

# Forging Democracy: The Connection Between the Current Mortgage Industry and Postbellum Virginia

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## ABSTRACT

An essential element of the American dream is owning a home in the neighborhood of one's choice. But what happens when banks discriminate against minorities and consequently undermine fair mortgage lending laws? The implications cannot be understated: by denying minority families mortgage credit, the financial industry is essentially denying them the opportunity to accumulate household wealth. However, mortgage lenders are intentionally (and in other cases unintentionally) discriminating against blacks and Hispanics — a prominent issue that undermines past fair lending statutes and threatens democracy within the United States. Unfortunately, though, this is not the first time in American history where the law has been loopholed. In the same way racist county judges subverted postbellum legislation by excluding black citizens from jury pools, mortgage lending firms are deliberately undermining fair lending laws by targeting minority communities and manipulating the process so that minorities end up with high-cost loans; however, even among well-intended, color-blind organizations who do not pursue this predatory lending strategy, minority customers may not be receiving equal treatment, ultimately demonstrating that anti-discrimination laws can become Madisonian parchment barriers regardless of the intent of the institutions that perpetrate the discrimination.

## Postbellum Virginia

Despite the Civil Rights Act of 1875, Virginia county jurors deliberately excluded black citizens from jury pools, underscoring how the law can be loopholed. In February 1879, regarding a case involving the murder of a white man by two black teenagers, federal judge Alexander Rives launched an investigation into Patrick, Henry, Franklin, Charlotte, and Pittsylvania counties to test the exclusion of blacks on the all-white jury that convicted these teenagers. Taking into account population statistics by race, Rives had good reason to believe that the absence of a black juror was a statistical anomaly. For instance, in Patrick County in 1880, the black population was 2,734 people while the white population was 10,099.<sup>1</sup> In Henry county, the total black population was 7,395 people, almost equal to the white population of 8,614 people.<sup>2</sup> At the very least, these statistics reveal a discrepancy in population representation and judicial representation. While this does not provide conclusive evidence of discrimination, these statistics *imply* some sort of exclusion of blacks. This discrepancy, though, was explained by the results of Rives' investigation. The evidence from this investigation revealed that the Henry County judge had declared, "No [n-word] shall ever sit on a jury in my court!"<sup>3</sup> Furthermore, investigators were told that in Pittsylvania County that "a negro has never been on a jury since the present judge [James Dodridge Coles] has been in office" and that one at least one occasion a request for a mixed jury was asked for by interested parties and denied."<sup>4</sup> County judges were responsible for making out and

<sup>1</sup> David Moss and Marc Campasano, "Battle over a Bank: Defining the Limits of Federal Power Under a New Constitution," HBS N9-716-052 (Boston: Harvard Business School Publishing, 2016), p.18.

<sup>2</sup> Ibid., 18

<sup>3</sup> Ibid., 13

<sup>4</sup> Ibid., 14

returning jury lists, and the strong, discriminatory diction from the country judge exemplified a *deliberate intent* to exclude blacks from jury pools. Thus, this was a clear violation of the Civil Rights Act of 1875, which asserted that “no citizen possessing all other qualifications...shall be disqualified for service as a grand or petit juror in court of the United States... on account of race, color, or previous condition of servitude” and that “...any officer or other person charged with any duty in the selection or summoning of jurors who shall exclude or fail to summon any citizen for the cause aforesaid shall, on conviction thereof, be deemed guilty of a misdemeanor.”<sup>5</sup> Yet, none of the racist county judges ended up being convicted.<sup>6</sup> The fact that black people were not involved in the process revealed how they were denied their fundamental rights of citizenship, ultimately diminishing trust and faith in the legal system as a whole.

## The Current Mortgage Lending Industry

Mortgage loan originators operate within a business structure that aggressively targets minority communities and deliberately traps them into subprime borrowing; this practice of predatory lending reflects the *institutionalized* discrimination that loopholes the Fair Housing Act in the same way the Civil Rights Act of 1875 was subverted in postbellum Virginia. In cases where banks have both prime and subprime lending operations, “internal controls [are] designed to drive potential borrowers towards subprime loans but not the other way around.”<sup>7</sup> This is because it is more profitable for lenders and originators to place a customer in a high-cost subprime loan than in a conventional loan, *even if* the borrower qualifies for a lower-cost prime loan. Unfortunately, this system targets and consequently traps many minority borrowers into unknowingly high-cost loans even when they qualify for prime rates. One Wells Fargo loan officer described this type of predatory lending: “It was.. at the Wells Fargo.. where I worked *to target* African Americans for subprime loans. It was generally assumed that African-American customers were less sophisticated and intelligent and could be manipulated more easily into a subprime loan with expensive terms than white customers.”<sup>8</sup> In other cases, lenders use “language drop-down menu to print marketing materials in Spanish” and “generate materials in ‘African American English’ designed to draw in black and hispanic customers.”<sup>9</sup> After specifically targeting minority communities, lenders then manipulate co-ethnic intermediaries in minority communities to secure the trust of minority buyers, and then trap them into paying high-cost loans. Loan originators “target church leaders in order to gain access to congregants” through the trusted intermediary of the community church.<sup>10</sup> The originator “often provides a donation to a non-profit of the intermediary’s choice for each new loan, further cementing the relationship between mortgage lenders and local religious and civic leaders.”<sup>11</sup> One Wells Fargo officer encapsulates this process of manipulation: “Wells Fargo hoped to sell the African American pastor or church leader on the program because Wells Fargo believed that African American church leaders had a lot of influence over their ministry, and in this way would convince the congregation to take out subprime loans with Wells Fargo.”<sup>12</sup> Thus, this practice of lending implies an *intent* to discriminate because minority communities in specific are targeted and manipulated. This process parallels the deliberate exclusion of blacks on juries by racist country jurors in the reconstruction era. Both cases subvert the statutes intended to prevent racial discrimination. In the contemporary case, the practice of predatory lending violates the 1968 Fair Housing Act (FHA). This law proclaims that a lender may not “impose different terms

<sup>5</sup> Ibid., 18

<sup>6</sup> Ibid., conclusion.

<sup>7</sup> Justin P. Steil et al., “The Social Structure of Mortgage Discrimination,” National Center for Biotechnology Information, last modified November 3, 2017, accessed March 2, 2022, <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC6084476/>.

<sup>8</sup> Steil et al., “The Social,” National Center for Biotechnology Information.

<sup>9</sup> Steil et al., “The Social,” National Center for Biotechnology Information.

<sup>10</sup> Steil et al., “The Social,” National Center for Biotechnology Information.

<sup>11</sup> Steil et al., “The Social,” National Center for Biotechnology Information.

<sup>12</sup> Steil et al., “The Social,” National Center for Biotechnology Information.

or conditions on a loan, such as different interest rates, points, or fees... based on race or color.”<sup>13</sup> In this sense, since the business structure of mortgage lending first incentivizes subprime lending and then uses tools of manipulation and deception to capitalize on minority communities, mortgage lenders are effectively violating the FHA at the institutional level. Thus, in both the reconstruction era and in the present, laws intended to prevent discrimination (such as the Civil Rights Act and the FHA) essentially ‘went to sleep’ and became Madisonian parchment barriers.

However, even among organizations who appear to be color-blind, minority customers may not be receiving equal treatment, thus inadvertently undermining the Fair Housing Act. One specific case study conducted interviews with seven employees over a two day period and conducted follow-up interviews with the lender’s president and two loan counselors. Every staff member interviewed said the entire process was ‘race-blind’ and the staff “... seemed bewildered by the suggestion that race could be a factor in the lender’s origination decisions.”<sup>14</sup> However, after controlling for income differences — a credit relevant factor that varies with race — these lenders’ denial rates for moderate-to-low and middle-income black and Hispanic applicants are significantly higher than the denial rate of white applicants with the same financial background.<sup>15</sup> Another instance of this so-called inadvertent discrimination occurs at the pre-application stage of the mortgage lending process. At this stage, prospective borrowers collect information to determine whether they can afford to purchase a home and which loan types may meet their needs. One study researched well-intended, ‘color-blind’ institutions and found convincing evidence that minorities were “less likely to receive information about loan products, received less time and information from loan officers, and were quoted higher interest rates in most of the cities where tests were conducted.”<sup>16</sup> Although these factors are not in-depth indicators of the final outcome of the loan, they are a part of the “encouragement process,” and can shape how prospective borrowers think they can afford to purchase a loan.<sup>17</sup> Thus, if minorities are given less pre-application stage information than their white counterparts, they are essentially being discouraged at disproportionate rates to obtain a loan. Moreover, lenders that provide extra information will presumably spend more time, on average, with a prospective applicant. Thus, the fact that minority applicants are discriminating against in the pre-application stage reveals that minorities are barred the process before it even happens — a nearly identical situation of blacks being barred from the jury process in postbellum VA.<sup>18</sup> Just like how postbellum Virginia’s exclusion of blacks diminished faith and trust in the legal system, this type of discrimination by color-blind firms diminishes trust and faith in the United States’ financial system for black Americans. What’s more though, is that these institutions *perceive* their practices to be ‘color-blind’ — effectively discriminating at the subconscious level.

## Discussion

Both 1880 Virginia and current mortgage lending practices exemplify the weak ability of the law to protect minorities from discrimination. To the extent that discrimination is blatant and intentional — such as the targeting and manipulation of black communities — designing systemic and institutional remedies are very plausible. For one,

<sup>13</sup> Fair Housing -- Equal Opportunity for All, 1 Stat. (Apr. 11, 1968). Accessed March 3, 2022. [https://www.hud.gov/sites/documents/FHEO\\_BOOKLET\\_ENG.PDF](https://www.hud.gov/sites/documents/FHEO_BOOKLET_ENG.PDF).

<sup>14</sup> Margery Austin Turner and Felicity Skidmore, "Mortgage Lending Discrimination: A Review of Existing Evidence," ed. Michelle DeLair, et al., The Urban Institute, accessed March 2, 2022, <https://www.urban.org/sites/default/files/publication/66151/309090-Mortgage-Lending-Discrimination.PDF>.

<sup>15</sup> Turner and Skidmore, "Mortgage Lending," The Urban Institute.

<sup>16</sup> Turner and Skidmore, "Mortgage Lending," The Urban Institute.

<sup>17</sup> Turner and Skidmore, "Mortgage Lending," The Urban Institute.

<sup>18</sup> Margery Austin Turner et al., "All Other Things Being Equal: A Paired Testing Study of Mortgage Lending Institutions," Housing Urban Development, last modified April 2002, accessed March 3, 2022, <https://www.huduser.gov/publications/pdf/aotbe.pdf>.

employees must perceive the importance of change and reforms must be effectively integrated into the day-to-day operations of a business. Possible corrective remedies include monitoring fair lending performance, developing a more diverse workforce, providing employee training in fair lending, conducting outreach to minorities, and even designating a company position to receive fair lending complaints.<sup>19</sup> However, at institutions who appear or claim to be color-blind, other types of corrective measures must be taken. Of significant importance is to align the interests — both morally and financially — of the mortgage originators, securitizers, and investors more closely with those of borrowers in order to prevent the vertically-segmented structure from exploiting minority borrowers into high cost, subprime loans. Lastly, as decision-making increasingly moves from humans to AI-powered machines and lending transitions into the FinTech era, it is important to look into possible subconscious discrimination within lending algorithms and other impersonal classifiers. Overall, in the same way racist county judges subverted postbellum legislation by excluding black citizens from jury pools, mortgage lending firms are deliberately undermining fair lending laws by targeting minority communities and manipulating the process so that minorities end up with high-cost loans; however, even among well-intended, color-blind organizations who do not pursue this predatory lending strategy, minority customers may not be receiving equal treatment, ultimately demonstrating that anti-discrimination laws can become parchment barriers regardless of the intent of the institutions that perpetrate the discrimination.

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<sup>19</sup> Turner and Skidmore, "Mortgage Lending," The Urban Institute.