- According to the Federal Reserve Survey of Consumer Finances, the median value of financial assets was \$38,500 for whites, but only \$7,200 for “minorities” in 2001.
- Whites have more than five times the dollar amount of financial assets than minorities.
- Likewise the median home value for whites was \$130,000 and only \$92,000 for minorities in 2001



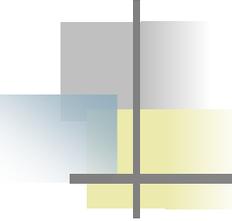
Debunking Lender Mythology

- The single most utilized defense of lenders and their trade associations concerning bias is that credit scoring systems allow lenders to be “colorblind” in their loan decisions.
- This study, the largest and among the first of its kind, debunks that argument and clearly makes the case that African-American and elderly neighborhoods, regardless of the creditworthiness of their residents, receive a disproportionate amount of high cost sub-prime loans.



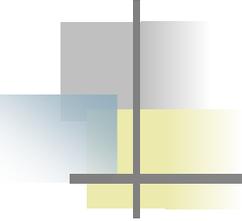
Study Metropolitan Areas

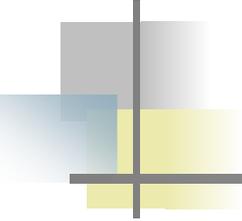
- Atlanta
- Baltimore
- Cleveland
- Detroit
- Houston
- Los Angeles
- Milwaukee
- New York
- St. Louis
- Washington, D.C.

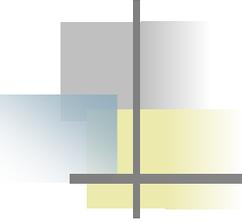


The Findings – Race Discrimination

- The level of refinance sub-prime lending increased as the portion of African-Americans in a neighborhood increased in nine of the ten metropolitan areas. In the case of home purchase sub-prime lending, the African-American composition of a neighborhood boosted lending in six metropolitan areas.

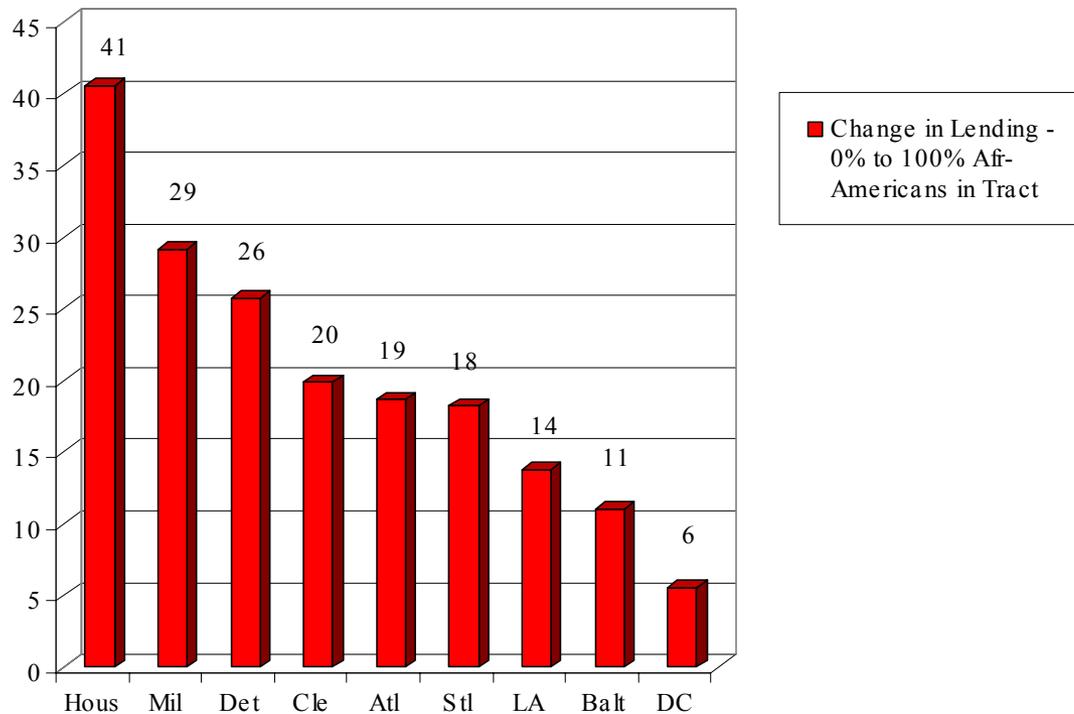
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- The percent of African-Americans in a census tract had the strongest impact on sub-prime refinance lending in Houston, Milwaukee, and Detroit.
 - Even after holding income, creditworthiness, and housing market factors constant, going from an all white to an all African-American neighborhood (100 percent of the census tract residents are African-American) increased the portion of sub-prime loans by 41 percentage points in Houston.

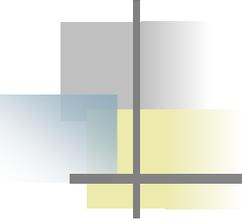
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- For example, if 10 percent of the refinance loans in the white neighborhood were sub-prime, then 51 percent of the loans in an African-American neighborhood in Houston would be sub-prime.
 - The portion of sub- prime refinance loans increased by 29, 26, and 20 percentage points in Milwaukee, Detroit, and Cleveland, respectively, from an all white to an all African-American neighborhood.

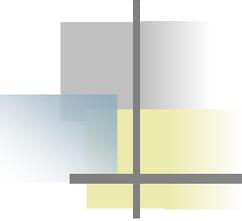
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- The next graph provides details of this phenomenon across the metropolitan areas and shows a strong race factor in Atlanta, St. Louis, and Los Angeles as well.

Index of Discrimination Against African-American Neighborhoods

Graph 1: Index of Discrimination Against African-American Neighborhoods: Subprime Refinance Lending

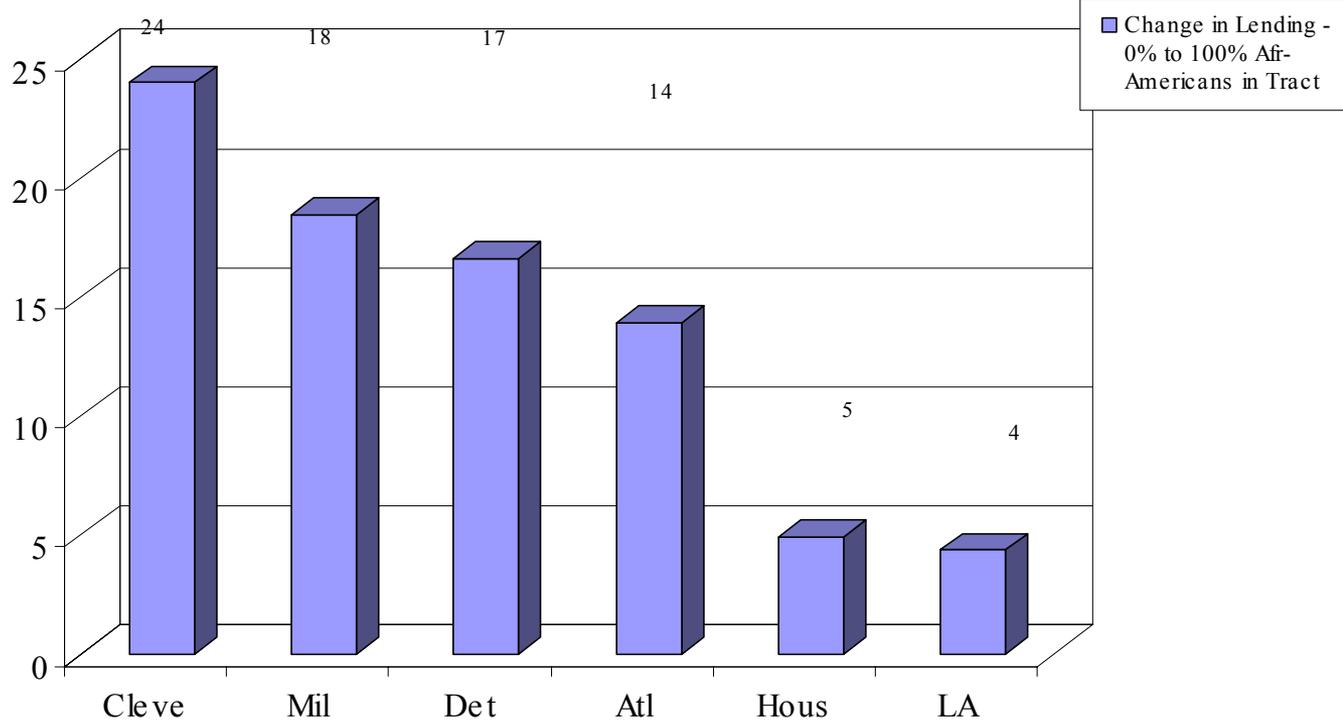


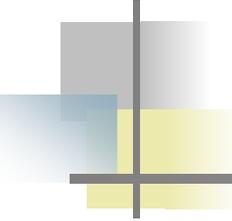
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- Solely because the percentage of the African-American population increased, the amount of sub-prime home purchase lending surged in Cleveland, Milwaukee, and Detroit.
 - From an all white to an all African-American neighborhood in Cleveland, the portion of sub-prime home purchase loans climbed 24 percentage points.

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- The next graph reveals that the portion of sub-prime purchase loans similarly rose by 18 and 17 percentage points in Milwaukee and Detroit, respectively, in African-American neighborhoods compared to white neighborhoods.

Index of Discrimination Against African-American Neighborhoods

**Graph 2: Index of Discrimination Against African-American Neighborhoods:
Subprime Home Purchase Lending**

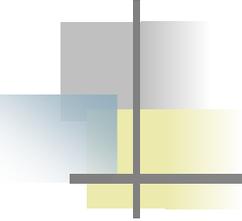




Age Discrimination

- The impact of the age of borrowers was strong in refinance lending.
- In seven metropolitan areas, the portion of sub-prime refinance lending increased solely when the number of residents over 65 increased in a neighborhood.

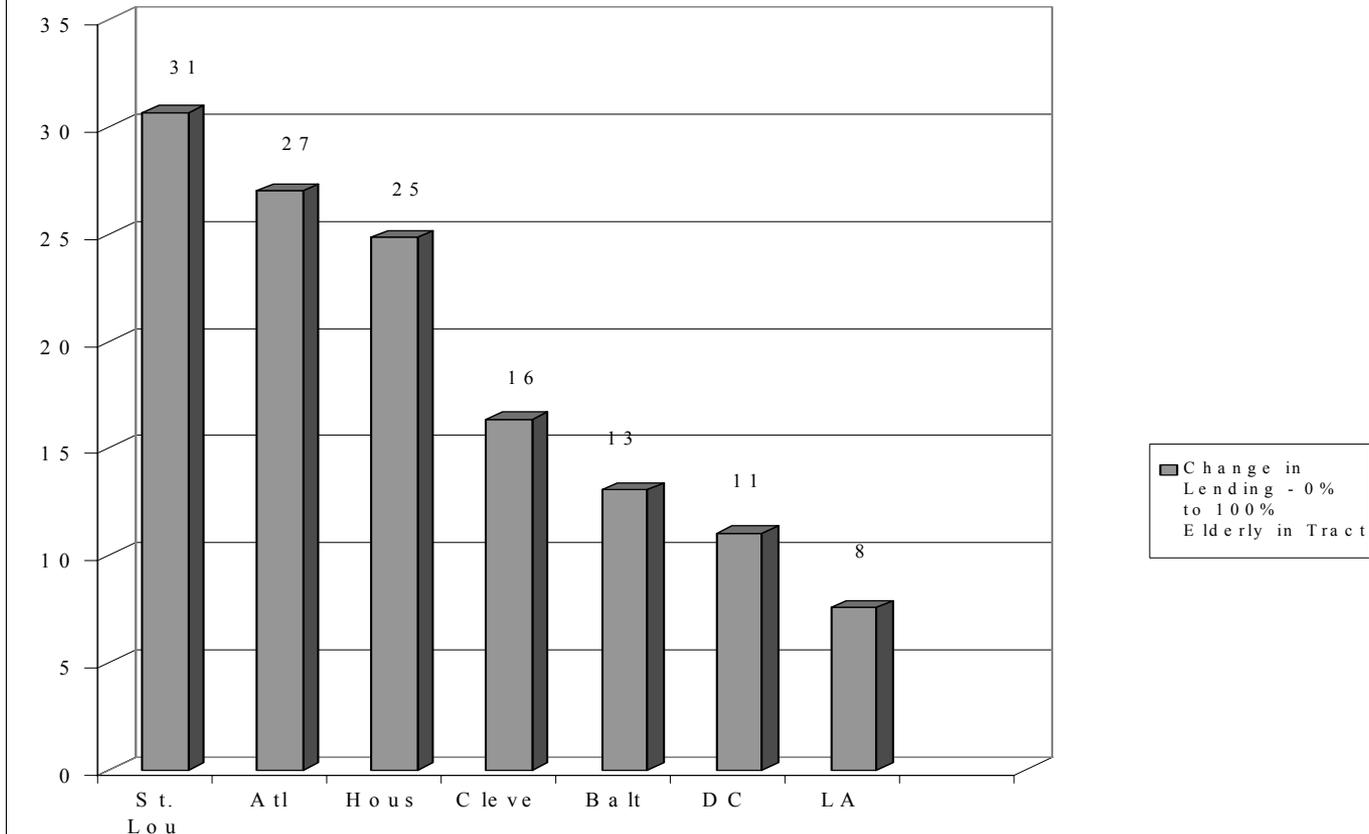
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- Elderly neighborhoods experienced the greatest increases in sub-prime refinance lending in St. Louis, Atlanta, and Houston.
 - Even after holding income, creditworthiness, and housing market factors constant, the portion of sub-prime refinance lending would surge 31 percentage points in St. Louis from a neighborhood with none of its residents over 65 to all of its residents over 65.

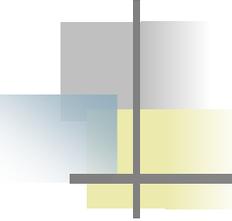
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- Likewise, the increases were 27 and 25 percentage points in Atlanta and Houston, respectively.
 - Although neighborhoods with such extreme age distributions (none or all residents over 65) are unusual, the regression analysis highlights and isolates the impacts of age on the level of sub-prime lending.
 - Indeed, the level of sub-prime lending is likely to be considerably higher in neighborhoods with large concentrations of senior citizens.

Index of Discrimination Against the Elderly –

Elderly

**Graph 3: Index of Discrimination Against the Elderly:
Subprime Refinance Lending**

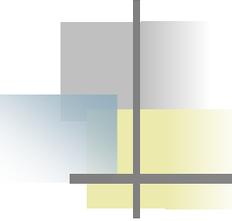




Findings – The Unbanked

- The level of sub-prime lending increased in a statistically significant fashion in the great majority of metropolitan areas as the percentage of neighborhood residents with no credit scores increased.
- Sub-prime refinance and home purchase lending climbed in nine and seven metropolitan areas, respectively, as the portion of neighborhood residents without credit scores increased.

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- This is a significant issue for recent immigrants and other un-banked populations, many of whom are creditworthy for loans at prevailing interest rates, but receive high cost loans simply because they lack conventional credit histories.



A Preemptive Thought

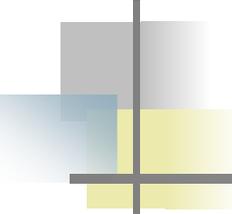
- *"NCRC's study documents widespread discrimination across the country and in Atlanta. I find it deplorable that the office of the Comptroller of the Currency preempted Georgia's strong state anti-predatory lending law, particularly in light of the study's findings. In Atlanta, predatory lenders are stripping wealth from the elderly and African American communities."*

Congressman John Lewis (D-Georgia)



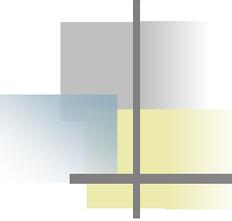
Predatory Lending Issues

- Extension of credit on unfair terms or by unfair or deceptive methods to vulnerable consumers.
- Vulnerable consumers are individuals:
 - Who are perceived not to be financially sophisticated – minorities, elderly, women;
 - Who lack alternatives – “the dual lending market,” low to moderate income customers, customers with impaired credit, urban & rural customers.



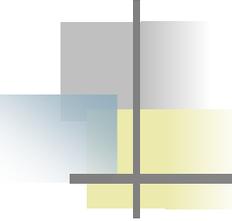
Predatory Lending Civil Rights & Consumer Protection Issues

- Unfair pricing / excessive points and fees
- Broker conduct – 50% of referrals to NCRC remedial loan fund
- Ancillary products (credit insurance) sales practices
- Refinancing – “flipping” issues
- Debt to income ratios – “equity stripping” issue
- Prepayment fees
- Stated income loan programs – fraud risk
- Balloon payments
- Appraisers – property flipping risks
- Deceptive advertising
- Unfair collections practices
- Different channels/different pricing – “referrals”
- Servicing issues – NCRC, HUD, FTC & OTS developments



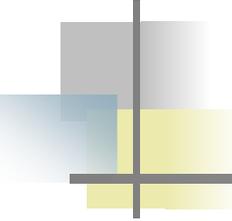
Reverse Redlining Fact Patterns

- Cap Cities Litigation
- Toussie Litigation



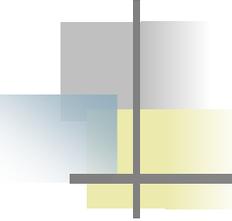
Legal Tools

- Federal Fair Housing Act
- Truth In Lending Act (TILA)
- Equal Credit Opportunity Act (Reg B)
- Home Ownership & Equity Protection Act (HOEPA)
- Home Mortgage Disclosure Act (Reg C)
- Community Reinvestment Act
- Fair Debt Collection Practices Act
- Real Estate Settlement Procedures Act (RESPA).
- State & Local Protections
- Fraud & Racketeering Arguments
- FTC Act



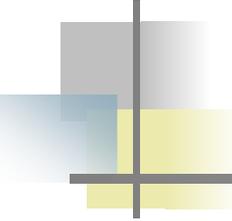
NCRC FHIP PEI Initiative

- Testing for fair lending compliance of non- prime lenders, focus on financial service corporations
- Testers seeking information on a loan based on the equity in their home
- HUD/treasury predatory lending task force hearing “hot spots”
- Targets identified by HMDA, FOIA, focus groups & NCRC consumer rescue fund referrals
- Testers had similar qualifications, sought similar opportunities and products, should get similar information



PEI Audit Metropolitan Areas

- Atlanta
- Baltimore
- Chicago
- New York
- Washington, D.C
- Los Angeles



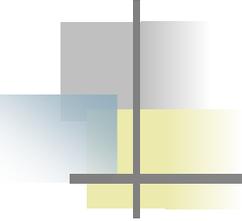
Compliance Factors:

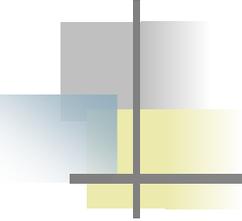
- *Access* - Refers to difficulties encountered in speaking with or scheduling an appointment with a loan officer. If a tester made four phone calls over a period of a few days, and none of these calls were returned, that was considered a complete test. This category would also cover appointments canceled by a loan officer which were not rescheduled, if a loan officer said an application must be completed prior to scheduling an appointment, or referred one tester to another company, that would also be an issue of access.



- *Terms and Conditions* - Includes, among other things: interest rate quoted; whether or not the interest rate was fixed or adjustable in some way; how many points were required (and whether one or more points represented an origination fee); available loan terms; closing costs; and reserve requirements for insurance and taxes.

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- *Differential application of a qualification standard* - Refers to, for example, both a white tester and a minority tester being told about the same qualification ratio, but the white tester being told that exceptions could be made while the minority tester was told the ratio is firm.

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- *Level of Service* - Covers a multitude of service-related issues, such as: extent to which information was volunteered by the lender vs. extent to which the tester had to ask for information; amount of helpful information provided by the loan officer (i.e., using some cash to reduce debt to lower ratios); quality and quantity of information provided (both verbally and in writing); and efforts made by the loan officer to secure a tester's business.

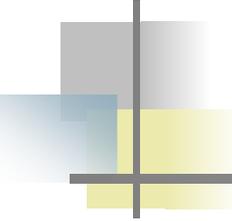
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- *Qualification standards* - Includes actual qualifications and underwriting standards which were conveyed to testers, with regard to maximum ratios, credit flaws, minimum down payment levels, minimum income levels, etc.
 - *Policies or Practices which may be Discriminatory in Effect* - Includes minimum loan amounts, minimum income or asset levels, limitations in service territory, extraordinarily low ratios, and other factors that may disparately impact Black or Latino loan seekers.

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- *Application process* - includes documentation testers were told would be necessary in order to process their application (i.E., Social security card, bank statements); The amount of time testers were told the application process would take; The conveyed application fee; And any “specials” related to application.

Tester Profiles

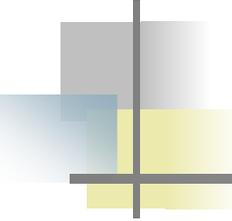


- Testers qualified for prime loans
- Protected 695 FICO, Comparison 675 FICO
- Long time homeowners with substantial equity, seeking refinance, home improvement
- Good income
- Good ratios
 - LTV
 - DTI



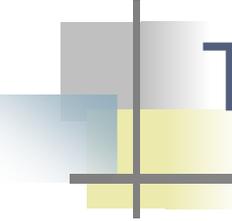
Testing Findings

- 48 tests of 12 sub-prime lenders in 6 cities
- 45% rate of disparate treatment based on race
- Instances of sex discrimination brings rate over 50%
- Redlining in Baltimore City
- Disparate impact
 - District of Columbia
 - Minimum loan amounts



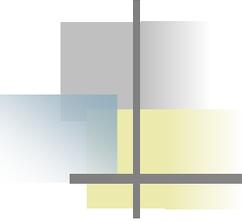
Testing Findings

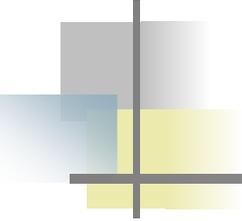
- Failure to “refer up” to prime products
- African American mystery shopper sales pitch often focused on “quick money”
- White mystery shopper pitch focused on competitive terms.
- Little or no follow-up to African American Testers

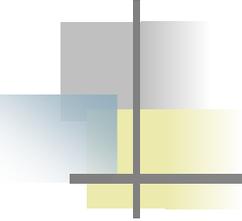


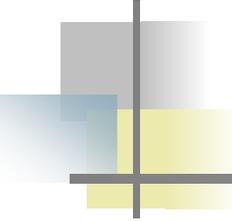
The Servicing Situation

- Servicing rights are bought and sold - borrowers have become the product – not the loan. Homeowner perception is that the consumer has lost control and that they are perceived as a commodity. *How do we re-establish trust in the market?*
- *NCRC & It's members received over 250 referrals to Consumer Rescue Fund.*
- Role of master servicer, sub-servicer and special Servicer needs to be closely examined to promote best practices, compliance, consumer education and the administration's goal of expanded homeownership.

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- Financial modernization confuses consumers, whether they understand that their loan is serviced by holder, private label, etc. – Need CRA Modernization
 - Unfriendly regulatory and/or policy environment due to sub-prime predatory lending debate complicates responsible lenders and servicers business model during a time of rapid growth, demonstrated by FTC/Fairbanks & OTS/Ocwen.

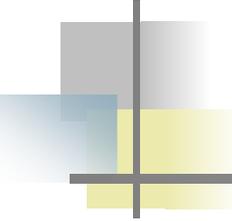
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- Consumers, and many consumer groups & advocates, do not understand or differentiate between role of the servicer, securitizer, originator, etc.
 - Securitization “un-bundles” the loan, lenders have information advantage over investors and there is a strong incentive to “pass off” bad paper by lenders - placing servicers in the middle of the debate.

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- S&P Credit Enhancement
 - FTC v. First Alliance Mortgage Co
 - Securitization manages and prices loss, rather than seeking out bad loans. Often, consumers, advocates, lenders and/or servicers are caught in the middle dealing with problematic loans.



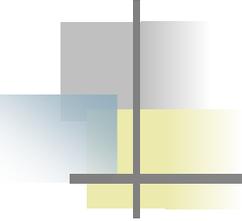
Factors Considered

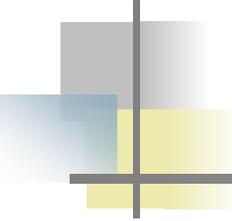
- NCRC's sub-prime servicer experience was that we are operating in a fee based system, with little motivation to keep the consumer happy or in their home. Issues are now being identified in self-held portfolios.
- Review of materials reveals that automation of systems promotes efficiencies and loss mitigation strategies, but also limits flexibility in dealing with individual consumer matters. *Adequate staffing, diversity, quality control (secondary review) & expertise must be assured and multiple points for dispute resolution created in servicing system.*



Servicing Issues

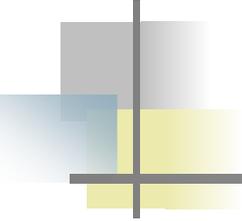
- Community groups considering the creation of borrowers servicer, modeled upon buyers broker.
- Pyramiding: Servicers are holding consumers' checks with the intent to tack on late fees and accelerate foreclosure
- Failure to provide payoff statements
- Forced place insurance
- Cashiering & Escrow Issues
- Coercing borrowers into E-Z Pay rather than cost free alternatives
- Suspense account – misapplication of payments, related to pyramiding.
- Improperly clouding (reporting payments) on credit reports,
- Accelerated or costly foreclosure actions
- Unprofessional customer service.
- Selective & Accelerated Foreclosure
- Equity Stripping

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- System is currently overloaded due to loan servicing volume, refinances, staff turnover.
 - Inaccurate accounting/cashier practices, misstating amounts owed, demanding payments that have already been made - many issues start with poor Sub-prime servicer communication strategies with consumer. *Reliance on verbal.*
 - Harassing phone calls, perception of “script manipulation” rather than customer service & sensitivity.



Where are we?

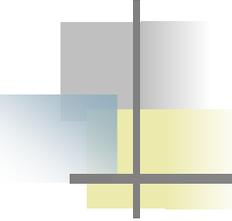
- Focus on assignees – broker/originator; victims seeking relief from assignees – should produce an incentive to screen. *10% sample rule?*
- But, loan portfolio review is not cost effective, risk of litigation against securitizers low, and can structure SPV's to avoid liability. *Holder in due course debate – intentional fraud vs. willful ignorance – accepting fruits of fraud.* Once again, the “the consumer & the lender is caught in the middle.”
- Role of Mortgage Broker & Originator, Appraisers, Realtors.

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- Market discipline in time - by best practice, reg or law, will drive out predatory lenders & servicers – but must reach all aspects of the market. Certainly this is a long term solution, but can be short term. *Working with all industry & consumer advocates is critical.*

Post Fairbanks

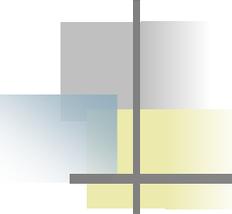


- Customer satisfaction survey – Sample size? Does sampling over sample loan portfolios that have indicated compliance risk?
- Executive Response Unit
- Separate compliance assurance *team as point of entry for community advocates*
- Sensitivity & Diversity training as a component of customer service and incorporated into time management component of Workforce Management Software.
- Special Exception Notation for problem situations so staff does not feel pressured to resolve situation hastily.
- ESL/Interpreters and staff diversity to insure equal availability of services. Multilingual collection staff and statements/letters in multiple languages.

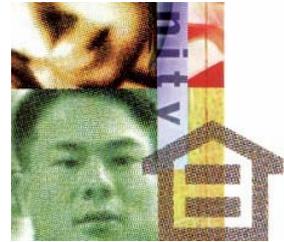


The Market

- NCRC is sensitive to the fact that investors face pre-payment risk and interest rate risk. Sub-prime, credit constrained, idiosyncratic financing, and higher default rate.
- Securitization factors: deal provisions; refusal to rate certain types of loans; recourse provisions, indemnification; preservation of holder in due course status. Assignees can contract away risk - borrowers do not benefit.
- Special purpose vehicles – need purchase criteria, investigate originators; monitor performance to detect under achieving loans. Electronic screening plus random sampling. Require assignees to institute controls, limited liability of assignees who comply, full liability for those who do not. Net Effect: lower lit/compliance risk.
- Brokers, appraisers, realtors, developers, lenders, contractors, all play a role

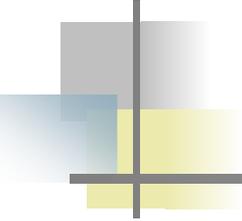


Recommendations



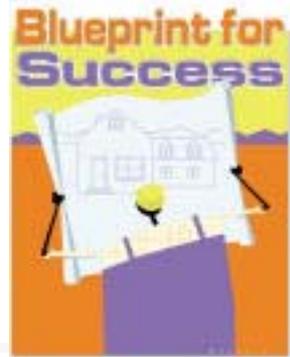
Legislative

- *Reform FCRA to mandate complete and accurate credit reports.* NCRC also recommends that an FCRA renewal bill requires additional studies on credit scoring and fund and promote nationwide financial education initiatives.
- *Comprehensive anti-predatory legislation*
- *Congress must pass a CRA modernization bill*
- *Enhance the quality of HMDA data*
- *Financial education critical, especially for populations lacking credit scores*



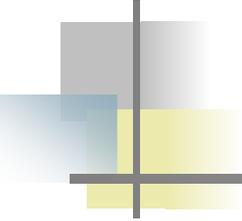
Regulatory:

- *Federal agencies must step up enforcement of existing laws to promote full product choice and prevent product steering*
- *Halt preemption of state anti-predatory and consumer protection law*
- *Federal reserve board must step up anti-discrimination and fair lending oversight*
- *Increase fair lending enforcement of non-bank lending*
- *CRA exams must scrutinize non-prime lending more rigorously*
- *Full disclosure of automated underwriting systems*



Recommendations for Lenders, Community Groups, and Consumers:

- *Lenders Must Adopt Risk-Based, Not Race-Based or Age-Based Pricing: Best Practices Needed*
- *Community Groups Must Advocate and Offer Financial Education and Counseling Programs*
- *Consumers Must Shop for Affordable Loans and Obtain Credit Reports, Credit Scores, and Pursue Inaccuracies*

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- NCRC recommends that consumers consult with NCRC's *Best and Worst Lenders* at <http://www.ncrc.org> to find a list of lenders most likely to approve minorities, women, and low- and moderate-income consumers for affordable loans. *Best and Worst Lenders* provides detailed information on lenders in 25 major metropolitan areas.
 - Consumers should regularly review their credit reports.