Chapman and Cutler LLP

To the Point!

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Department of Housing and Urban Development 2013 Disparate Impact Rule Is Vacated

The United States District Court for the District of Columbia recently struck down the Department of Housing and Urban Development (*"HUD"*) Disparate Impact Rule (*"Rule"*). The Court held that the Fair Housing Act (*"FHA"*) prohibits disparate treatment *only* and that HUD exceeded its authority in adopting the Rule in February 2013.

In its opinion, the Court noted that while eleven other Circuit Courts of Appeal have found that disparate impact claims were actionable under the FHA, the Court was not precluded from its finding. The Court based its decision on the following: (i) the District of Columbia Court had never ruled on the specific question and (ii) the other rulings were (for the most part) made before the 2005 Supreme Court decision in *Smith v. City of Jackson*, where the Supreme Court made it clear that the availability of disparate impact liability was based on the presence, or absence, of effects-based language in the statute. The Court then reviewed the FHA and found no such effects-based language.

The Supreme Court has recently agreed to hear a third case (the prior two cases granted certiorari, having settled before reaching the Supreme Court) addressing whether disparate impact liability is permitted under the FHA. This case involves the allocation of low-income tax credits to minority neighborhoods by the Texas Department of Housing and Community Affairs which the plaintiff alleges perpetuates residential segregation by making dwellings unavailable in certain areas.

While the use of the disparate impact doctrine in claims brought under the FHA continues to be decided in the courts, financial institutions should keep in mind that the Equal Credit Opportunity Act legislative history indicates that Congress intended that an "effects test" disparate impact doctrine be applied in lending discrimination cases, and the CFPB has voiced its agreement with this approach in its recent fair lending guidance.

FFIEC Cybersecurity Guidance

In June the FFIEC launched its Cybersecurity Web Page for financial institutions, providing current guidance and resources on cybersecurity. In connection with the Web Page launch, the FFIEC conducted a cybersecurity assessment of over 500 community financial institutions. The FFIEC recently completed its assessment and issued a report titled *FFIEC Cybersecurity Assessment General Observations* (the *"Report"*).

The Report found that risk levels vary significantly among institutions based on operational considerations (*e.g.,* types of network connections, types of products and services and technologies used), and it included a series of questions to be considered by financial institution chief executive officers and boards of directors to help identify their institution's cybersecurity risk and preparedness. The Report concluded by stating that the FFIEC is reviewing and updating its current cybersecurity guidance.

When it issued the Report, the FFIEC released a statement encouraging financial institutions to participate in the private sector information-sharing group, Financial Services Information Sharing and Analysis Center. The FFIEC emphasized that membership in the group will assist financial institutions and their technology service providers in critical risk mitigation, allowing financial institutions to monitor risk, share information and respond to rapidly evolving cybersecurity threats.

2014 Federal Interagency Fair Lending Hot Topics Webinar

Representatives from seven federal agencies recently participated in an Outlook Live Fair Lending Hot Topics webinar hosted by the Federal Reserve System. The webinar can be accessed on the Federal Reserve Bank of Philadelphia's website and the material provided by the presenters can be downloaded for review.

The following agencies participated in the webinar, discussing these topics:

Fair Lending Updates – Consumer Financial Protection Bureau (CFPB)

Risk-Based Approach to Fair Lending Examinations – Federal Deposit Insurance Corporation (FDIC)

Fair Lending Risk Assessments – Office of the Comptroller of the Currency (OCC)

Expectations for Compliance Management Systems – National Credit Union Administration (NCUA)

Target Pricing for Mortgages: An Emerging Fair Lending Risk – Federal Reserve Board (FRB)

Recent Enforcement Actions: REO Properties and Maternity Leave – Department of Housing and Urban Development (HUD)

Auto Lending Enforcement – Department of Justice (DOJ)

Of note, the CFPB provided factors identified by examiners during recent fair lending examinations that could lead to greater scrutiny: policies that consider prohibited bases; discretionary policies without sufficient controls or monitoring; insufficient documentation for pricing and underwriting exceptions; and data inaccuracies that impair the institution's self-assessments.

For directors and management, the NCUA described steps that must be taken to establish sufficient oversight regarding fair lending, including demonstrating clear expectations about fair lending compliance within the institution and by third parties; adopting a clear fair lending policy statement; defining responsibilities for fair lending compliance management; allocation of resources; and implementation of a fair lending audit function appropriate to the institution.

The FRB highlighted the following business practices that have recently resulted in referrals from the FRB to the DOJ: pricing, including mortgages, indirect auto lending, unsecured loans and mortgage discount points; redlining; underwriting, including maternity leave discrimination and disability and public assistance discrimination; spousal signatures; and credit reporting.

The FRB also reviewed in detail the practice of target pricing for mortgages, where financial institutions set a different target price (*i.e.,* interest rate and fees) for each mortgage loan originator. The FRB noted that although the practice may comply with Regulation Z since the mortgage loan originator's compensation is fixed, the practice results in rates and fees that are not based on the credit characteristics of the borrower and can raise fair lending risks. If the mortgage loan originators with higher target prices are based in minority neighborhoods, it can result in statistically significant unexplained disparities in pricing.

The webinar provided current insight into the agencies' views on various fair lending issues not generally available except during a fair lending examination. We encourage financial institutions to review the webinar and consider whether to make modifications to products and services and/or raise awareness of these issues in their fair lending compliance programs.

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To the Point! is a summary of items of interest and current issues for financial institutions with primary focus on regulatory, consumer, and corporate issues. Chapman maintains a dedicated practice group with the experience to counsel on these issues and other enterprise risk management matters facing financial institutions. If you would like to discuss any of the items contained in these briefings or other legal, regulatory, or compliance issues facing your institution, please contact one of the partners in our Bank Regulatory Group:

Marc Franson • 312.845.2988
Heather Hansche • 312.845.3714
John Martin • 312.845.3474
Scott Fryzel • 312.845.3784
Doug Hoffman • 312.845.3794
Dianne Rist • 312.845.3404