

FAIR LENDING 2.0: A BORROWER-BASED SOLUTION TO DISCRIMINATION IN MORTGAGE LENDING

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Fair lending laws promise that borrowers with similar credit profiles will receive similar loan products—regardless of their race. Yet, studies reveal that black and Latino borrowers consistently receive loan products that are inferior to those of white borrowers with similar credit characteristics. Despite frequent amendments since their passage during the Civil Rights Era, the Fair Lending Laws that opened doors for minority borrowers are unable to root out the subtle discrimination that persists in today’s mortgage lending market. These traditional Fair Lending Laws are built on an outdated framework that focuses exclusively on punishing lenders and righting past wrongs. This Article proposes a new borrower-based approach to solving the problem of discrimination in lending. This new framework gives borrowers the tools to effectively understand and compare loan offers, reduces the complexity of loan products, and enhances the ability of borrowers to receive loan offers from a variety of potential lenders. This Article also provides examples of tools derived from the new borrower-based approach that may take us the last mile toward a true fair lending environment.

INTRODUCTION

The data from the recent mortgage crisis paint a clear and disturbing picture: black borrowers consistently receive inferior mortgage products when compared to similarly situated white borrowers.¹ This disparity occurs at every income level, every credit profile, for prime and subprime loans, and in almost every state in the country.²

The Fair Housing Act, the Equal Credit Opportunity Act, and other Civil Rights Era legislation designed to create racial equality in lending (Fair Lending Laws),³ have opened the door to credit that was once entirely closed to black and other minority

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1. See Carolina Reid & Elizabeth Laderman, *The Untold Costs of Subprime Lending: Examining the Links among Higher Priced Lending, Foreclosures and Race in California 7* (2009), available at <http://iasp.brandeis.edu/pdfs/ReidPaper.pdf>.

2. *Id.*

3. The Home Mortgage Disclosure Act and Community Reinvestment Act were not passed with the express intention of remedying racial discrimination in lending. However, these laws are consistently employed to bring about that result, and are thus often considered part of the Fair Lending Laws.

borrowers. No longer are black and minority borrowers explicitly denied service by lenders, and seldom do lenders explicitly treat minority borrowers differently from white borrowers. Certainly, these Civil Rights Era laws have provided greater access to lending institutions and products; however, they have fallen short of ensuring parity in lending because of two significant weaknesses. First, Fair Lending Laws focus only on restricting and punishing the lender rather than empowering the borrower. Second, these laws address only past instances in which harm has already occurred, rather than providing tools to identify and avoid discriminatory loans from the outset. As a result, minority borrowers consistently purchase inferior and more expensive loan products than similarly situated white borrowers.⁴

The existing Fair Lending Laws are based on an outdated approach to remedying overt discrimination that is ill-suited for solving today's persistent and subtle discrimination. These Fair Lending Laws rely on regulation and reporting requirements for lenders and create causes of action that empower government agencies and private citizens to sue if lenders violate the laws and regulations. This approach focuses entirely on restricting and punishing lenders. As a result, the existing Fair Lending Laws often leave minority borrowers with little recourse other than to wait for lenders to change their discriminatory behavior.

Each of the Fair Lending Laws has undergone amendments and other adjustments—including significant changes made in July 2010 as a part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).⁵ Despite these changes, the existing Fair Lending Laws perpetuate a backward-looking and reactionary approach to ending discrimination in lending. Their lender-focused methods remain one step behind new loan products and finance processes that create new forms of discrimination. Until legislation moves beyond this outdated approach, lending discrimination will remain a permanent part of the home-lending market.

Given both the inability of the Fair Lending Laws to provide a discrimination-free lending environment and the country's recovery from a historic housing and mortgage crisis, this Article argues that it is time to rethink the way we lend. We need an approach to mortgage lending that empowers borrowers to make educated and

4. See Vikas Bajaj & Ford Fessenden, *What's Behind the Race Gap?*, N.Y. TIMES, Nov. 4, 2007, at D16.

5. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

rational decisions about the kinds of loans they buy, rather than simply waiting for lenders to police their own behavior. By providing more information to borrowers, producing simpler loans, and increasing competition, a borrower-based approach to fair lending will ensure that the loans are based on default risk rather than on race.

For most consumer purchases there are a variety of tools a buyer may use to better understand products and compare prices. There are numerous magazines, websites, and smartphone applications to help buyers learn about cars, televisions, or toasters and to then find the product that best meets their needs at the most competitive price.⁶ Taking out a home mortgage is one of the most important transactions an individual may engage in and yet in comparison to consumer products, borrowers of all races lack adequate tools to distinguish between a bad deal and a good one. In response, this Article proposes an innovative, borrower-based conception of fair lending that empowers borrowers by increasing access to a variety of lenders, reducing the complexity of loan products, and enabling borrowers to easily understand and compare loan offers. This borrower-based approach, combined with tools developed out of this framework, has the potential to finally close the gap between black and white borrowers.

This Article proceeds in four parts. Part I presents evidence that the existing Fair Lending Laws have failed to achieve fairness in lending. Volumes of research document the same unsettling result: a borrower's race or the racial makeup of a borrower's neighborhood is a significant determinant of the loan the borrower will receive. Part II discusses the current Fair Lending Laws and presents a brief history and description of each relevant law. Additionally, this Part addresses why these laws are incapable of resolving modern day discrimination in lending and explains why the result is continuing disparate impact for minority borrowers. Part III explores the changes brought about by Dodd-Frank, the latest attempt to make fair lending work. This Part also explains how recent reforms perpetuate the existing lender-focused approach and why Dodd-Frank will not eliminate discriminatory lending. Part IV discusses a new borrower-based approach to fair lending and discusses how this approach will reduce discrimination by enabling borrowers to shop for a loan more effectively and by encouraging competition among lenders. This Part also

6. Magazines such as Consumer Reports and a variety of websites offering reviews, opinions, and prices, such as Google Product Search, help consumers research and select products.

proposes specific tools to implement the new borrower-based approach, for example, an innovative Loan Comparison Report. Ultimately, the Article concludes that racial discrimination in lending will persist without laws that create a borrower-based approach to home mortgage lending.

I. EXISTING FAIR LENDING LAWS HAVE NOT ELIMINATED DISCRIMINATION

Today, researchers have more complete data on borrowers and loan products than ever before, and they are also better able to use this data to draw conclusions on the state of residential mortgage lending. The bulk of the data comes from the Home Mortgage Disclosure Act (HMDA), described further in Part II.⁷ HMDA data are sufficient to identify trends in mortgage lending and, when combined with other local or specialized data, can identify patterns of racial discrimination.

The HMDA data demonstrate the persistence of discrimination in lending, which is compelling evidence that current Fair Lending Laws are not creating a race-neutral lending market. Part I provides a variety of evidence of continued racial discrimination in lending, including studies of the connection between race and inferior loan products.

A. Correlation Between a Borrower's Race and Likelihood of Receiving a Subprime Loan

Several studies have observed correlations between a borrower's race and the type of loan products she receives. For example, a study of HMDA data from the years 1998, 2002, and 2006 that contained information from more than 46 million mortgage applications illustrates subprime lending behavior for both white and black borrowers.⁸ The study found that in every state, black

7. The HMDA requires lenders to record and periodically report specific information on each loan application that they receive, including the type of loan, purpose of loan, dollar amount, the census tract where the property is located, and whether the application was approved or denied. Demographic data about the borrower is also recorded; including income, gender, and race or ethnicity. 12 C.F.R. § 203.4(a) (2010). See also FED. FIN. INSTS. EXAMINATION COUNCIL, A GUIDE TO HMDA REPORTING C-4, C-5 (2010), available at <http://www.ffiec.gov/Hmda/pdf/2010guide.pdf>.

8. Carol Necole Brown, *Intent and Empirics: Race to the Subprime*, 93 MARQ. L. REV. 907, 928–40 (2010). Subprime lending generally refers to loans made to individuals that would not qualify under traditional underwriting criteria, such as loans containing higher interest

borrowers applied for loans from subprime lenders more frequently than whites.⁹ Lenders also accepted subprime applications from black borrowers at higher rates than white borrowers.¹⁰ Although a rational, discrimination-free lender would approve any loan that it could justifiably underwrite, regardless of race, this research indicates that in most states, whether a borrower was black had a “positive, statistically significant effect on whether a lender approved a subprime loan.”¹¹

The correlation between a borrower’s race and the likelihood of receiving a subprime loan is independently troubling. However, the research also shows that race is a factor in determining the loan a borrower receives, even after controlling for other underwriting variables. When income, house value, area median income, the percentage of owner-occupied homes, and the percentage of residents within a particular census tract who are minorities are held constant, “black applicants are more likely to be approved for a loan from a subprime lender than are white applicants.”¹² This result indicates that racial discrimination remains a real part of the lending process.

The research also shows that the strength of race as a determinative factor grew between 1998 and 2006.¹³ During this period, neighborhood median income, the percentage of homes occupied by their owner (rather than rented to a tenant), and a borrower’s income level have all become less significant indicators that a borrower will receive a subprime loan.¹⁴ However, during the same time period, “the substantive effect of the borrower’s race grew . . . , suggesting that black borrowers are bearing the true brunt of the subprime market.”¹⁵

All income levels experience racial discrimination in lending. Differences between the loans offered to black and white borrowers become more pronounced when comparing low and middle-income (LMI) black borrowers to middle and upper-income (MUI) black borrowers.¹⁶ A borrower’s income can be used as an

and more onerous terms than traditional loans to compensate lenders for the additional risk.

9. *Id.* at 928.

10. *Id.*

11. *Id.* at 934.

12. *Id.* at 936.

13. *Id.* at 938–39.

14. *Id.*

15. *Id.*

16. NAT’L CMTY. REINVESTMENT COAL., INCOME IS NO SHIELD AGAINST RACIAL DIFFERENCE IN LENDING: A COMPARISON OF HIGH-COST LENDING IN AMERICA’S METROPOLITAN AREAS 4 (2007), available at http://ncrc.org/images/stories/mediaCenter_reports/ncrc%20metro%20study%20race%20and%20income%20disparity%20july%2007.pdf.

inexact proxy for creditworthiness to compare similarly situated borrowers and to reveal the effect of a borrower's race. For example, researchers compared borrowers at similar income levels and identified the metropolitan areas across the country where black borrowers were more than twice as likely as white borrowers to receive subprime loans. The results revealed that LMI black borrowers were twice as likely to receive subprime loans as their white counterparts in each of seventy metropolitan areas, while in 167 metropolitan areas, MUI black borrowers were twice as likely as white borrowers to receive a subprime loan.¹⁷ It is especially concerning that a large percentage of the total number of loans given to MUI black borrowers were subprime loans. In 159 metropolitan areas, more than 40 percent of the loans MUI black borrowers received were subprime.¹⁸ Although this study did not consider borrower and loan characteristics necessary to prove racial discrimination, such as credit scores and loan-to-value and debt-to-income ratios, the results do indicate a strong likelihood that racial bias influenced the loan decisions. This study also illustrates the need for analysis of more complete borrower and loan data in order to fully understand the cause of these disparities.

B. Correlation Between the Racial Makeup of a Neighborhood and the Likelihood of Receiving a Subprime Loan

Research also shows that the loan product a borrower receives closely correlates with the neighborhood where the mortgaged property is located. A study by the U.S. Department of Housing and Urban Development found differences in the rates of subprime lending in predominantly black neighborhoods.¹⁹ In predominantly black neighborhoods, the study determined that “subprime lending accounted for 51 percent of home loans in 1998—compared with only 9 percent in predominately white areas.”²⁰ Subprime refinance mortgages accounted for only one-tenth of the refinance mortgages in predominantly white neighborhoods, but in predominantly black neighborhoods, half of the refinance mortgages were subprime.²¹ These data indicate that

17. *Id.* at 5.

18. *Id.*

19. U.S. DEP'T OF HOUS. & URBAN DEV., *UNEQUAL BURDEN: INCOME AND RACIAL DISPARITIES IN SUBPRIME LENDING IN AMERICA 1* (1999), available at www.huduser.org/Publications/pdf/unequal_full.pdf.

20. *Id.* at 2.

21. *Id.* at 4.

“only one in ten families in white neighborhoods pay higher fees and interest rates” while “five in ten families in African-American communities are saddled with higher rates and costs.”²²

The study also found a dramatic difference in subprime lending when comparing black and white neighborhoods at similar income levels. Only six percent of homeowners living in upper-income white neighborhoods borrowed from subprime lenders, compared to 39 percent of homeowners living in upper-income black neighborhoods.²³ As neighborhood income increases, the disparity between the black and white neighborhoods also grows. Homeowners in low-income black communities are almost three times as likely as homeowners in low-income white communities to rely on subprime refinancing,²⁴ and black moderate-income neighborhoods are four times as likely to rely on subprime refinancing as comparable white neighborhoods. Black upper-income neighborhoods are six times as likely to rely on subprime financing as comparable white neighborhoods.²⁵ Using income as a rough indicator of creditworthiness we should expect few, if any, subprime loans among upper income homeowners, or at very least, similar rates of subprime lending among black and white borrowers. However, the fact that the prevalence of subprime lending among black borrowers as compared to white borrowers increases as income increases indicates that, at a minimum, subprime lending is not blind to race. It may also indicate that when making a loan some banks consider race rather than relying solely on income and other creditworthiness factors.

C. Statistical Evidence of Racial Discrimination in Lending

To prove racial discrimination, rather than to show mere correlations between race and loan products, creditworthiness data are essential. Historically, HMDA or other readily accessible databases have not collected creditworthiness data. Thus, where obtainable, researchers have supplemented HMDA data with additional creditworthiness data to examine the influence of race on lending. For example, researchers supplemented 2004 HMDA data with credit scores and other relevant loan underwriting variables taken

22. *Id.*

23. *Id.*

24. *Id.* at 2.

25. *Id.* at 4.

from a proprietary database.²⁶ They found that after controlling for mortgage-product type, credit score, loan-to-value ratio, and other variables, black borrowers were up to 34.3 percent more likely than white borrowers to receive a high-interest-rate-subprime mortgage, and Latinos were up to 44.6 percent more likely than white borrowers to receive a mortgage with a higher interest rate.²⁷ A particularly troubling picture emerged when the researchers examined borrowers with high credit scores and marginal loan-to-value ratios.²⁸ Such borrowers should qualify for prime loan products; however, the study found that 21.3 percent of black borrowers with high credit scores and marginal loan-to-value ratios received subprime loans, compared with 14.5 percent of Latino and only 7.5 percent of white borrowers with similar profiles.²⁹

Another method of detecting discrimination is to calculate the percentage of a borrower's interest rate determined by race as opposed to other legitimate borrower risk characteristics, including credit score, loan-to-value ratio, and debt-to-income ratio.³⁰ Proprietary loan data from 2004 and 2005 from a large group of borrowers indicate that black borrowers paid mortgage interest rates 1.28 percent higher, and Latino borrowers up to 0.74 percent higher, than those paid by white borrowers.³¹ These data provide further proof that racial discrimination affects the loan products that racial minorities receive.

A study of ten metropolitan areas that included creditworthiness data also shows that the racial composition of the neighborhood affects the amount of subprime lending.³² Controlling for creditworthiness, the study found that in nine of the ten metropolitan areas “[t]he level of refinance subprime lending increased as the portion of African-Americans in a neighborhood increased.” The data reveal that in six of the metropolitan areas, an increase in the

26. DEBBIE GRUENSTEIN BOCIAN, KEITH S. ERNST & WEI LI, UNFAIR LENDING: THE EFFECT OF RACE AND ETHNICITY ON THE PRICE OF SUBPRIME MORTGAGES 3 (2006), available at http://www.responsiblelending.org/mortgage-lending/research-analysis/rr011-Unfair_Lending-0506.pdf.

27. *Id.* at 17–18.

28. Loan-to-value ratio indicates what percentage of a mortgaged property's total cost will be borrowed from the lender. The higher a loan-to-value ratio, the more risky a loan is to a lender. As this number increases it is also more likely that it will be a subprime loan.

29. BOCIAN, ERNST & LI, *supra* note 26, at 11.

30. See Marsha J. Courchane, *The Pricing of Home Mortgage Loans to Minority Borrowers: How Much of the APR Differential Can We Explain?*, 29 J. REAL EST. RES. 399 (2007).

31. *Id.* at 405.

32. NAT'L CMTY. REINVESTMENT COAL., THE BROKEN CREDIT SYSTEM: DISCRIMINATION AND UNEQUAL ACCESS TO AFFORDABLE LOANS BY RACE AND AGE 7 (2003), available at <http://nrcr.org/images/stories/pdf/research/nrcrdiscrimstudy.pdf>.

African-American composition of a neighborhood boosted the amount of subprime lending.³³

Taken together, these studies indicate that borrowers in majority black neighborhoods consistently receive more unfavorable loan products than borrowers in white neighborhoods, despite comparable creditworthiness.

D. The Greatest Predictor of Mortgage Foreclosure in New York City Is Whether a Home Is Located in a Black Neighborhood

Race also accounts for other disparities in lending, particularly the rate of mortgage default and foreclosure. Researchers from New York University's Furman Center for Real Estate and Urban Policy performed a study that merged HMDA data with a commercial database of non-prime mortgage performance statistics along with the specific geographic locations of mortgaged properties in New York City.³⁴ The results showed that in New York City, after controlling for loan and borrower characteristics—including interest rate paid, borrower credit score, and race—mortgage holders in predominantly black neighborhoods “have a substantially higher chance of falling behind on their mortgages” regardless of the borrower’s own race.³⁵ This research indicates that some aspect of the loans sold to borrowers living in predominantly black neighborhoods makes such loans, regardless of whether the borrowers are black or white, more likely to default.

The Furman study also concluded that for borrowers in census tracts that are over 80 percent black, the likelihood of default “is over 25 percent higher than that of borrowers in tracts with fewer than 20 percent black residents.”³⁶ By comparison, when analyzing only the race of the borrower, rather than the racial make up of the neighborhood, and controlling for other loan and borrower

33. *Id.* Additionally, the research found that age had an effect similar to race on the rate of subprime lending, after controlling for creditworthiness. “In seven metropolitan areas, the portion of subprime refinance lending increased solely when the number of residents over 65 increased in a neighborhood.” *Id.* Discrimination based on the age of borrowers is prohibited by the Fair Housing Act. Although age discrimination in lending is not the focus of this paper, many of the remedies proposed to address racial discrimination in lending may also help prevent discrimination based on age.

34. Sewin Chan, Michael Gedal, Vicki Been & Andrew Haughwout, *The Role of Neighborhood Characteristics in Mortgage Default Risk: Evidence from New York City 2* (Furman Ctr. for Real Estate & Pub. Policy, Working Paper, 2010).

35. *Id.* at 3.

36. *Id.* at 20–21.

characteristics,³⁷ the study found that the likelihood of default is only 10 percent higher for black borrowers than white borrowers.³⁸ In sum, the study indicates that in New York City, the question of whether a subprime mortgaged property is located in a predominantly black neighborhood “is as important in explaining default as the borrower’s own race.”³⁹ The researchers hypothesize that the most likely explanation for their findings is that the non-prime mortgage industry treats “black neighborhoods differently in terms of marketing and underwriting practices or loan terms.”⁴⁰ Although this study focused exclusively on New York City, the results indicate that lenders are discriminating against all borrowers that live in New York City’s majority black neighborhoods, regardless of the borrower’s own race, a pattern that may be repeated across the country.

E. Mystery Shopping Data Corroborate Evidence of Discrimination

In addition to the empirical data, qualitative data also corroborate the evidence of disparate treatment and discriminatory loan pricing for black borrowers. For example, the National Community Reinvestment Organization (NCRO) conducted “mystery shopping” tests of eighty-four large and small mortgage broker companies. NCRO sent white, black, and Latino testers to meet with or call brokers to inquire about loan products.⁴¹ The black and Latino testers were given more attractive borrower profiles with regard to equity, credit standing, and employment than the white testers.⁴²

Despite these borrower profiles that made the minority testers more amenable to receiving loans, the testing showed that in 46 percent of the interactions with lenders, minority testers received less favorable treatment.⁴³ Specifically, 25 percent of the time black

37. Loan and borrower characteristics controlled for include loan amount, initial interest rate at closing and at the first adjustment, credit score, debt-to-income ratio, loan-to-value ratio, whether the borrower took on additional debt, whether the borrower provided full documentation to support her loan application, and whether there was a co-borrower.

38. Chan, Gedal, Been & Haughwout, *supra* note 34, at 21.

39. *Id.* at 21–22.

40. *Id.* at 29.

41. NAT’L CMTY. REINVESTMENT COAL., TESTIMONY OF JOHN TAYLOR BEFORE THE OVERSIGHT AND INVESTIGATIONS SUBCOMMITTEE OF THE HOUSE FINANCIAL SERVICES COMMITTEE, ROOTING OUT DISCRIMINATION IN MORTGAGE LENDING: USING HMDA AS A TOOL FOR FAIR LENDING ENFORCEMENT 7 (2007), available at http://nrcr.org/images/stories/mediaCenter_testimony/nrcr_test_reg_oversight_hearing_finsvs_july_07%282%29.pdf.

42. *Id.* at 8.

43. *Id.*

and Latino testers were discouraged from obtaining credit all together, although white testers were discouraged only 12 percent of the time.⁴⁴ Additionally, “[blacks] and Latinos were questioned about their credit over 32% of the time” while “[w]hite shoppers were only questioned about credit 13% of the time.”⁴⁵ White shoppers also received two interest rate quotes for every one quote received by black and Latino shoppers.⁴⁶ Twenty five percent of the tests showed pricing discrimination.⁴⁷ Sixty-two percent of white testers, compared to only 35 percent of black and Latino testers, received full disclosure of all mortgage costs, including fees.⁴⁸ Finally, lenders discussed fixed rate loans with 77 percent of the white testers, but only 50 percent of the black and Latino testers.⁴⁹ The qualitative evidence from mystery shopper studies illustrates that racial discrimination remains prevalent in mortgage lending.

F. Testimony of Former Lenders Corroborates Evidence of “Steering” and Racial Discrimination

Evidence from inside the lending industry bolsters the above claims that lenders discriminate against minority borrowers. The testimony of former Wells Fargo loan officers, Elizabeth Jacobson and Tony Paschal—as part of a lawsuit brought by the City of Baltimore alleging racial discrimination in mortgage lending—provides insight into Wells Fargo’s lending practices.⁵⁰ While the suit was eventually dismissed because of the city’s inability to show a causal connection between Wells Fargo’s lending practices and Baltimore’s loss in property tax revenue,⁵¹ the former loan officers’ testimony remains an important insider account of discriminatory and questionable loan practices and raises questions about the entire industry.

44. *Id.*

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.*

50. See Second Amended Complaint for Declaratory and Injunctive Relief and Damages, *Mayor v. Wells Fargo Bank*, No. 1:08-CV-00062-JFM (D. Md. Apr. 7, 2010), 2009 WL 3100269.

51. Edvard Pettersson, *Wells Fargo Wins Dismissal of Baltimore’s Suit Over Subprime Foreclosures*, BLOOMBERG (Sept. 14, 2010, 7:29 PM), <http://www.bloomberg.com/news/2010-09-14/wells-fargo-wins-dismissal-of-baltimore-s-suit-over-subprime-foreclosures.html>.

Other cities and organizations, including the city of Birmingham, Alabama,⁵² the National Association for the Advancement of Colored People in Los Angeles,⁵³ and the state of Illinois on behalf of the city of Chicago,⁵⁴ have filed similar suits against mortgage lenders. These suits allege that the discriminatory steering of minority borrowers toward subprime loans resulted in significant losses of homeowner equity and property tax revenue. However, none of these suits provided similar testimony by former employees regarding the inner working of a lender as in the Wells Fargo case.

In the Wells Fargo case, the former employees alleged that Wells Fargo targeted black borrowers and black neighborhoods in Baltimore and elsewhere for subprime loans and that Wells Fargo employees relied on a range of deceptive and predatory practices aimed at minority communities.⁵⁵ Specifically, the former employees alleged that Wells Fargo marketed subprime products in predominantly African-American zip codes and targeted subprime marketing at African-American churches.⁵⁶ The employees also alleged that the lender tailored its subprime marketing materials based on race, even creating “software to print out subprime promotional materials in different languages, one of which was called ‘African American.’”⁵⁷

The employees also described how Wells Fargo gave loan officers significant financial incentives for closing subprime loans and allowed employees to steer minority borrowers to subprime loan products.⁵⁸ For example, Paschal stated that he saw many “minority customers who had good credit scores and credit characteristics in subprime loans who should have qualified for prime or FHA loans.”⁵⁹ Similarly, Jacobsen claimed that “[loan officers] who made prime loans generally made more money in referral fees by referring a person with prime credit to a subprime loan officer than by originating a prime loan.”⁶⁰

52. See *City of Birmingham v. Citigroup Inc.*, No. CV-90-BE-467-S, 2009 U.S. Dist. LEXIS 123123 (N.D. Ala. Aug. 19, 2009).

53. See *Nat'l Ass'n for the Advancement of Colored People v. Ameriquest Mortgage Co.*, 635 F. Supp.2d 1096 (C.D. Cal. 2009).

54. See *Complaint, People v. Wells Fargo & Co.*, No. 09 CH 26434 (Ill. Cir. Ct. Jul. 31 2009), available at http://www.nclc.org/images/pdf/unreported/Wells_Fargo_Illinois.pdf.

55. Second Amended Complaint for Declaratory and Injunctive Relief and Damages at 27–28, *Mayor v. Wells Fargo Bank*, No. 1:08-CV-00062-JFM (D. Md. Apr. 7, 2010), 2009 WL 3100269.

56. *Id.* at 21.

57. *Id.* at 31.

58. *Id.* at 32.

59. *Id.* at 24.

60. *Id.*

Although subprime lending may have a legitimate place within the American mortgage lending landscape, the strategy to maximize profit by aggressively marketing and selling subprime loans in black neighborhoods likely resulted in significant racial discrimination. The employees' testimony also illustrates the willingness of individual loan officers to maximize their own financial gain by closing as many subprime loans as possible—regardless of whether the borrower could qualify for a prime loan product or should not have qualified for a loan at all.

G. Minorities Access Home Loans through More Expensive Channels

Other research indicates that discrimination in mortgage lending is not solely the result of overt racial bias on the part of individual mortgage brokers or bank lending agents, but is also caused by the fact that minority borrowers access loans through channels that preclude the most competitive rates and terms.⁶¹ Low-cost channels for obtaining a home mortgage loan include national banks that provide both prime and subprime products. High-cost channels include mortgage brokers and mortgage lending companies that deal exclusively in subprime loan products.

The fact that minority borrowers are far more likely to receive loans through less regulated and higher priced channels than white borrowers is an effect known as “channeling.”⁶² Channeling is caused by a borrower's inability to gather the information needed to shop for the best loan offer.⁶³ Research indicates that one of the main reasons minorities pay higher mortgage rates is that minority borrowers are more likely to receive a mortgage through a broker than directly from a lender.⁶⁴ Estimates indicate that between one-half and two-thirds of the difference in the price of loan products that minority borrowers receive is a result of receiving loans from high-cost subprime lenders.⁶⁵ Explanations for why a minority borrower is more likely to use higher priced lenders include a distrust of banks, a lack of access to traditional banks, and a preference for

61. Alan M. White, *Borrowing While Black: Applying Fair Lending Laws to Risk-Based Mortgage Pricing*, 60 S.C. L. REV. 677 (2009).

62. *Id.* at 687.

63. *See generally id.*

64. *Id.*

65. *Id.*

and willingness to trust mortgage lenders that are already known and active within a community.⁶⁶

The presence of channeling raises significant concerns about the ability of the Fair Lending Laws to create a race-neutral lending marketplace. Although Fair Lending Laws have made significant headway towards creating a lending environment that is fairer than the environment before the Civil Rights Era, the evidence discussed overwhelmingly indicates that racial discrimination remains pervasive throughout the lending market.

II. CURRENT FAIR LENDING LAWS CANNOT END DISCRIMINATION

The discrimination in lending discussed in Part I persists because the current Fair Lending Laws are based on an outdated model for regulating and redressing racial discrimination. Such an approach was essential during the Civil Rights Era when racial minorities were routinely excluded from many aspects of life, including participation in competitive home mortgage lending.⁶⁷ At that time, racial exclusion was blatant and egregious, and, as a result, laws were designed to respond to this explicit discrimination. For example, the 1968 Fair Housing Act (FHA)⁶⁸ and the 1974 Equal Credit Opportunity Act (ECOA)⁶⁹ prohibit racial discrimination in lending and provide borrowers with a private right of action to sue lenders. The HMDA, passed in 1975, requires banks to disclose information about mortgage loan applications in an effort to identify discrimination in lending.⁷⁰ The Community Reinvestment Act (CRA), passed in 1977, gives regulators the ability to prevent bank expansion if a bank does not open up lending to black neighborhoods.⁷¹ Each of these Fair Lending Laws was a direct product of the Civil Rights Era, and sought to provide the means to regulate lending and eliminate racial discrimination. The sections below discuss each law in greater detail and indicate why these laws remain unable to address modern day racial discrimination.

66. *Id.* “Channeling” may also work in tandem with the “steering” discussed above, whereby even those minority borrowers able to avoid high priced channels are steered back toward the same high priced products due to race.

67. See GUY STUART, DISCRIMINATING RISK: THE U.S. MORTGAGE LENDING INDUSTRY IN THE TWENTIETH CENTURY 10 (2003).

68. 42 U.S.C. §§ 3601–19 (2006).

69. 15 U.S.C. §§ 1691–1691f (2006).

70. 12 U.S.C. §§ 2801–10 (2006).

71. 12 U.S.C. §§ 2901–08 (2006).

A. The Home Mortgage Disclosure Act

HMDA was enacted in 1975 to provide the public with loan data that can be used:

- (i) To help determine whether financial institutions are serving the housing needs of their communities;
- (ii) To assist public officials in distributing public-sector investment so as to attract private investment to areas where it is needed; and
- (iii) To assist in identifying possible discriminatory lending patterns and enforcing antidiscrimination statutes.⁷²

HMDA was designed to be temporary and to expire in June 1980; however, this date was later extended to 1985, and HMDA was made permanent in 1987.⁷³ HMDA has also undergone a number of minor changes to update the form and method of disclosure, as well as the types of institutions that are required to make disclosures.⁷⁴

HMDA does not create a cause of action like FHA, as discussed below; rather it only requires disclosure of specific information regarding institutions' lending activities and instead relies on public and regulatory scrutiny of this information to encourage fair lending.⁷⁵ The FHA permits suits based on disparate impact, and HMDA data is consistently a critical tool in proving such discrimination.⁷⁶

Financial institutions covered by HMDA are required to "collect data regarding applications for, and originations and purchases of, home purchase loans, home improvement loans, and refinancings" each calendar year.⁷⁷ Most importantly, HMDA also requires banks

72. 12 C.F.R. § 203.1(b) (2010).

73. MATTHEW BENDER, 8-157 BANKING LAW § 157.02.

74. See, e.g., BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, REGULATIONS: RECENT REGULATORY AMENDMENTS, <http://www.federalreserve.gov/bankinforeg/reghist.htm#C>.

75. MATTHEW BENDER, 8-157 BANKING LAW § 157.03.

76. See generally *id.*

77. 12 C.F.R. § 203.4(a) (2010). See also FED. FIN. INSTS. EXAMINATION COUNCIL, *supra* note 7, at C-4, C-5.

The data recorded shall include the following items: (1) An identifying number for the loan or loan application, and the date the application was received. (2) The type of loan or application. (3) The purpose of the loan or application. (4) Whether the application is a request for preapproval and whether it resulted in a denial or in an origination. (5) The property type to which the loan or application relates. (6) The owner-occupancy status of the property to which the loan or application relates. (7) The amount of the loan or the amount applied for. (8) The type of action taken, and the date. (9) The location of the property to which the loan or application relates, by metropolitan area, state, county, and tract, if the institution has a home or branch

to report borrower demographics including ethnicity, race, sex, and income,⁷⁸ general loan characteristics, and the geographic location of the mortgaged property.⁷⁹

Despite the amount of data available through HMDA, significant information deficits remain. This lack of data can impede a plaintiff from successfully proving a clear connection between a protected class and a racially discriminatory loan or loan denial. In addition to borrower demographics, plaintiffs need the specific creditworthiness characteristics of each borrower so that an accurate comparison of similarly situated borrowers can be made, and so that race—or membership in any other protected class—can be isolated as a determinative variable of what loan is received. Absence of creditworthiness information precludes a finding of discrimination based on HMDA data alone. Additionally, HMDA information is consistently anywhere from several months to more than a year old. This time lag limits the usefulness of this information solely to backward looking analyses, as HMDA data cannot provide an instant picture of the home lending environment.⁸⁰ Such a lapse in time is unnecessary given modern technological capabilities and should be reduced.

Dodd-Frank, discussed in Part III, updates HMDA disclosure requirements in an attempt to make it easier to prove racial discrimination in lending. However, HMDA's true capacity to promote fair lending is only as powerful as the FHA, because FHA provides the requisite cause of action. Unfortunately, as explained below, even with updated HMDA data the law will remain unable to provide lending free from discrimination.

office in that metropolitan area. (10) The ethnicity, race, and sex of the applicant or borrower, and the gross annual income relied on in processing the application. (11) The type of entity purchasing a loan that the institution originates or purchases and then sells within the same calendar year (12)(i) For [certain loans], the difference between the loan's annual percentage rate (APR) and the average prime offer rate for a comparable transaction as of the date the interest rate is set, if [it is above a certain amount] (13) Whether the loan is subject to the Home Ownership and Equity Protection Act of 1994, as implemented in Regulation Z (12 CFR 226.32). (14) The lien status of the loan or application (first lien, subordinate lien, or not secured by a lien on a dwelling).

Id.

78. With the exception of loans purchased by the financial institution. *Id.* at C-5.

79. *See id.* at 8.

80. *See id.* at 2.

B. The Fair Housing Act

When the Federal Housing Act was passed as part of the Civil Rights Act of 1968, racial discrimination in housing was prevalent. Blacks were excluded from many neighborhoods and deprived of housing opportunities by landlords and brokers.⁸¹ Covenants running with the land precluded real estate owners from selling to black families, keeping black homeowners out of majority-white neighborhoods.⁸² In a discriminatory practice known as “redlining,” banks drew a red line on a map around majority-black neighborhoods and refused to lend to any borrower within that area.⁸³ As a result, minority borrowers were relegated to predatory and unscrupulous lenders who peddled loan products designed both to strip equity and lead to foreclosure.⁸⁴

FHA sought to put all borrowers and homeowners on equal footing.⁸⁵ FHA prohibits, among other things, discrimination in the sale, rental, or marketing of housing based on a person’s race, religion, national origin, disability or family status.⁸⁶ Although the law protects members of other classes that often faced housing discrimination, such as attempts to exclude families, in practice the exclusion of blacks and other minorities from housing opportunities remains the most important and most litigated aspect of the FHA.⁸⁷

Most relevant to this Article is FHA’s prohibition on discrimination in mortgage lending. FHA 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

81. STUART, *supra* note 67, at 10.

82. See *Shelley v. Kraemer*, 334 U.S. 1, 4–5 (1948).

83. See generally BERYL SATTER, FAMILY PROPERTIES: HOW THE STRUGGLE OVER RACE AND REAL ESTATE TRANSFORMED CHICAGO AND URBAN AMERICA (2009).

84. *Id.*

85. See 114 CONG. REC. 2526 (1968) (statement of Sen. Brooke) (noting that African Americans are “surrounded by a pattern of discrimination based on individual prejudice, often institutionalized by business and industry, and Government practice” and the Act seeks to eliminate this discrimination in those areas).

86. 42 U.S.C. § 3604 (2006).

87. U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-10-75, U.S. DEPT. OF JUSTICE: INFORMATION ON EMPLOYMENT LITIGATION, HOUSING AND CIVIL ENFORCEMENT, VOTING AND SPECIAL LITIGATION SECTIONS’ ENFORCEMENT EFFORTS FROM FISCAL YEARS 2001 THROUGH 2007 43 (2009), available at <http://www.gao.gov/new.items/d1075.pdf> (finding that 44 percent of the cases under FHA deal with racial discrimination—more than any other category). In 1974, Congress also passed Equal Credit Opportunity Act (ECOA) to forbid discrimination in a variety of credit-based transactions, including mortgage loans. In the mortgage lending context the ECOA contains rights parallel to the FHA and the majority of discrimination suits are initiated under the FHA rather than the ECOA.

of such a transaction, because of race, color, religion, sex, handicap, familial status, or national origin.”⁸⁸ Included in the definition of “residential real estate-related transaction” is “the making or purchasing of loans . . . for purchasing, constructing, improving, repairing, or maintaining a dwelling” or loans that are “secured by residential real estate.”⁸⁹

Claims brought by aggrieved borrowers under FHA typically allege one of three violations: “overt discrimination,” in which a lender refuses to make a loan to a borrower based on her race; “disparate treatment,” in which the plaintiff alleges she was treated differently because of her race (for example, a black borrower who received inferior loan terms to a white borrower);⁹⁰ or “disparate impact,”⁹¹ where a facially neutral lending policy has a disproportionate adverse effect on a protected class. In the early days of FHA, the majority of the litigated cases dealt with overt discrimination and disparate treatment of borrowers,⁹² but today the majority of FHA claims are made under the theory of disparate impact.⁹³

Claims of overt discrimination and disparate treatment are contained within the explicit language of FHA. In contrast, whether a disparate impact claim can be made under FHA was left to the courts.⁹⁴ The Supreme Court has never directly ruled on whether FHA permits disparate impact claims.⁹⁵ However, there is overwhelming consensus among the lower courts allowing disparate impact claims,⁹⁶ and interpretation of the statute by the

88. 42 U.S.C. § 3605(a) (2006).

89. 42 U.S.C. § 3605(b) (2006).

90. See FED. DEPOSIT INS. CORP., *SIDE BY SIDE: A GUIDE TO FAIR LENDING* 23 (1996), available at <http://www.fdic.gov/regulations/resources/side/side.pdf>.

91. *Id.*

92. See WILLIAM C. APGAR & ALLEGRA CALDER, *THE DUAL MORTGAGE MARKET: THE PERSISTENCE OF DISCRIMINATION IN MORTGAGE LENDING* 12 (2005) (“Discrimination in housing and mortgage markets is more subtle today . . .”), available at <http://www.jchs.harvard.edu/publications/finance/w05-11.pdf>.

93. See Vern McKinley, *Community Reinvestment Act: Ensuring Credit Adequacy or Enforcing Credit Allocation?*, 17 REG. 25, 28 (1994).

94. See NAT’L FAIR HOUS. ALLIANCE, *DISPARATE IMPACT UNDER THE FAIR HOUSING ACT: A PROPOSED APPROACH* 3 (2009), available at <http://www.nationalfairhousing.org/Portals/33/DISPARATE%20IMPACT%20ANALYSIS%20FINAL.pdf>.

95. See *City of Cuyahoga Falls v. Buckeye Cmty. Hope Found.*, 538 U.S. 188, 199–200 (2003); *Town of Huntington v. Huntington Branch, NAACP*, 488 U.S. 15, 18 (1988). The Supreme Court avoids the issue of determining whether the FHA has a disparate impact standard.

96. See NAT’L FAIR HOUS. ALLIANCE, *supra* note 94, at 6–7 (citing *Langlois v. Abington Hous. Auth.*, 207 F.3d 43, 49 (1st Cir. 2000); *2922 Sherman Ave. Tenant’s Ass’n v. Dist. of Columbia*, 444 F.3d 673, 679 (D.C. Cir. 2006) (assuming that plaintiffs may bring disparate impact claim under FHA); *Pfaff v. U.S. Dep’t of Hous. & Urban Dev.*, 88F.3d 739, 745–46 (9th Cir. 1996); *Mountain Side Mobile Estates P’ship v. U.S. Dep’t of Hous. & Urban Dev.*, 56 F.3d 1243, 1250–51 (10th Cir. 1995); *Jackson v. Okaloosa Cnty.* 21 F.3d 1531, 1543 (11 Cir.

Department of Housing and Urban Development—the regulatory agency charged with enforcing the FHA—firmly establishes that the FHA contains a disparate impact standard.⁹⁷

To make out a prima facie case of disparate impact, a plaintiff must first factually establish that a lender's facially neutral lending policy has a disproportionate adverse effect on a protected class.⁹⁸ Frequently the disproportionate adverse effect is established through statistical analysis of a particular lending practice and its effect on applicants or potential applicants. For example, statistical analysis has been used to prove that yield spread premiums, which are commission bonuses given to mortgage brokers who convince borrowers to accept higher interest rates, are more consistently included in loans given to black borrowers than white borrowers.⁹⁹ Discriminatory intent is not required to make a disparate impact claim; the plaintiff need only establish that the policy results in a disparate outcome for minority borrowers.¹⁰⁰ In an early disparate impact appellate decision, the Eighth Circuit held that proof of discriminatory intent is not required because "effect and not motivation, is the touchstone" of discrimination and "clever men may easily conceal their motivations."¹⁰¹ The Court also "firmly recognize[d] that the arbitrary quality of thoughtlessness can be as disastrous and unfair to private rights and the public interest as the perversity of a willful scheme."¹⁰² Once the plaintiff has established that the practice has a disproportionate adverse effect on a protected class, the burden shifts to the defendant to show that the policy is justified. The defendant must prove that the practice

1994); *Huntington Branch NAACP v. Huntington*, 844 F.2d 926, 934–35 (2d Cir. 1988), *aff'd per curiam*, 488 U.S. 15 (1988); *Hanson v. Veterans Admin.* 800 F.2d 1381, 1386 (5th Cir. 1986); *Arthur v. Toledo, Ohio*, 782 F.2d 565, 574, 75 (6th Cir. 1986); *Betsey v. Turtle Creek Assocs.*, 736 F.2d 983, 986 (4th Cir. 1984); *Resident Advisory Bd. v. Rizzo*, 564 F.2d 126, 146–148 (3d Cir. 1977); *Metro. Hous. Dev. Corp. v. Arlington Heights*, 558 F.2d 1283, 1290 (7th Cir. 1977); *United States v. Black Jack*, 508 F.2d 1179, 1184–85 (8th Cir. 1974)).

97. See FED. DEPOSIT INS. CORP., INTERAGENCY POLICY STATEMENT ON DISCRIMINATION IN LENDING, available at <http://www.fdic.gov/regulations/laws/rules/5000-3860.html>. See also Erin Elisabeth Dancy, *Latimore v. Citibank Federal Savings Bank: A Journey through the Labyrinth of Lending Discrimination*, 3 N.C. BANKING INST. 233, 241–42 (1999) ("Although the Policy Statement purports to provide guidance and establish a clear standard for banking institutions to follow, the Policy Statement does not confer any substantive or procedural rights that a court could enforce in an administrative or civil proceeding. Thus, without any federal enforcement power, litigation of these issues persists, feeding the controversy as to the appropriate standard by which to judge credit discrimination cases."); Peter P. Swire, *The Persistent Problem of Lending Discrimination: A Law and Economic Analysis*, 73 TEX. L. REV. 787 (1995).

98. FED. DEPOSIT INS. CORP., *supra* note 97.

99. See BOCIAN, ERNST & LI, *supra* note 26, at 21.

100. See *EEOC v. Metal Service Co.*, 892 F.2d 341, 346–47 (3d Cir. 1990).

101. *United States v. Black Jack*, 508 F.2d 1179, 1185 (8th Cir. 1974).

102. *Id.*

serves a legitimate “business necessity,”¹⁰³ and that there is no alternative non-discriminatory policy that could serve the same purpose.¹⁰⁴

Unfortunately, it is extremely difficult for a plaintiff to prove disparate impact. In large part, this is a result of the lack of freely available lending data. Banks and other lending channels are extremely secretive about their underwriting guidelines, and the information they are required to disclose under HMDA, as discussed *supra*, is insufficient to prove disparate impact because it lacks creditworthiness information. This information gap creates a barrier to entry for potential litigants. Only those with significant resources are able to initiate a FHA suit and gather the statistical data necessary for successful litigation under a disparate impact theory.¹⁰⁵

Although FHA has reduced discrimination in lending, the law is inadequate and cannot produce a lending environment that is truly fair. Even if a litigant is successfully able to prove disparate impact in a particular lending scenario, it is often difficult for others to replicate because lending products are constantly changing and the fluidity of negotiated terms provides lenders flexibility to treat one borrower differently from another.¹⁰⁶ As a result, disparate impact litigation will always trail behind the latest discriminatory methods created by a new loan product or term. Meanwhile, minority borrowers will continue to bear the cost of FHA’s inability to root out discrimination in lending.

C. The Community Reinvestment Act

Congress enacted CRA in 1977 to ensure access to capital by encouraging “depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income [LMI] neighborhoods, consistent with safe and sound

103. The standard of defendant’s burden under an FHA disparate impact claim is debated. See NAT’L FAIR HOUS. ALLIANCE, *supra* note 94, at 21–25.

104. There is some debate as to whether the plaintiff or defendant has the burden to prove the “less discriminatory alternative,” but generally the burden falls to defendant or is shared by the parties. See *id.* at 25–26.

105. See PHILIP C. ESCHELS & MARK J. GOMSAK, DEFENDING EMPLOYMENT CASES: PRETRIAL LITIGATION ISSUES AND STRATEGIES 16 (2008) (explaining in the context of employment that “[d]isparate impact cases are often complex and expensive, require the use of experts and involve sophisticated statistical methods.”), available at <http://pps.americanbar.org/labor/lel-annualcle/08/materials/data/papers/101.pdf>.

106. See APGAR & CALDER, *supra* note 92, at 1–2.

banking operations.”¹⁰⁷ Historically, some institutions avoided lending in poor neighborhoods despite having a branch office that accepted deposits in the same neighborhood.¹⁰⁸ Congress passed CRA because banks and savings institutions, although privately capitalized, have an underlying “obligation to serve their local communities,” and that such an obligation comes in exchange for government backing, including the federal deposit insurance that banks receive.¹⁰⁹

To comply with CRA, banks must undergo a series of tests, which vary depending on the size of the bank. These tests may include a lending test to evaluate the number, size, and distribution of loans; an investment test to measure the dollar amount of community development investment; and a service test to track the number and availability of branches and ATMs.¹¹⁰ After completing the CRA examination, banks are given one of four CRA ratings: Outstanding, Satisfactory, Needs to Improve, or Substantial Non-Compliance.¹¹¹ There is little difference—aside, perhaps, from improved public image—in obtaining an “Outstanding” rather than a “Satisfactory” rating.¹¹² Needs to Improve and Substantial Non-Compliance are considered failing grades. However, because CRA lacks enforcement mechanisms to compel lender behavior, a failing grade can be of little consequence.¹¹³

CRA does not provide a civil cause of action, nor do the CRA regulatory agencies have the authority to impose sanctions directly on the banks. However, the agencies are required “to publicly disclose certain findings and conclusions regarding lending institutions, including whether an institution is meeting community needs,”¹¹⁴ and to consider CRA ratings when evaluating applications for a new charter, deposit insurance, branch openings,

107. FED. FIN. INSTS. EXAMINATION COUNCIL, COMMUNITY REINVESTMENT ACT: BACKGROUND & PURPOSE, <http://www.ffiec.gov/CRA/history.htm>.

108. Jonathan R. Macey & Geoffrey P. Miller, *The Community Reinvestment Act: An Economic Analysis*, 79 VA. L. REV. 291, 307–08 (1993); see also 123 CONG. REC. 17603 (1977) (statement of Sen. Proxmire).

109. Allen J. Fishbein, *The Community Reinvestment Act After Fifteen Years: It Works, But Strengthened Federal Enforcement is Needed*, 20 FORDHAM URB. L.J. 293, 293 (1993).

110. John Taylor & Josh Silver, *The Community Reinvestment Act at 30: Looking Back and Looking to the Future*, 53 N.Y.L. SCH. L. REV. 203, 205 (2008).

111. *Id.*

112. ROBERTO QUERCIA & JANNEKE RATCLIFFE, THE COMMUNITY REINVESTMENT ACT: OUTSTANDING, AND NEEDS TO IMPROVE 55 (2009), available at http://www.frbsf.org/publications/community/cra/cra_outstanding_needs_improve.pdf.

113. *Id.*

114. MATTHEW BENDER, 1–5 DEBTOR-CREDITOR LAW § 5.01 (2010).

branch relocations, and mergers or acquisitions.¹¹⁵ Applications by banks are rarely denied on CRA grounds, but “delays occasionally occur while a bank answers various questions about its past CRA performance or makes specific promises to improve CRA performance.”¹¹⁶

Most banks seeking a higher CRA rating have implemented limited “CRA Special Lending Programs.”¹¹⁷ The majority of these programs involve changing the underwriting standards for low and moderate-income borrowers.¹¹⁸ These changes include requiring lower down payments, using alternative measures and/or lower standards of credit quality, or more liberally assessing repayment ability through, for example, higher debt ratios or de-emphasizing employment history.¹¹⁹ Although these alternative measures may be used to qualify borrowers, 93 percent of these institutions describe these programs as profitable or breakeven.¹²⁰

The original purpose of CRA was to encourage lending in marginalized communities. From a home mortgage perspective, however, the CRA’s potency in bringing about fair lending has since dwindled because of the proliferation of alternative avenues of credit. CRA’s jurisdiction is limited to deposit-taking institutions, as deposits were once the principle source of funds for loans.¹²¹ Today’s mortgage market, however, consists primarily of non-bank mortgage lenders who profit by selling mortgages to the secondary market and are exempt from CRA scrutiny. HMDA data from 2006 indicate that 34 percent of all home loans were made to low and moderate-income borrowers, but only 10 percent of all loans were both held by low and moderate-income borrowers and CRA related.¹²² In other words, 24 percent of all loans are made to low or moderate-income borrowers by exempt mortgage companies and unregulated arms of traditional banks outside the reach of the CRA.¹²³

115. Camden C. Betz, Note and Comment, *Recent Changes to the Community Reinvestment Act and Their Impact on Community Banks and Rural Economies*, 10 N.C. BANKING INST. 157, 161 (2006).

116. Taylor & Silver, *supra* note 110, at 206.

117. QUERCIA & RATCLIFFE, *supra* note 112, at 49.

118. *Id.*

119. *Id.*

120. *Id.*

121. Kevin Park, *CRA Did Not Cause the Foreclosure Crisis*, UNC CENTER FOR COMMUNITY CAPITAL 1 (2010), available at http://www.ccc.unc.edu/documents/CRA_Did_Not_Cause_Foreclosure_Crisis.pdf.

122. REN S. ESSENE & WILLIAM C. APGAR, *THE 30TH ANNIVERSARY OF THE CRA: RESTRUCTURING THE CRA TO ADDRESS THE MORTGAGE FINANCE REVOLUTION* 12 (2009), available at http://www.frbsf.org/publications/community/cra/30th_anniversary_cra.pdf.

123. *Id.*

It is clear that CRA has not kept pace with the changing mortgage market, to the detriment of both borrowers and CRA-regulated entities alike. As a result, there have been calls for reform and modernization of the law.¹²⁴ For example, Essene and Apgar argue that CRA must provide uniformity for consumers:

[F]undamental fairness suggests that the nature and extent of federal oversight and consumer protection should not depend on whether a loan application is submitted by a loan officer working for a CRA-regulated institution or a mortgage broker working for a nonbank or CRA-regulated bank operating outside its assessment area. Nor should it matter to the consumer which particular retailer or wholesaler originates the mortgage, and which secondary market channel is tapped to secure the investment dollars that ultimately fund the loan. Instead, all consumers need access to an efficient mortgage market built on a foundation of uniform and fair regulations and oversight.¹²⁵

Even a complete overhaul of CRA to allow jurisdiction over every type of entity that makes mortgage loans would not be adequate to end racial discrimination in lending. Without effective enforcement mechanisms, CRA's power would remain limited to merely encouraging certain bank behavior toward borrowers. The problem is not simply that banks need to lend to a greater number of minority borrowers. Instead, a genuine fair lending environment requires that lenders offer minority borrowers loans comparable to similarly situated white borrowers. CRA enforcement, however, is only equipped to count the number of loans rather than assess their quality.

*E. Existing Fair Lending Laws Are Insufficient to End
Discrimination in Lending*

HMDA, FHA, EOCA, and CRA were all enacted in an era when minorities were excluded from meaningful participation in the home lending market. To their credit, each of these laws has played a role in achieving broad access to home loans for minority borrowers. The remaining elusive goal of fair lending, however, is to ensure that minority borrowers receive loan products that are

124. See generally *id.*

125. *Id.* at 26.

comparable to those received by similarly situated white borrowers. As the evidence in Part I indicates, the existing Fair Lending Laws have proven unable to achieve this goal. This failure occurred for two reasons. Firstly, these laws are based on an approach that is focused exclusively on lenders and does not empower borrowers. Secondly, the laws provide tools that can only rectify past wrongs rather than preventing future discrimination.

1. Fair Lending Laws Are Focused Solely on Restricting Lenders

The Existing Fair Lending Laws rely on regulation of and litigation against lenders to bring about non-discriminatory lending. These methods have proved somewhat successful in rooting out the most blatant forms of discrimination, but have been unable to curb subtle, though no less harmful forms of discrimination. This failure is a result of at least two causes. First, lenders are profit-seeking entities and discriminating against borrowers can be profitable when lenders are able to charge interest rates in excess of the actual credit risk posed by a particular borrower. Lenders constantly explore new products or processes to maximize profits within a given regulatory framework.¹²⁶ A new product will introduce regulatory grey areas as it will be unknown whether it will be legally classified as discriminatory. In these cases, lenders will err on the side of profit until required to do otherwise. In many instances, including the recent increase in subprime products, lenders will discriminate against minority borrowers until forced to curb a particular practice.¹²⁷

Secondly, lenders are not monolithic entities that act consistently. Rather, they operate based on the decisions of individual lending agents such as lending officers and brokers that interact directly with potential borrowers. To make loans, lenders must classify borrowers based on credit profiles and other underwriting information. This process includes some degree of flexibility for lending agents to make decisions regarding individual borrowers as they explain products and gather information necessary for underwriting. When exercising this discretion to classify borrowers, lending officers will express conscious or subconscious subtle preferences or biases such as a preconceived view of the likelihood that

126. See generally Gretchen Mortensen, *FAIR GAME; Home Loans: A Nightmare Grows Darker*, N.Y. TIMES, Apr. 8, 2007, at B1.

127. See *supra* Section II.B (discussing yield spread premiums and disparate impact theory).

an individual borrower will repay a loan based on her race.¹²⁸ The compounding effect of these preferences creates a lending environment that discriminates against minority borrowers. Although banks and lending companies are legally responsible for the actions of their employees, the current approach to fair lending has proven ineffective because it relies on pressuring lenders to change employee behavior. Rather than relying on lenders to end the biases of their agents, fair lending laws should empower borrowers to identify and respond to discrimination.

2. Fair Lending Laws Are Focused on the Past

The existing Fair Lending Laws look to the past in their efforts to curb discrimination by lenders. As a result, these Fair Lending Laws must constantly chase whatever new iteration of lending that lenders may devise. Additionally, the primary recourse provided by Fair Lending Laws—a private cause of action for damages—only addresses past discrimination and thus is ineffective in proactively preventing discrimination.

Under the existing Fair Lending Laws, the process for a borrower who has experienced lending discrimination to achieve a just resolution is lengthy, generally because of delays inherent in the legal system. This lapse of time often has disastrous and irreversible effects on individual borrowers and, in some cases, entire neighborhoods. From the time the discrimination is identified until the time the litigation is resolved and a lender changes the disputed policy—often lasting a period of several years—other borrowers may have both received similarly discriminatory loans and some may even have lost their homes to foreclosure. Even if, as a result

128. See INST. OF MED. OF THE NAT'L ACADS., *UNEQUAL TREATMENT: CONFRONTING RACIAL AND ETHNIC DISPARITIES IN HEALTH CARE* 10 (Brian D. Smedley, Adrienne Y. Stith & Alan R. Nelson eds., 2003) (indicating that there is "considerable empirical evidence that even well-meaning whites who are not overtly biased and who do not believe that they are prejudiced typically demonstrate unconscious implicit negative racial attitudes and stereotypes" when interacting with others); see also JANET E. HELMS, *INTRODUCTION: REVIEW OF RACIAL IDENTITY TERMINOLOGY, BLACK & WHITE RACIAL IDENTITY: THEORY, RESEARCH, AND PRACTICE* 3, 7 (Janet E. Helms ed., 1990) ("Race consciousness refers to the awareness that (socialization due to) racial-group membership can influence one's intrapsychic dynamics as well as interpersonal relationships. Thus, one's racial awareness may be subliminal and not readily admitted into consciousness or it may be conscious and not readily repressed."); Sara James, *Nightline: Testing for a Hidden Racial Bias: Mistakes Volunteers Make in Computerized Test are Revealing* (NBC television broadcast Apr. 15, 2007), available at http://www.msnbc.msn.com/id/18122831/ns/datetime_nbc/t/testing-hidden-racial-bias (finding that "even unconscious racial biases may affect your behavior . . . [and] when it comes to the potent question of race, our subconscious is making decisions everyday. They're decisions that in real time in real life have real consequences.").

of litigation, the lender eventually modifies the discriminatory loans, each month that a family struggles with an onerous loan can have a significant impact on its emotional and financial health.¹²⁹ These harms indicate the clear need for an approach to fair lending that identifies and rectifies discrimination more rapidly and aims to prevent, rather than redress, the negative consequences of such loans.

III. DODD-FRANK PERPETUATES THE OUTDATED APPROACH TO FAIR LENDING

The primary aim of the July 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act is to regulate the way banks and bankers do business.¹³⁰ However, two articles toward the end of the act create significant changes to the mortgage industry and are an important addition to the Fair Lending Laws. Article X of Dodd-Frank amends HMDA to require gathering of additional data about borrowers.¹³¹ Article XIV creates a duty for mortgage originators to verify that borrowers will be able to repay their loans; thus, limiting the incentive to steer borrowers towards subprime loan products.¹³² These changes to mortgage lending are not focused on ending racial discrimination, but rather on ensuring that the loan products sold by the mortgage industry are better products for the borrowers who use them and the investors that rely on them.¹³³ The changes brought about by Dodd-Frank are significant and will certainly bring about fairer lending. However, they also perpetuate the existing ineffective approach to fair lending, and thus will ultimately be unable to entirely eliminate lending discrimination.

129. See generally *Predatory Mortgage Lending: The Problem, Impact, and Responses: Hearing Before the Sen. Comm. on Banking, Housing, and Urban Affairs*, 175th Cong. (2001), available at <http://www.gpo.gov/fdsys/pkg/CHRG-107shrg82969/html/CHRG-107shrg82969.htm>.

130. 156 CONG. REC. S4067 (daily ed. May 20, 2010) (statement of Sen. Kerry) (stating that Dodd-Frank is designed to “protect consumers from unfair, deceptive and abusive financial products and practices” and “to insure that when families apply for a mortgage, a bank loan or other complicated financial products, they will also receive clear information that they need to make the best decision possible. With a watchdog in place, families will be less likely to enter into mortgages they don’t understand or be a victim of unfair and deceptive loan practices. It will increase fairness and help reduce the casino atmosphere of too many financial products.”).

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

132. *Id.* §§ 1400–1498.

133. 156 CONG. REC. H5229 (daily ed. June 30, 2010) (statement of Sen. Hare) (“This bill is a landmark achievement . . . [and] dedicated to ensuring that bank loans, mortgages, and credit cards are fair, affordable, understandable, and, most importantly, transparent.”).

A. Dodd-Frank Article X: Increased Disclosure under HMDA

As discussed in Part I, borrower and loan data disclosed under HMDA is critical to demonstrating discrimination in litigation under the traditional Fair Lending Laws. However, significant gaps in the data have hampered litigants' ability to isolate membership in a protected class as the determinative factor in the outcome of a loan application. Amendments to HMDA under Section 1094 of Dodd-Frank seek to close some of those holes.

The amendments to HMDA require that lenders report more detailed borrower characteristics as well as a clear description of the loan product sold. 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, and the value of the property to be pledged as collateral under the loan.¹³⁴

The disparate impact standard under the FHA requires a more robust statistical analysis than was possible with previous HMDA data, which lacked creditworthiness information. These new reporting requirements may permit an accurate comparison among borrowers and let researchers and litigants see which borrower attributes are correlated with subprime and other onerous loan products. It may even allow researchers and litigants to demonstrate discrimination using HMDA data alone, rather than having to combine data from other sources. Increased information about the loan product combined with a more complete borrower profile will permit researchers and litigants to see which types of borrowers end up with which types of loans and will provide the data required to prove such connections conclusively. Additionally, the ability to find proof of disparate impact within reported data will remove the significant barriers to entry for disparate impact claims under either the FHA or EOCA.

Dodd-Frank also requires that lenders provide greater information about the proposed loan product. They must report "total points and fees payable at origination;" the annual percentage rate for the loan 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;" the term of the loan; and the "channel through which application was made, including retail, broker, and other relevant

134. Dodd-Frank Act § 1094.

categories.”¹³⁵ Although these new reporting requirements apply to all loans, they are specifically geared toward presenting a more complete picture of “exotic” or onerous loan products and terms, particularly those that involve increased closing costs or prepayment penalties.¹³⁶

B. Dodd-Frank Article XIV: Changes to Mortgage Origination

Whereas the changes brought about by Dodd-Frank Article X seek to provide the data necessary to determine which types of borrowers receive which loan products, Article XIV significantly alters the types of loan products available as well as the relationship between mortgage originators and borrowers in the home lending process.¹³⁷ Dodd-Frank seeks to ensure that “consumers are offered and receive residential mortgages loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive.”¹³⁸ The result is less flexibility for mortgage brokers and loan officers to steer borrowers toward inferior or onerous loan products.

In general, the new provisions require the mortgage originator, and in some cases the lending institution, to share the burden that traditionally was borne solely by the borrower—namely to ensure that a loan is fair and that a borrower can repay it. Previously, because of information asymmetries and bank lending policies, both insidious and benign, many borrowers could not ensure that they were receiving a fair loan. Article XIV of Dodd-Frank shifts this balance between lenders and borrowers so that the mortgage market is fair and more sustainable.

Article XIV creates a broad definition of “mortgage originator” that includes any person who receives compensation for taking a loan application, assisting a consumer in obtaining a loan, preparing loan packages, collecting information on available loans for a consumer, or negotiating loan offers or terms for a consumer.¹³⁹ Article XIV also eliminates the incentive for loan originators to steer consumers towards more onerous loan products by mandating that compensation to mortgage originators, from any direct or indirect source, may not vary “based on the terms of the loan (oth-

135. *Id.*

136. *Id.*

137. The changes are brought about by an amendment to the Truth in Lending Act, which regulates a lender’s responsibility to the borrower. Dodd-Frank Act §§ 1400–1498.

138. *Id.* § 1402.

139. *Id.* § 1401(cc)(2).

er than the amount of principal).”¹⁴⁰ In other words, brokers can no longer be paid based on the loan terms that they encourage a borrower to accept. The new law also bans “yield spread premiums.”¹⁴¹ Such premiums have been consistently shown to be discriminatory toward minority borrowers.¹⁴²

Article XIV also instructs the Federal Reserve Board to prescribe regulations to prohibit “mortgage originators from steering any consumer to a residential mortgage loan” if “the consumer lacks a reasonable ability to repay,” the loan “has predatory characteristics or effects (such as equity stripping, excessive fees, or abusive terms),” or is not a “qualified mortgage” and the consumer qualifies for a “qualified mortgage.”¹⁴³ More generally, the regulations will forbid any lending practice that promotes “disparities among consumers of equal credit worthiness but of different race, ethnicity, gender or age.”¹⁴⁴ This wording provides an implicit approval of disparate impact theory.

In addition to the rights of action already contained within the existing Fair Lending Laws, Dodd-Frank creates a new private right of action for the violation of the laws against steering and predatory lending. A violation can result in treble damages, calculated using the amount of the mortgage originators’ compensation plus the costs of the action, including attorney’s fees.¹⁴⁵ Although the new private right of action does not enforce the ability-to-repay provisions, Dodd-Frank does allow borrowers to raise any violation of such provisions in foreclosure proceedings and to seek a recoupment or offset for the damages of such a violation.¹⁴⁶

Under Dodd-Frank, the Federal Reserve Bank must also create regulations to prohibit mortgage originators from “mischaracterizing [the] credit history of a consumer,” mischaracterizing or supporting the mischaracterization of the “appraised value of the property,” or discouraging a consumer from trying to find a better loan from another mortgage originator.¹⁴⁷ Section 1411 of Article XIV also creates new minimum standards for all mortgages. No

140. *Id.* § 1403(c)(1).

141. *See supra* Section II.B (discussing yield spread premiums and disparate impact theory).

142. BOCIAN, ERNST & LI, *supra* note 26, at 21.

143. Dodd-Frank Act § 1412. A qualified mortgage is defined as any residential mortgage loan where the regular periodic payments for the loan does not increase the principal balance or allow the consumer to defer repayment of principal (with some exceptions), and has points and fees that total less than 3 percent of the total loan amount.

144. *Id.* § 1403.

145. *Id.* § 1404.

146. *Id.*

147. *Id.* § 1403.

mortgage loan can be made unless the lender makes a “reasonable and good faith determination based on verified and documented information” that the borrower has the ability to repay the loan, taxes, and insurance.¹⁴⁸ In making such a determination, the lender must use a fully amortizing payment schedule and not merely an interest only or introductory rate payment schedule, regardless of the loan product.¹⁴⁹ These provisions not only limit the ability of borrowers to accept loans that they cannot afford, but also give investors some baseline confidence that the mortgage-backed securities they invest in have met a minimum standard of underwriting and a reasonable expectation that the securities will retain value. Additionally, these requirements seek to push lenders away from exotic loan products and toward “qualified mortgage” products by exempting qualified mortgages from the onerous requirement that lenders closely scrutinize the borrower’s ability to repay.

The changes to the lending environment made by Dodd-Frank provide significant new protections for all borrowers. The new law also provides tools to better understand the mortgage lending market and the persistent discrimination that results in disparate impact on minority borrowers. Yet, while significant and promising, these changes do not alter the existing approach to fair lending, which remains unable to end discrimination. Certainly, the law identified and remedied existing problems in the mortgage market—such as steering, prepayment penalties, and yield spread premiums—and tightens up data reported under HMDA. However, loan products are continuously evolving and lenders will inevitably create new terms and exotic loan products that are not covered by the new law. So long as the approach to fair lending focuses solely on lenders and on the past, a truly fair lending environment will always be just out of reach.

Although this Article argues that the current approach to providing fair lending is outdated and will not alone eliminate discrimination in lending, it must also be acknowledged that the traditional Fair Lending Laws do remain important and relevant. These laws serve as backstop to the most egregious cases of lending discrimination. The HMDA, in particular, continues to provide invaluable information that permits researchers to understand and draw conclusions about housing and lending that would otherwise be impossible. Thus, any new approach to fair lending must build from, rather than entirely replace, the existing laws.

148. *Id.* § 1411.

149. *Id.*

IV. FAIR LENDING 2.0

A. *A Borrower-Based Approach to Fair Lending*

The preceding Parts of this Article have outlined the traditional Fair Lending Laws, described the way each works, and explained why they alone will not end racial discrimination in mortgage lending. The approach to fair lending that was created in response to concern for minorities' ability to participate in the mortgage market at all has demonstrated an inability to adequately address the *quality* of that participation. In contrast, a genuinely fair lending environment demands that similarly situated borrowers receive similar loan products.

This Part proposes an entirely new borrower-based approach to mortgage lending that is focused on empowering borrowers and enabling them to find a loan that meets their borrowing needs and is free of discrimination. This borrower-based model is built on three principles: increasing access to a variety of lenders; reducing complexity of loan products; and providing borrowers with the necessary tools to analyze, understand, and compare loan offers. Each of these principles is discussed below. This Part also discusses several tools that should be used to implement this new approach, including a loan price tag, a reverse auction, and loan comparison report.

1. Clear and Comparable Loan Offers

The ability to effectively compare the cost of one product to another is essential to any thoughtful transaction and is particularly critical when buying a home loan. Entering into a mortgage with a lender is one of the most significant transactions in a person's lifetime, and yet most borrowers do not have the financial sophistication to understand the potential ramifications of the loan terms they accept, especially when such terms depend on future events such as a change in interest rate.¹⁵⁰ Any new borrower-based approach must create tools that permit borrowers to effectively understand and compare one loan offer to another.

Increasingly complex loan products, discussed below, and borrowers' reliance on heuristics, or mental short-cuts, rather than purely wealth-maximizing rational decision making create

150. See Lauren E. Willis, *Decision making and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 MD. L. REV. 707, 753 (2006).

impediments to a borrower's ability to understand loan products.¹⁵¹ The current legal regime "fails to effectively facilitate price shopping because it is based on an unrealistic, rational actor model of borrower behavior."¹⁵² In other words, laws designed to protect borrowers assume that, no matter how fine the print or complicated the loan product, disclosure will allow the borrower to understand and rationally analyze the loan offer, compare it to other loan offers she has received, and make a well reasoned decision as to which loan best serves her needs. In reality, particularly in subprime lending, this is far from the case. Even when lenders disclose all relevant provisions of the loan, studies show that borrowers frequently accept loans that are not in their self-interest.¹⁵³ Potential borrowers frequently experience two common subconscious decision making failures: a desire to minimize the "cognitive effort and resources spent on decision making" as well as the negative feelings that may result from decision-making.¹⁵⁴ Such tendencies can "short circuit" a person's rational analysis of a loan offer and lead them to make a decision based only on few relevant factors. For example, a borrower might focus solely on the introductory monthly payment amount, or rely too heavily on a friendly salesperson's assessment of what is in the borrower's best interest.

New borrower-based fair lending tools must reflect the limits of a borrower's technical, rational, and emotional ability to seek out and identify the loan that is in his best interest. Such tools should provide a borrower with information that fits within her identified decision-making strengths and enables her to effectively choose a loan that is right for her.

2. Reduce Complexity in Loan Products

The loan products that are currently available can be extremely complex. As a result of this complexity, the true financial cost of many loans is not clear to the borrower at the time they enter into the transaction. As a result, a borrower-based approach requires the simplification of loan products. A borrower must be able to understand and appreciate all the possible ramifications of entering into a loan and to compare a range of available loan options.

As discussed above, Dodd-Frank takes a few small steps toward a less complex lending environment by requiring the Federal Re-

151. *See generally id.*

152. *Id.* at 713.

153. *Id.* at 739.

154. *Id.* at 755–56.

serve Bank to ban the most predatory terms and to reduce the incentive to steer borrowers toward more complex and costly loans. A genuinely borrower-based approach, however, requires that loans be limited to only a few simple terms that convey the full financial outcome. Simpler loans will help prevent lenders from manipulating a borrower's cognitive and emotional weaknesses¹⁵⁵ and facilitate effective price shopping and comparison.

3. Maximize Access to a Variety of Lenders

In addition to simplifying both the process for borrowers and the loan products themselves, a new borrower-based approach must also provide each borrower with maximum access to a variety of lenders. As discussed in the sections above, many minority borrowers live in neighborhoods that have few lending institutions. Other minority borrowers that have access to a greater variety of lenders are still steered toward subprime and other more costly loan products. Still others access credit exclusively through high-cost channels that ignore prime loans, regardless of the borrower's credit profile. Each of these outcomes is, in part, the result of a scarcity of real and accessible loan options for borrowers. This scarcity is a significant contributing factor to the persistent discrimination in lending discussed herein. Tools based upon a borrower-based approach need to provide borrowers easier access to a variety of lenders, show lenders the underserved markets that exist, and employ the efficiencies of the Internet without relying on an individual borrower's Internet literacy.

My proposed borrower-based approach to achieving fair lending does not rely on the effectiveness of regulation and litigation alone to bring about a change in the behavior of lenders. Rather, this new approach relies on providing borrowers with a more efficient interaction with the lending market in order to guarantee loans that are free of discrimination. All borrowers, not just racial minorities, must have access to a variety of lenders and the tools necessary to compare mortgage offers.

B. Borrower-Based Fair Lending Tools

Above, this Article laid out three principles of a borrower-based approach to fair lending, namely clear and comparable loan offers,

155. *Id.*

reducing the complexity of loan products, and creating the maximum access to a variety of lenders. The sections below discuss three tools, derived from the three principles of my borrower-based approach, which will help to create a fair lending environment. These sections examine two tools suggested by other fair lending scholars that incorporate my borrower-based fair lending principles, and also suggest a new strategy to end discrimination in lending.

1. The Loan Price Tag

Lauren Willis has proposed that all loan products be required to contain a “Loan Price Tag.”¹⁵⁶ Willis has identified four loan terms that should be included in the creation of this loan price tag: (1) total loan proceeds; (2) total up-front fees, points, and costs (whether financed or not financed); (3) the maximum monthly payment; and (4) the loan length in years.¹⁵⁷ Taken together the four loan terms describe all of the possible financial outcomes of a loan. As a result, “prepayment penalties,” as well as “balloons and negative amortization” would be prohibited as the financial outcome of such products could not be communicated in the four terms.¹⁵⁸ Once this price tag is attached and the four terms clearly expressed, it should constitute a locked offer from the lender that the borrower can then compare directly with other loan offers.¹⁵⁹

This simplified way of explaining the relevant loan terms, particularly if combined with a reduction in the complexity of the actual loan products, would permit borrowers to avoid the heuristic biases and coping mechanisms that so often land borrowers in loans that are contrary to their best-interest. Thus, the loan price tag represents a significant step towards creating simpler loans that permit borrowers to compare loan offers and thus would contribute well to the borrower-based approach to fair lending.

2. The Reverse Auction

Willis’ proposed “reverse auction competition” also fits well with a borrower-focused approach to ending racial discrimination in lending. This auction would occur among lenders who would

156. *Id.* at 821.

157. *Id.*

158. *Id.* at 823.

159. *Id.* at 823–24.

compete for the borrowers' business. The system would be facilitated through a government agency, possibly the Department of Housing and Urban Development.¹⁶⁰ Once a loan price tag is applied to a loan offer, the offering lender would transmit the offer and all other borrower information to a website coordinated by this agency. This online database would allow other lenders to see the offer and to use that information to mail competing loan offers to the borrower.¹⁶¹ Combined with the loan price tag, such a process would not only give borrowers the tools to price shop, but would also provide borrowers with alternative loan options. Additionally, the reverse auction competition among lenders could end "lending deserts"—areas where there are no prime lending institutions—because the reverse auction would be online and lenders could participate from any location.¹⁶² Like the loan price tag, the reverse auction would represent a significant advance toward creating a more competitive lending environment.

3. A New Borrower-Based Fair Lending Tool: The Loan Comparison Report

Although Willis' proposals represent helpful borrower-based tools, these alone are not sufficient to create a fair lending environment. As a result, this Article proposes that lenders should be required to provide all borrowers with a clear and understandable loan comparison report. Such a report should take the form of a concise graphic that compares the cost of the loan offered to a particular borrower to loans closed by other borrowers of similar credit profiles. Providing a borrower with this report would increase her ability to immediately identify a bad or discriminatory loan offer and use this information to decide whether to close the loan or to walk away. Such disclosure would need to occur sufficiently before the loan closing date to allow the opportunity to back out of the loan or to shop with other lenders while still maintaining a reasonable home purchase timeline.

An online database administered by a government agency, preferably the Department of Housing and Urban Development, and accessible by mortgage originators should be created to administer a loan comparison report. The database should be populated with anonymous borrower information collected at the time of loan

160. *Id.* at 825.

161. *Id.*

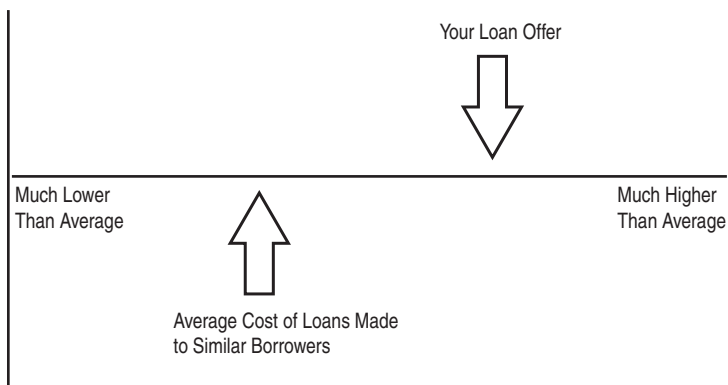
162. *See id.* at 825–26.

closings, including borrower credit profiles and the basic terms of the loan product they received. Upon the approval of a new application for a loan, the lender would be required to enter the new borrower information into the database. The database would then populate a report and graphic indicating how the cost of the loan product offered to the borrower compares to the loan products received by other borrowers with similar creditworthiness profiles. The lender should be required to disclose this loan comparison report to the borrower.

The reporting method in the loan comparison report could be as simple as comparing the annual percentage rating (APR) of the loan offered to a new borrower to the APRs of loans taken by other borrowers with similar credit profiles. However, using APR may create some problems given that “only 10% of recent home loan borrowers understand APR well enough to know that it is higher than the note interest rate.”¹⁶³ For those borrowers who do not understand APR, and to avoid adding complexity to the loan offer, the loan comparison report could take a form similar to the well-known EnergyGuide stickers that are required for many large appliances. These stickers compare the power usage of a particular appliance to others in its class. Thus, the loan comparison report could express the APR of the borrowers loan offer simply as “much lower than average,” “lower than average,” “about average,” “higher than average” or “much higher than average.” An example of how the loan comparison report could look when presented to the borrower is illustrated below:

LOAN COST COMPARISON REPORT

This report compares the loan offered to you by your lender to the loans purchased by other borrowers with credit similar to yours.



163. *Id.* at 822.

Result: The cost of the loan offered to you is much higher than the average loan made to other borrowers with creditworthiness characteristics similar to yours. You are likely to find other lenders willing to offer you a less expensive loan.

The comparison report should not be provided only to borrowers with membership in a protected class, but should instead include all borrowers and be produced every time a lender accepts an application for any mortgage loan. The provision of loan comparison information neutralizes the role of race, gender, or other protected status in the lending process. The loan comparison merely identifies whether similarly situated borrowers end up with similar loan products. If the report indicates that the loan offered to a particular borrower is significantly more expensive than those offered to other similarly situated borrowers, then, regardless of whether the reason for the less favorable terms was discriminatory or not, the borrower can either knowingly accept the less favorable terms or, preferably, avoid the transaction entirely. Thus, by using the loan comparison report, individual borrowers can enforce fair lending practices before loan transactions are final. This is a much more efficient solution than the old model that relies on enforcement by regulatory agencies or litigation by aggrieved borrowers years after the data has been produced.

a. Benefits of a Loan Comparison Report

One important benefit of a loan comparison report is that, unlike the current fair lending regime, it will permit the enforcement of fair lending beyond any one particular lender. Allegations of discriminatory practices, disparate treatment, or disparate impact are, by their nature, based on a comparison of one borrower to another and thus cannot extend beyond a particular lender's portfolio. For example, a litigant can only argue that a single lender treats its black borrowers differently than its white borrowers. However, evidence from the recent housing crisis suggests that certain lenders set up operations exclusively in black or minority neighborhoods. These methods make it difficult for a black borrower to prove discrimination if the lender's portfolio contains few or no white borrowers. The loan comparison report would take a new loan beyond the confines of a particular lender's portfolio, where discrimination might not be evident, and permit comparison to a more general class of borrowers.

If created correctly, the database of borrower and loan information could work in tandem with the current reporting

requirements under HMDA. Much of the information that must be collected under HMDA following the Dodd-Frank amendments is relevant to the production of a loan comparison report. Similarly, once the loan comparison data from the lenders is captured and stored, the production of quarterly and annual HMDA reports would be a simple process.

Another important benefit of a loan comparison report is that the lending market, rather than regulators, would play a greater role in ensuring fair lending compliance. Some argue that the unregulated market could solve the problem of discrimination in lending, asserting that if a lender is charging a minority borrower a premium based solely on race, then a competing lender should present itself and offer a less expensive product.¹⁶⁴ However, research has shown that in practice such a result does not occur, and that many minority communities interact with lenders in near isolation, which results in the “channeling” described in Part I.¹⁶⁵ In contrast, my proposed loan comparison report would take the borrower’s credit profile out of the individual community or neighborhood and compare it to the broader market containing a greater number of competitive lenders. As a result, borrower decisions based on the loan comparison report would be a more efficient market-based solution to fair lending than simply relying on lenders to identify and enter underserved markets.

b. Weaknesses of a Loan Comparison Report

Reliance on a loan comparison report alone assumes that a particular borrower has access to the broader marketplace of lenders. A borrower’s ability to turn the information provided in the loan comparison report into a fair loan is only as good as her ability to find a competing lender willing to give the terms that the report identifies as the market rate for her credit profile. As discussed in Part II, many minority borrowers who should qualify for prime loans end up with subprime products because of the channels they use to enter the mortgage market. In many minority neighborhoods those subprime loan channels are the only channels available.¹⁶⁶ Despite this drawback, the report could be an effective tool for borrowers with limited access to prime lending channels.

164. See generally GARY S. BECKER, *THE ECONOMICS OF DISCRIMINATION* (2d ed. 1971).

165. See GARY A. DYSKI, *DISCRIMINATION IN THE CREDIT AND HOUSING MARKETS: FINDINGS AND CHALLENGES* 24–25 (2005), available at <http://economics.ucr.edu/papers/papers02/02-18.pdf>.

166. See *supra* Section I.G.

Once borrowers are made aware of the exact cost of their neighborhood's isolation from traditional lenders, they may be more willing to venture beyond the brokers and subprime lenders in their particular neighborhood and to attempt to access the broader lending market. Additionally, they may be more motivated to seek out additional lenders over the Internet.

Admittedly, the loan comparison report alone may be of limited use to an individual borrower if she is both geographically and technologically constrained from accessing multiple lenders. However, the data collected would still serve as instant evidence of a particular lender's discriminatory policies and allow for traditional fair lending scrutiny by regulators and litigants. Additionally, the comparison reports would identify underserved markets that traditional lenders could enter, creating the very market necessary for competitive loans. Still, the reverse auction system described above would neutralize this issue entirely by taking the market online, rather than waiting for lenders to enter new areas.¹⁶⁷

Another potential drawback is rooted in the strong correlation between race, wealth, and creditworthiness in the United States.¹⁶⁸ This correlation raises the concern that the loan comparison report regime might be self-defeating. Minorities, who are disproportionately represented among the poor,¹⁶⁹ less creditworthy, and generally the recipients of worse loan products, might skew the comparison reports for all low-income and less creditworthy borrowers. This may even create a progressively worse lending environment for these classes of borrowers. Although the correlation between racial minorities and poor credit may generally be accurate, a fair lending regime is only concerned with the instances in which the correlation is wrong. For example, if minority borrowers as a class are generally less creditworthy, a fair lending regime should ensure that minority borrowers that have above average credit receive appropriate loan offers. The comparison report would permit these borrowers to identify and avoid discrimination. Without the comparison reports they might be unknowingly lumped in with the less creditworthy solely because of race. Additionally, the comparison report would merely be an

167. See Willis, *supra* note 150, at 825–26.

168. See CHI CHI WU & BIRNY BIRNBAUM, CREDIT SCORING AND INSURANCE: COSTING CONSUMERS BILLIONS AND PERPETUATING THE ECONOMIC RACIAL DIVIDE 2, 16 (2007), available at http://www.cej-online.org/NCLC_CEJ_Insurance_Scoring_Racial_Divide_0706.pdf.

169. See U.S. CENSUS BUREAU, INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2009 14–20 (2010), available at <http://www.census.gov/prod/2010pubs/p60-238.pdf> (indicating that poverty rates for minorities are almost three times higher than those for whites and the number of poor minorities is disproportionate when compared to their population size).

instrument to ensure parity among borrowers within a certain credit profile and would not indicate whether a loan is a “good deal” or “bad deal” for a borrower. The comparison report itself would do nothing to prevent lenders from giving all borrowers with bad credit a bad loan product—even if the majority of such borrowers are minorities. That said, by creating a forum for borrowers, lenders, and the public to identify the types of loan products available to certain credit profiles, enterprising lenders could identify those credit profiles where borrowers were paying in excess of the risk they posed and compete by offering better products.

Even if the lending market did not respond to the comparison reports by offering the best possible loan commensurate with the risk it poses, at a minimum the comparison reports would indicate when race played a role in determining the loan price. Currently, if a borrower receives an onerous loan, it is unclear to what extent her race and her creditworthiness each affected the outcome. However, once a comparison report indicates a mismatch between borrower creditworthiness and the offered loan product, race will become apparent as the determinative variable in the loan product outcome. Policy makers can then use this data to determine whether the loan products given to a particular credit profile are a “good deal” or “bad deal” and take appropriate action.

CONCLUSION

Even with the adoption of the tools discussed herein, there is a clear need for the traditional Fair Lending Laws to continue to play an important role in the home lending environment. By relying on these laws we have made significant and seemingly permanent moves toward eliminating racial discrimination. The existing Fair Lending Laws have taken us from a time when minority borrowers were completely excluded by mortgage lenders to the present when black borrowers are an integral part of the lending market. We cannot afford to lose the momentum. Thus, the Fair Lending Laws must remain as a permanent backstop.

The traditional Fair Lending Laws have proven unable to root out the subtle discrimination in lending experienced by minority borrowers. The current nature of this discrimination is such that the old approach that focused exclusively on lenders and on rectifying past wrongs will not work. Unfortunately, even the significant changes to fair lending law made under Dodd-Frank perpetuate the old approach and thus will not produce a lending environment

that is meaningfully different or less discriminatory. We must not, however, be satisfied until lending occurs without any regard to race, gender, or membership in any other protected class. As a result, a new approach to fair lending is urgently needed: a model that recognizes that the resolution to discrimination will not come from policing lenders, but instead from empowering borrowers. It is the new borrower-based lending framework that can take us this last mile toward a fair lending environment.

Only a borrower-based solution can address persistent and subtle discrimination in lending. Such an approach must focus on simplifying loans, increasing borrower access to mortgage offers from a range of lenders, and empowering borrowers to compare multiple loan offers. This new borrower-based approach can be realized through borrower-based tools such as the loan price tag, the reverse auction, and the loan comparison report.

The loan comparison report proposed here will help correct the information asymmetry between lenders and borrowers and better employ the market to allow borrowers to identify lending discrimination the very moment it occurs, thereby enabling them to refuse unfair loans. Although this solution is admittedly imperfect, it still promises to make a significant contribution toward achieving a fair lending environment. Adopting this new approach to addressing lingering discrimination will also open the door—and the dialogue—to other solutions for addressing disparate impact discrimination in fair lending, and perhaps, discrimination generally.