

ADVISORY | Financial Institutions

January 23, 2012

FAIR LENDING COMPLIANCE AFTER THE *COUNTRYWIDE* SETTLEMENT

On December 21, 2011, the Department of Justice (“Department”) announced a settlement with Countrywide Financial Corporation (“Countrywide”) to resolve allegations that Countrywide engaged in a pattern or practice of discrimination against minorities in mortgage lending from 2004 through 2008. Specifically, the Department alleged that Countrywide charged minority borrowers higher fees and interest rates than non-minority borrowers in retail and wholesale mortgage lending and steered minority borrowers to nonprime loans when similarly situated non-minority borrowers received prime loans. The settlement provides \$335 million in compensation for Countrywide’s borrowers.

The Department’s settlement with Countrywide is noteworthy for a number of reasons and highlights aspects of fair lending compliance that institutions should incorporate in their fair lending programs. This client alert summarizes key aspects of the settlement.

- ***Interagency Cooperation.*** The Department’s investigation resulted from a series of referrals from the Federal Reserve Board and Office of Thrift Supervision (now, the Office of the Comptroller of the Currency) in 2007 and 2008. In remarks following announcement of the settlement, Assistant Attorney General for the Civil Rights Division Thomas E. Perez also thanked the Department of Housing and Urban Development and the Consumer Financial Protection Bureau for their assistance. Fair lending is a high priority for multiple agencies, and the settlement indicates that interagency cooperation in this area will be the rule and not the exception.
- ***Wholesale Lending.*** The Department alleged that Countrywide provided mortgage brokers “subjective and unguided pricing discretion” that resulted in minority borrowers paying more for a loan than non-minority borrowers. The settlement once again reflects the Department’s position that depository institutions should be held accountable for loans originated by their mortgage brokers. The Department asserted this position most notably in its settlement with AIG, FSB and Wilmington Finance on March 4, 2010.
- ***Termination of Business.*** Countrywide no longer originates residential mortgage loans. In the event that Countrywide seeks to reenter the mortgage lending business, Countrywide must implement policies, practices, and monitoring acceptable to the Department to detect and prevent fair lending violations. Thus, the settlement confirms that the Department will not be deterred from enforcement simply because an institution has terminated the relevant business.
- ***Steering Allegations.*** The Department alleged that Countrywide’s underwriting practices allowed brokers to place minorities into nonprime loans even though non-minorities with similar credit qualifications were placed into prime loans. The settlement highlights the importance of internal controls designed to prevent illegal steering.
- ***Internal Monitoring.*** The Department regularly stated in its complaint that Countrywide’s internal monitoring systems were inadequate to rectify discriminatory lending practices, but sufficient to put the company on notice of pricing differences based on race and national origin. The Department further alleged that Countrywide monitored pricing only after loan origination, did not investigate pricing differences, and did not take remedial action to address such differences.

These allegations suggest that the Department expects institutions to monitor pricing prior to origination and proactively investigate and remediate pricing differences.

- **Pricing and Exception Discretion.** According to the Department’s complaint, Countrywide allowed its mortgage loan originators and mortgage brokers to increase or decrease interest rates and other fees from the prices set by rate sheets that took into account borrowers’ objective credit characteristics. Countrywide allegedly failed to provide guidance about the criteria to be considered in increasing or decreasing interest rates and fees. The settlement highlights the importance of using well-documented objective criteria throughout the underwriting process.
- **Statistical Significance of Findings.** The complaint notes that Countrywide conducted statistical analyses of loan data maintained pursuant to the Home Mortgage Disclosure Act (“HMDA”) and that such analyses demonstrated statistically significant discriminatory pricing differences, at the national level and in numerous geographic markets, in loans between minorities and non-minorities. The Department considers a pricing difference to be statistically significant if its probability of occurring by chance is less than 5% – *i.e.*, the difference is statistically significant at the 95 percent confidence level. The differences in pricing are stated in the complaint as a net pricing exception (“NPE”) that approximates the amount by which the total cost of a loan to a borrower differs from the total cost of that loan based on the price set by the applicable rate sheet. The complaint lists NPE differences between minorities and non-minorities of approximately 15 to 28 basis points.
- **Remediation Program in Consent Order.** The Department’s consent order requires Countrywide to deposit \$335 million in an interest-bearing escrow account. Countrywide is required to provide data and information to the Department so the Department can identify all impacted borrowers and specify the amount each impacted borrower is to receive. All funds not distributed to impacted borrowers are required to be paid to qualified credit and housing counseling organizations.

Institutions’ fair lending compliance programs should incorporate the lessons learned from the *Countrywide* settlement. If you have any questions, feel free to contact any of the following members of our financial institutions practice group:

| | | |
|-----------------|--------------|--|
| John Dugan | 202.662.5051 | jdugan@cov.com |
| Michael Nonaka | 202.662.5727 | mnonaka@cov.com |
| Keith Noreika | 202.662.5497 | knoreika@cov.com |
| Mark Plotkin | 202.662.5656 | mplotkin@cov.com |
| Stuart Stock | 202.662.5384 | sstock@cov.com |
| D. Jean Veta | 202.662.5294 | jveta@cov.com |
| Edward Yingling | 202.662.5029 | eyingling@cov.com |

This information is not intended as legal advice. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.

Covington & Burling LLP, an international law firm, provides corporate, litigation and regulatory expertise to enable clients to achieve their goals. This communication is intended to bring relevant developments to our clients and other interested colleagues. Please send an email to unsubscribe@cov.com if you do not wish to receive future emails or electronic alerts.

© 2012 Covington & Burling LLP, 1201 Pennsylvania Avenue, NW, Washington, DC 20004-2401. All rights reserved.