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CRA Plays Role In DOJ Fight Against Redlining

By **Collin Grier and Levi Swank** (July 27, 2023, 1:04 PM EDT)

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On May 31, the U.S. Department of Justice announced that it had entered into a consent order with ESSA Bank & Trust to resolve allegations that the bank had engaged in unlawful redlining in the Philadelphia metropolitan area.

This is the latest development in the DOJ's two-and-a-half-year "Initiative to combat modern-day redlining."[1]

In this particular case — USA v. ESSA Bank & Trust in the U.S. District Court for the Eastern District of Pennsylvania — the DOJ alleged that the bank's practices violated the Fair Housing Act and the Equal Credit Opportunity Act because the bank had failed to originate mortgage loans and provide other mortgage-related services to majority-Black and Hispanic neighborhoods in Philadelphia.

Specifically, the DOJ alleged that the bank excluded predominantly Black and Hispanic census tracts in Philadelphia County from its Community Reinvestment Act "assessment areas" even though it operated two branches "within miles" of those census tracts.

The DOJ first began investigating ESSA after the Federal Deposit Insurance Corporation determined, during a compliance examination of the bank, that ESSA actually could, or could reasonably be expected to, market and provide credit beyond its self-defined assessment area.

The FDIC concluded that ESSA's actual "lending area" encompassed Philadelphia County, even though the county was excluded from its assessment area. The FDIC referred its findings to the DOJ.

In its complaint, the DOJ alleged that ESSA failed to adequately staff branches that served minority neighborhoods and that its marketing and outreach largely excluded residents from minority neighborhoods.

In addition, because one of the bank's lending programs was limited to its assessment area, and because that assessment area was drawn to exclude Philadelphia County, the bank excluded minority census tracts from its lending program even though those tracts were within its lending area.

The ESSA matter is a rare example — one of only two instances we have identified — where the DOJ has alleged that a financial institution's assessment area is relevant to potential violations of the FHA and ECOA.[2]

ESSA is a reminder that even though the CRA lacks a civil enforcement provision, a financial institution's CRA compliance efforts may have ramifications under the FHA, ECOA and other anti-discrimination statutes.

The Community Reinvestment Act

The CRA places an affirmative obligation on "regulated financial institutions" to "demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business."[3]

By its terms, the CRA gives — depending on the chartering and supervisory authority of the financial institution — the Office of the Comptroller of the Currency, the Federal Reserve and the FDIC authority to examine regulated entities.[4]

The examining body is required to release both a public and private report detailing the regulator's findings. The CRA does not provide for any civil enforcement of its provisions, nor has it been interpreted to do so.

Neither the CRA nor the Federal Reserve's regulations, which are promulgated jointly with the OCC and FDIC, are explicitly targeted at race-based lending discrimination, instead focusing on lending to low-to-moderate income individuals and in LMI census tracts.

As part of the CRA framework, the regulations require most CRA-regulated entities to "delineate one or more assessment areas within which the appropriate Federal banking agency evaluates the bank's or savings association's record of helping to meet the credit needs of its community."[5]

Crucially,

> [t]he assessment area(s) for a bank or savings association other than a wholesale or limited purpose bank or savings association must:
>
> (1) Consist generally of one or more [metropolitan statistical area] or metropolitan divisions ... or one or more contiguous political subdivisions, such as counties, cities, or towns; and
>
> (2) Include the geographies in which the bank or savings association has its main office, its branches and its deposit-taking ATMs, as well as the surrounding geographies in which the bank or savings association has originated or purchased a substantial portion of its loans.[6]

Among other requirements, delineated assessment areas may not "reflect illegal discrimination" or "arbitrarily exclude low- or moderate-income geographies."[7]

Neither the regulations nor the CRA itself contains a definition of "illegal discrimination" or state what acts would constitute arbitrary exclusion.

However, the regulations specify that a determination of whether a bank "arbitrarily" excluded LMI geographies accounts for "the bank's or savings association's size and financial condition."

The primary purpose of these assessment areas is to define the bank's primary lending areas in order for regulators to evaluate banks with respect to their operations within these defined geographies.

However, the regulations provide that a regulator may "review[] the delineation for compliance with the requirements of [Title 12 of the Code of Federal Regulations, Section 25.41]."

Even though the CRA lacks a civil enforcement provision, regulators examining a financial institution for compliance with the CRA are authorized by statute to "refer the matter to the Attorney General" if they have "reason to believe that 1 or more creditors has engaged in a pattern or practice of discouraging or denying applications for credit," for example.[8] That is what the FDIC did here.

Then, if the DOJ determines that a civil action is warranted, rather than bring an enforcement action directly under the CRA, the DOJ may choose to initiate an enforcement action under the FHA and/or ECOA.

Here, the DOJ did just that. According to the DOJ, the bank's CRA assessment area designation determined eligibility for certain loan programs, and because the assessment area was allegedly drawn to exclude majority-Black and Hispanic neighborhoods, ESSA's alleged failure to delineate an adequate assessment area under the CRA led directly to alleged redlining in violation of the FHA and ECOA.

Meeting the CRA's Requirements and Reducing the Risk of Liability Under ECOA and the FHA

Navigating the CRA's requirement to properly delineate an assessment area is no straightforward matter. But, as the ESSA matter illustrates, the drawing of a financial institution's assessment area may have ramifications beyond compliance with the CRA.

The stakes are particularly high for financial institutions whose fair lending compliance measures are designed with its currently designated CRA assessment area(s) in mind.

For example, if a financial institution measures the adequacy of its loan officer staffing or marketing efforts by assessing those metrics within an assessment area, but the assessment area is inadequate, the financial institution may not be accurately gauging its fair lending risk.

The DOJ faulted ESSA for setting an assessment area that did not match its lending area, but a financial institution's lending area is not always self-evident.

While the CRA specifies a number of factors for financial institutions to consider in setting their assessment areas — including geographies encompassing its main office and branches — how far the perimeter must extend from a main office or branch is not specified, nor is the propriety of using natural features, such as rivers, or municipal designations as natural boundaries.

The other factors specified in the CRA are even more subjective and are likely to fluctuate over time, such as "the surrounding geographies in which the bank or savings association has originated or purchased a substantial portion of its loans."[9] Neither of those two relatively subjective qualifiers — "surrounding geographies" and "substantial portion of its loans" — are defined in the CRA.

It is probable that these areas would change as a given bank's operations vary over time. How responsive a financial institution must be in redrawing its assessment area in light of these fluctuations also poses potential challenges.

In light of these complexities and the attendant risks, financial institutions should consider third-party objective testing of their assessment areas, both for compliance with the CRA and for potential redlining risk.

Financial institutions should also understand the extent to which their own internal fair lending testing and monitoring may be compromised by unartful or inadequate assessment designations, and adopt prophylactic control measures that decouple those risks.

Finally, while offering different products and services in different geographies is often a business necessity, financial institutions should be fully aware of the potential risks inherent in varying products and services for consumers located within an assessment area versus those immediately outside the assessment area but within the same general geography.

Proper, objective fair lending monitoring and testing is essential to ensuring business necessities do not raise fair lending risk.

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[1] Attorney General Merrick B. Garland Delivers Remarks Announcing a New Initiative to Combat Redlining, Oct. 22, 2021, https://www.justice.gov/opa/speech/attorney-general-merrick-b-garland-delivers-remarks-announcing-new-initiative-combat.

[2] See, e.g., United States v. Old Kent Fin. Corp., No. 04-71879 (E.D. Mich. May 19, 2004), Dkt. 1.

[3] 12 U.S.C. § 2901(a)(1). "[T]he convenience and needs of communities include the need for credit services as well as deposit services." Id. § 2901 (a)(2).

[4] 12 U.S.C. § 2902.

[5] 12 C.F.R. § 25.41(a).

[6] Id. § 25.41(c).

[7] Id.

[8] 15 U.S.C. § 1691e(g).

[9] Id.