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Disparate Impact Rule Under Lending Laws

What will the Supreme Court Say?

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The Consumer Financial Protection Bureau (CFPB) has reportedly sent notice to at least four banks that they may have violated the Equal Credit Opportunity Act (ECOA) through the manner in which vehicle loans and interest-rate markups were made by auto dealers, although financed by the banks. The CFPB previously telegraphed this regulatory enforcement action when it issued an April 2012 bulletin emphasizing that the legal doctrine of disparate impact may be utilized as the CFPB exercises its supervision and enforcement authority under a number of federal consumer protection laws, including ECOA.

Additionally, the Department of Housing and Urban Development (HUD) published a final rule on February 8, 2013, confirming the use of the disparate impact theory to bring claims of housing discrimination under the Fair Housing Act (FHA). The rule is effective 30 days after publication in the Federal Register, although it is HUD's position that the rule is not new, but rather a formal written statement of the agency's long-standing interpretation of the FHA. "HUD, which is statutorily charged with the authority and responsibility for interpreting and enforcing the Fair Housing Act and with the power to make rules implementing the Act, has long interpreted the Act to prohibit practices with an unjustified discriminatory effect, regardless of whether there was an intent to discriminate."

To the extent they have not already done so, financial services companies should review their policies and practices to determine whether CFPB, HUD, or a state regulator might consider them to have a disparate impact. If they do, such companies should consider whether there are any effective alternatives that would be less discriminatory.

Overview of Disparate Impact Claims – The Supreme Court Has Yet to Weigh In

Plaintiffs in discrimination cases, as well as other civil rights laws, often rely on the doctrine of disparate impact when an allegedly discriminatory practice or policy is involved, and the question of discriminatory intent is not raised. The doctrine has been increasingly focused on mortgage lending in the last few years. The disparate impact doctrine, also referred to as discriminatory effects test, provides that policies having a discriminatory effect can be examined to ensure that they serve a legitimate purpose and that no effective, less-discriminatory means of achieving that purpose is available.

The crux of FHA disparate impact claims challenging mortgage lending practices is that lenders' policies authorizing loan charges based on subjective, rather than risk-based, factors have the direct causal effect of minorities paying more subjective charges than comparable non-minority borrowers. While these cases are highly dependent on the facts and circumstances, the majority of the courts to decide the issue have found that the FHA supports a disparate impact theory of liability.

To allege a disparate impact claim under the FHA, a plaintiff's complaint must:

1) Identify a specific practice or policy adopted by a defendant;
2) Demonstrate a disparate impact on a protected group; and
3) Show a causal relationship between the challenged practice and the alleged disparate impact.

The legal viability of disparate impact claims has recently withstood dismissal in numerous federal district and appellate courts; however, the issue remains undecided by the United States Supreme Court. Opponents of the disparate impact theory assert that the law does not contain express language to permit liability based on effect, rather the language only supports liability based on intent to discriminate.

Support for the opponents' arguments is found in *Smith v. City of Jackson*, a Supreme Court case involving the disparate impact theory arising under the Age Discrimination in Employment Act. There, the Court held that when the statutory text lacks a provision creating a cause of action based on "effects" of actions, the statute does not permit disparate impact claims. The issue of disparate impact under the fair housing laws was expected to be decided last term when the Court granted a petition for a writ of certiorari in *Magner v. Gallagher*; however, the parties involved in the case agreed to dismiss the matter before the Court could rule. The Court may yet have another chance to decide the issue, as it is currently deciding whether to grant review in the case of *Township of Mount Holly v. Mt. Holly Gardens Citizens in Action, Inc.*, another case of the disparate impact theory arising under the FHA.

State Fair Lending Laws and State Regulators' Use of Disparate Impact

Aside from whether the Supreme Court finally resolves the issue of disparate impact claims under the federal fair housing laws, recently state regulators have begun using the disparate impact theory of liability under state fair lending laws. For instance, in July 2009, Illinois Attorney General Lisa Madigan filed a lawsuit against one of the nation's largest mortgage lenders and servicers, using the disparate impact theory to allege the company illegally discriminated against African American and Latino homeowners by selling them high-cost subprime mortgage loans while white borrowers with similar incomes received lower cost loans. One of the concerns with increased use of the doctrine by state regulators is that state laws often have expansive definitions of who are contained within the definition of a protected group.

The Illinois Attorney General's lawsuit was specifically mentioned by the CFPB when it issued an April 2012 bulletin emphasizing that the legal doctrine of disparate impact may be utilized as the CFPB exercises it supervision and enforcement authority under a number of federal consumer protection laws. The authority of the CFPB and states to use the disparate impact theory will also likely be the subject of litigation as regulated entities challenge whether there is "effects" or comparable language in the text of the federal and state consumer protection laws, so as to allow extension of the doctrine to those laws.

Impact for Financial Services Companies

Regardless of whether the Supreme Court decides the issue of application of the disparate impact theory of liability under the federal fair housing laws and beyond, the management and counsel of financial services companies would be well-served to develop rules and develop project plans to test for possible fair lending law violations based on impact, and if a statistically significant impact is found to be certain to support that effect with legitimate, non-discriminatory business justifications.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the authors:

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