Compliance Chrestomathy

Notes from the Compliance Cutting Room Floor

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Encouraging Eligibility

'No good deed goes unpunished,' it is said.

How about encouraging traditionally disadvantaged groups to apply for credit?

As long as such applicants are eligible for a certain loan product and all the origination rules and regulations are followed – and there is no predatory lending or fair lending violations! – why not encourage them to apply?

It seems fair to conjecture that such a disadvantaged group could be encouraged to apply for a loan.

Occasionally, a good deed hides in plain sight!

One regulation that is supposed to keep everybody honest is Regulation B, the implementing regulation of the Equal Credit Opportunity Act (ECOA). Regulation B provides[i] that a creditor

> "shall not make any oral or written statement, in advertising or otherwise, to applicants or prospective applicants that would discourage on a prohibited basis a reasonable person from making or pursuing an application."

The comment to this provision states that

> "[a] creditor may affirmatively solicit or encourage members of traditionally disadvantaged groups to apply for credit, especially groups that might not normally seek credit from that creditor."

While Regulation B generally qualifies its prohibition against discouragement with the words "on a prohibited basis," many, if not most, lenders require their employees to encourage inquirers to apply, in part to fulfill the lender's standard policies and procedures designed to ensure compliance with ECOA and other regulatory requirements. These policies and

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procedures are also designed to prevent compliance failures by misinformed or rogue employees. In addition, they provide some assurance that employees will not make premature decisions based on incomplete information.

Recently, the U.S. Court of Appeals for the 5th Circuit considered a claim filed by consumers who alleged that their lender's encouragement of their application for a modification was "false or deceptive" within the meaning of the Texas Debt Collection Act (TDCA).[ii]

The Clarks defaulted on their home mortgage loan. Throughout 2013, they attempted to negotiate a modification to help remedy the default.

On December 13, 2013, they received a letter from their loan servicer regarding a HAMP modification, which stated:

> "Now that we've received your documents, our loan processing team will carefully review what you've submitted to determine if you are eligible… I will follow up with you by Sunday, January 12, 2014, to outline next steps in the process and address any additional documents that might be needed to complete our review…."

The Clarks immediately sent in the HAMP loan application with the requested documentation. One week later, they received a letter stating that they had failed to qualify. The creditors then proceeded with foreclosure

Ah, the unrequited! What are we to do but sue!

As Ulysses opines in Troilus and Cressida:

> "Time hath, my lord, a wallet at his back
> Wherein he puts alms for oblivion,
> A great-sized monster of ingratitudes:
> Those scraps are good deeds past, which are devour'd
> As fast as they are made, forgot as soon as done."

The good deed undone, the ineligible Clarks sued.

The Clarks asserted a claim for violating the Texas Debt Collection Act (TDCA), relying on its catch-all provision that prohibited creditors from "using any other false representation or deceptive means to collect a debt or obtain information concerning a consumer." The Clarks alleged that the creditor had violated the TDCA by making "affirmative statements" encouraging them to apply for a HAMP loan modification even though the modification was not available to them and they would not be approved.

Unfortunately for them, the district court dismissed the action, in part because the complaint had failed to allege any violation that resulted in damages. And the 5th Circuit affirmed.

The court began by explaining that, to maintain a cause of action under the TDCA provision, the debt collector must have made an affirmative statement that was false or misleading. But, none of the creditor's alleged statements, including the letter of eligibility, affirmatively represented that the Clarks qualified for or would qualify for the loan modification program. An earlier opinion of the court had made clear that even when a creditor tells a debtor "not to worry" about qualifying for a loan modification, that encouragement is not an affirmative statement for which TDCA relief is available.

Moreover, said the court, communications in connection with renegotiating a loan do not concern the collection of a debt, but instead relate to its modification and do not support a claim under the TDCA.

The Court rejected the Clarks' contention that there might be circumstances in which misrepresentations made during loan discussions were actionable under the TDCA.

Of course, the good deed of offering credit to eligible borrowers in a traditionally disadvantaged group is not really altruistic. Generally, a good deed is something which helps either you or society. In this case, though, the good deed could provide a positive economic opportunity to both the borrower and the lender.

A lender might want to consider how best to offer credit eligibility to traditionally disadvantaged groups. For one thing, the case may illustrate the fact that even the best-laid policies and procedures cannot ensure every conceivable outcome; that is, encouraging rather than discouraging a marginal borrower to apply for a program may result in litigation. Also, some disappointed borrowers, especially those who have lost their homes, will turn to the courts for relief.

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[i] 12 CFR § 1002.4(b)

[ii] *Clark v. Deutsche Bank Nat'l Trust Co.,* 791 Fed. Appx. 341 (5th Cir. 2018)

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