WHITE PAPER

HOW DOES DISPARATE IMPACT AFFECT MORTGAGE BANKERS & WHAT YOU CAN DO TO PROTECT YOUR COMPANY.

WITH BONUS DISPARATE IMPACT READINESS CHECKLIST!

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DISPARATE IMPACT (HUD RULE):

A practice actually or predictably results in a disparate impact on a group of persons or creates, increases, reinforces, or perpetuates segregated housing patterns because of race, color, religion, sex, handicap, familial status, or national origin.

The Supreme Court recently issued their decision that upholds what was formerly the "Theory of Disparate Impact." Through this decision, that theory is now a legal precedent, which opens the door (or possibly Pandora's box) for regulatory enforcement and consumer litigation.

This is not the best news for mortgage lenders or financial lenders of any type, because it will require lenders to look hard at their current lending patterns and practices. Constant monitoring and correction, as well as potential consumer remediation, will become part of the 'business norm.'

For mortgage bankers in particular, this legal determination is historic! Until recently, mortgage lenders were never forced to look at the lending diversity in their data. They just decided to lend where they wanted to lend. Not anymore!

Bankers on the other hand have had to monitor their diversity based on CRA requirements. This will affect bankers more profoundly than before because there are no benchmarks for Disparate Impact. So even for those who are used to Fair Lending authority, the decision by the Supreme Court will intensify their monitoring far beyond the normal statistical analysis.

TWO TERMS THAT ARE IMPORTANT TO UNDERSTAND:

Disparate Treatment:

Individual of a protected group is shown to have been singled out and treated less favorably than others similarly situated. This is considered "intentional". It's also the most common.

Disparate Impact (HUD Rule):

A practice actually or predictably results in a disparate impact on a group of persons or creates, increases, reinforces, or perpetuates segregated housing patterns because of race, color, religion, sex, handicap, familial status, or national origin. This was less common until now, and the legal process to prove your company is innocent is intense. So a better defense is to monitor this so well that regulators do not dig deeper.

Although the court imposed some limitations on the legal theory, the bottom line is that it left a large bandwidth for the regulators to enforce upon. Regulators were given enough latitude that all lenders – including mortgage, credit card, consumer and auto lending – will need to take this new reality seriously, and implement strong controls and monitoring around it.

The Supreme Court directed lower courts to "examine with care," and "concentrate on the elimination of the practice in remedial orders." They also warned that a lender or examiner could not rely on statistical data alone. Therefore, a process of monitoring that is complementary to your traditional statistical analysis, and perhaps even more robust methods, will need to be implemented. Remember, even if your lending policy is facially neutral (meaning you treat all applicants the same way), your policy cannot somehow discourage applicants from applying. As a lender, you will need to add another dimension to your Fair Lending game plan!

HOW THE HECK DID THIS HAPPEN?

A Short Little History Lesson:

In 1968, Title VIII of the Civil Rights Act, aka the Fair Housing Act, was enacted. HUD oversees this regulation, and this was where the "Theory of Disparate Impact" originated. It prohibited discrimination in the sale, rental, and financing of dwellings based on race, color, religion, sex, or national origin.

In 1988, Title VIII was amended by the Fair Housing Amendments Act, which:

- Expanded the coverage of the Fair Housing Act to prohibit discrimination based on disability or on familial status (presence of child under age of 18, and pregnant women);
- Created an exemption to the provisions barring discrimination on the basis of familial status for those housing developments that qualified as housing for persons age 55 or older;
- Established new administrative enforcement mechanisms, with HUD attorneys bringing actions before administrative law judges on behalf of victims of housing discrimination; and
- Revised and expanded Justice Department jurisdiction to bring suit on behalf of victims in Federal district courts.

In 1991, updated with prohibitions on discrimination against individuals with disabilities, the Act contained design and construction accessibility provisions for certain new multifamily dwellings developed for first occupancy.

In 1999, HUD published a final regulation implementing the HOPA (Housing for Older Persons Act).

Now, let's not confuse the FHA (Fair Housing Act) with the ECOA (Equal Credit Opportunity Act) that the CFPB oversees. ECOA prohibits discrimination based on race, color, religion, national origin, sex, gender identity, marital status, age, or receipt of public assistance and exercises rights under the Consumer Credit Protection Act.

SO WHAT IS THE DIFFERENCE?

The Fair Housing Act specifically applies to prohibitions related to housing, and incorporates the Disparate Impact and Disparate Treatment theory.

ECOA specifically applies to prohibitions related to any sort of financial services.

So, you can see that if you get a "mortgage" which is a "financial service" and you buy a house (regulated under the Fair Housing Act) with your mortgage loan, there is legal precedent for both!

Also remember that the CFPB has control of the ECOA, so they can change that regulation to incorporate Disparate Impact as well. In fact, the CFPB has made it quite clear that they believe Disparate Impact is an issue.

Also remember that HUD has to refer to the Department of Justice to litigate this issue, while the CFPB does not.

The diagram below will help you understand how the two laws overlap.

Prohibited Basis	ECOA (Equal Credit Opportunity Act) Regulation B	Fair Housing Act
Race	☑	☑
Color	☑	☑
Religion	☑	☑
National Origin	☑	☑
Sex	☑	☑
Gender Identity	☑	☑
Handicap		☑
Familial Status		☑
Marital Status	☑	
Age	☑	
Receipt of Public Assistance	☑	
Exercise of Rights Under the Consumer Credit Protection Act	☑	
Under Authority Of	CFPB	HUD
Purpose	All Credit Types	Housing & Residential Finance

DISPARATE IMPACT READINESS CHECKLIST		1
STAFF TRAINED		
	Basic Fair Lending Laws	
	Advanced Fair Lending Training:	
	Role playing	
	Examples of violations	
	Interacting with the clients	
	Preventing "Discouraging from Applying" Training (i.e., credit score is too low, not enough income, etc.)	
	Training on affordable lending products and grant programs	
	Eliminating bias training	
	Diversity training	
	Call monitoring and In-the-Field mentoring (specifically related to Fair Lending)	
	Diverse lending practices and programs	
	Company policy, and monitoring of employee progression of that policy	
	Complaint policy and complaint resolution	
	Board involvement and training	
	Working with Community Groups and Non-Profit Housing Counseling Agencies	
MONITORING DISPARITY		
	Underwriting:	
	Are all rules applied fairly and equally?	
	How is bias controlled? (i.e., second reviews)	
	Are overlays causing Disparate Impact?	
	How are exceptions tracked for Disparate Impact or treatment?	
	Pricing:	
	Is pricing consistent in all areas of the MSA?	
	Are pricing overlays justified with empirical data?	
	Do products offered accommodate underserved markets?	
	Are exceptions monitored?	
	Are affordable products offered, and competitively priced against other lenders?	

DISPARATE IMPACT READINESS CHECKLIST	2
MONITORING FALLOUT	
	Customers who inquired but never applied
	Customers who applied but never closed
	Customers who applied but were denied (second review?)
	Why, and percentages for each category
	Action plan to correct issues, such as training or client remediation
DEFINE YOUR DIVERSITY MONITORING	
	How do you monitor diversity:
	What Technology?
	What Reports?
	How do you perform your MSA diversity evaluation?
	How and when do you self-remediate?
	What data is considered, and why?
	Mystery shopping plan and details?
ACTION PLANS TO INCREASE DIVERSITY IN LENDING	
	Marketing:
	MSA Agreement Diversity
	Product Diversity and Compatibility
	Personnel:
	Is your public face diverse?
	Do you demonstrate diversity in your consumer-facing personnel?
	Branch allocations:
	Are branches located in, or conveniently located to, underserved markets?
	If not cost justified, has this been addressed electronically?
	Digital loan application
	Ability to accept collateral information electronically
	Originator access to webinar platforms
	Financial training assistance in conjunction with community groups
	Partnerships with Non-Profit Housing Organizations

Optimal Blue offers **A COMPLETE SUITE OF TECHNOLOGY TOOLS** that assist you in Best Practices monitoring through our Enterprise Lending Services.

HOW CAN OPTIMAL BLUE HELP?

Real facts on a loan-by-loan basis or as an aggregate of your files!

- **Optimal Blue eOriginations** locks down the potential exclusion or mistreatment of a client by automating controls in production.
- **Optimal Blue Banker** Product Eligibility and Pricing lock down LO Comp, consistency in the pricing and management of products and distribution channels.

  Optimal Blue Banker **Premium Services** control re-locks, and allows the lender to look back historically to prove to a regulator that your consumer was priced based on their financial profile.
- **Optimal Blue Advantage** allows the lender to monitor pricing disparity and pricing exceptions, and demonstrate that to a regulator. Use of Optimal Blue Advantage with a periodic third-party statistical analysis review allows a lender to stay on top of potential Disparate Impact issues.
- **Optimal Blue Insight** quickly detects issues with product and pricing per MSA that may be a contributing factor to Disparate Impact.

All of these services can assist in Disparate Impact monitoring and documentation. Contact Optimal Blue for additional information or assistance with how these products can work with some of your existing technologies.

THE FUTURE:

Based on the recent ruling by the Supreme Court, DC attorneys are predicting the following:

- Increased scrutiny on LO Compensation and how it relates to Fair Lending issues
- Pricing Disparity and the reasons for it
- Any use of Pricing Discretion and how that affects Fair Lending
- Increased scrutiny in lenders only doing QM, because that policy creates a Disparate Impact situation
- Product and Personnel Diversification

BOTTOM LINE:

Monitor, correct, and then monitor and correct more!