

## Disparate Impact in Fair Lending: A Theory without a Basis & the Law of Unintended Consequences

By Andrew L. Sandler and Kirk D. Jensen

The disparate impact theory of discrimination allows the government or a private plaintiff to establish discrimination based solely on the outcome of a neutral policy, without having to prove any actual intent to discriminate. Although the text of the Fair Housing Act (FHA) does not create liability for facially neutral activities with unequal effects, lower court decisions over the years have relied on jurisprudence focused on other statutes with different language, agency guidance, and selective readings of legislative history to permit disparate impact claims. The US Supreme Court more recently has issued several decisions undermining this broad focus on the goals of the FHA, holding that the plain language of an anti-discrimination statute—and not a broad interpretation of its purpose—is dispositive of whether disparate impact claims are permitted. Nonetheless, these Supreme Court cases have not addressed the use of disparate impact under the FHA directly, and federal regulatory and enforcement agencies with fair lending enforcement authority seeking to achieve broad policy objectives increasingly seek to rely on disparate impact claims to advance their agenda. Because lenders have been reluctant to engage in protracted litigation with these agencies, disparate impact analysis continues to be effectively used to place affirmative obligations on lenders with respect to the underwriting and pricing of loans to protected-class borrowers designed to achieve statistical equivalence between groups. In effect, this result chills innovation and reduces the breadth of credit available to qualified borrowers, causing lenders to retreat from offering lending products and services that could increase vulnerability to claims of discrimination based only on statistical outcomes of objective and neutrally applied lending criteria. The Supreme Court signaled its interest in addressing directly the threshold question of whether the FHA permits disparate impact claims last term and again this term, granting certiorari on the issue in two successive cases. However, with the active encouragement and participation of government

agencies and/or community organizations receiving government funding, both cases settled shortly before oral argument, denying the Supreme Court the opportunity to rule on the longstanding issue.

### The Theory

The disparate impact theory of discrimination allows a party to establish discrimination based solely on the results of a neutral policy. Disparate *impact* is distinct from disparate *treatment* because a party is not required to show any intent to discriminate. To establish a disparate impact claim, a government agency or private plaintiff must show only that an otherwise neutral practice disparately affects qualified members of a protected class.

### Application of Doctrine in FHA Actions

The notion that the Fair Housing Act (FHA) permits disparate impact claims originated in three lower court decisions in the 1970s—*United States v. City of Black Jack*,<sup>1</sup> *Metropolitan Housing Development Corp. v. Village of Arlington Heights (Arlington Heights II)*,<sup>2</sup> and *Resident Advisory Board v. Rizzo*.<sup>3</sup> None of these cases held that the statutory text of the FHA permitted disparate impact claims—indeed, one of these cases, *Arlington Heights II*, acknowledged that the text of the FHA requires a showing of intent to discriminate to establish claims of discrimination.<sup>4</sup> Rather, these courts focused on cases decided under other laws and what the courts viewed as the broad purpose of the FHA. Lower courts subsequently followed these original three FHA disparate impact decisions and incorporated the rationale set forth in those opinions. However, recent Supreme Court precedent focused on other discrimination statutes now has undermined this approach.<sup>5</sup> Nonetheless, in the absence of a Supreme Court decision directly addressing the appropriate discrimination standard under the FHA, government agencies and the occasional lower court continue to permit use of disparate impact analysis to advance discrimination claims in the lending context.

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## Interagency Adoption of Standard and Subsequent Enforcement

Government agencies with fair lending enforcement powers issued a broad interagency Policy Statement on Discrimination in Lending in 1994. The Policy Statement addressed many aspects of the government's fair lending expectations of banks and other entities engaged in lending activity. Among the guidance provided was a statement that liability for violations of both the FHA and the Equal Credit Opportunity Act (ECOA) could be based on evidence of disparate impact.<sup>6</sup> At the same time, the Federal Reserve Board (FRB) amended its commentary to Regulation B implementing ECOA to note that use of the disparate impact theory is appropriate.<sup>7</sup> However, these statements were made in the context of a broad Policy Statement, which expressly recognized that factors such as borrower's income, continuity of income, adequacy of collateral, and availability of funds to close—objective considerations that often “effect” the decision on whether to make and how to price a loan—remain relevant to credit decisions.<sup>8</sup> Given the continued commitment to the notion that these objective factors appropriately might “effect” the lending decision, governmental fair lending enforcement activity from 1994 until 2008 continued to be focused almost exclusively on cases in which disparate treatment could be proven. During this period no government fair lending cases were brought based exclusively on statistical analysis showing nonequivalent results in availability or pricing of credit without regard to borrower loan qualifications or risk.

This approach to fair lending enforcement changed in 2009 when the Department of Justice Civil Rights Division (DOJ) announced that it would now pursue fair lending cases based on statistical evidence that neutral lending practices were having disproportional effects on members of protected classes. The Department of Housing and Urban Development (HUD)—the executive agency charged with administering, interpreting, and enforcing the FHA—soon followed with similar pronouncements. Since that time, the DOJ and HUD have brought numerous cases based on that theory.<sup>9</sup>

Most recently, HUD issued a proposed regulation purporting to authorize discrimination claims based on disparate impact under the FHA and codify a three-step,

burden-shifting approach to establishing liability under this theory.<sup>10</sup> The rule was finalized in 2013, just weeks after the Supreme Court agreed to hear a second case raising the question of whether the FHA permits disparate impact claims.<sup>11</sup> The final rule (HUD Rule) ostensibly authorizes private and governmental plaintiffs to assert discrimination under the FHA based on mortgage-lending practices that have a disparate impact on a protected class of individuals or that otherwise create, increase, reinforce, or perpetuate segregated housing patterns, even if the practice is facially neutral and there is no evidence of discriminatory motivation.<sup>12</sup> Subsequent to HUD issuing its proposed rule on disparate impact, the Consumer Financial Protection Bureau (CFPB) also took the position, relying on Regulation B, that ECOA permits disparate impact claims.<sup>13</sup> The DOJ has similarly reaffirmed its position that both the FHA and ECOA permit disparate impact claims.<sup>14</sup>

## Recent Supreme Court Jurisprudence Establishing Primacy of the Statutory Text

This relatively new reliance by the DOJ and other government agencies on the disparate impact theory analysis is directly inconsistent with recent Supreme Court jurisprudence setting forth the appropriate limits in use of the disparate impact theory. In 2005, the Supreme Court clarified its position with respect to congressional antidiscrimination statutes, explaining that the text of an antidiscrimination statute is dispositive of whether disparate impact is available.<sup>15</sup>

In *Smith v. City of Jackson*,<sup>16</sup> the Court clarified that its decisions permitting disparate impact claims in employment cases were based on specific language in Title VII and not broad interpretations of the statute's general purpose. The Court explained that Title VII contains two different provisions that prohibit discrimination: One that requires a showing of intent to discriminate, and a second which provides that an employer may not take actions that negatively “affect” a person's employment on the basis of race, sex, and other attributes. The *City of Jackson* Court explained that this “effects” language permits disparate impact claims and does not require a showing of intent. However, a close reading of the FHA and ECOA reveals that both statutes have only the language that the Supreme Court explained requires claimants to prove intent to discriminate—and neither statute has the “effects” language that the Court explained permits disparate impact claims.

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## The ‘Effects’ Test

The question before the Supreme Court in *City of Jackson* was whether the Age Discrimination in Employment Act (ADEA) permits disparate impact claims. To resolve this question, the Court first examined its prior interpretations of parallel antidiscrimination provisions in Title VII. The Court focused on *Griggs v. Duke Power Co.*, in which it originally held that Title VII permits disparate impact claims. In examining its Title VII jurisprudence, the Court clarified that the text of an antidiscrimination statute, not merely a broad interpretation of the statute’s purpose, resolves whether the statute permits disparate impact claims.

Essential to understanding *City of Jackson* and *Griggs* is to realize that Title VII contains two distinct provisions prohibiting different discriminatory employment practices. These two provisions, contained in Section 703 of Title VII, state:

1. It shall be an unlawful employment practice for an employer –
  1. to fail or refuse to hire or to discharge any individual, or otherwise to *discriminate against* any individual with respect to his compensation, terms, conditions, or privileges of employment, *because of* such individual’s race, color, religion, sex, or national origin; or
  2. to limit, segregate, or classify his employees or applicants for employment in any way which would deprive or tend to deprive any individual of employment opportunities or *otherwise adversely affect* his status as an employee, because of such individual’s race, color, religion, sex, or national origin.<sup>17</sup>

Justice Stevens’ plurality opinion in *City of Jackson* clarified that the Court’s holding in *Griggs* that Title VII permits disparate impact claims was based on the “effects” language in Section 703(a)(2).<sup>18</sup> Indeed, the opinion in *Griggs* quoted only Section 703(a)(2).<sup>19</sup> Section 703(a)(2), explained Justice Stevens, “focuses on the *effects* of the action on the employee rather than the motivation for the action of the employer.”<sup>20</sup> Put differently, “Congress had ‘directed the thrust of the Act [Title VII] to the *consequences* of employment practices, not simply the motivations.’”<sup>21</sup> Justice Stevens reasoned that Section 703(a)(2) not only “prohibits actions that ‘limit, segregate, or classify’ persons,” but also “prohibits such actions that ‘deprive any individual of employment opportunities or *otherwise adversely affect*

his status as an employee, because of such individual’s” race or age.<sup>22</sup> The phrase “otherwise adversely affect” was critical to the plurality opinion’s conclusion. Although Justice Stevens acknowledged that the *Griggs* Court had also relied on the purposes of Title VII, the Court had “subsequently noted that [the Court’s] holding [in *Griggs*] represented the better reading of the statutory text.”<sup>23</sup>

The Court further clarified in *City of Jackson* that Section 703(a)(1) requires a showing of intent to discriminate and “does not encompass disparate-impact liability.”<sup>24</sup> Similarly, Justice O’Connor, with whom Justices Kennedy and Thomas joined in dissent, thought it “obvious” that Section 703(a)(1) does not authorize disparate impact claims, but rather “plainly requires discriminatory intent.”<sup>25</sup> The “discriminate against...because of” language is the key text in Section 703(a)(1) supporting a requirement of discriminatory intent. Critically, Section 703(a)(1) does not contain the “effects” language present in Section 703(a)(2).

After clarifying its Title VII jurisprudence, the Court held that the ADEA also permits disparate impact claims because it contains a parallel provision to the disparate impact provision of Title VII (Section 703(a)(2)). This holding is consistent with other Supreme Court opinions holding that various statutes that contain “effects” or “results” language permit disparate impact claims.<sup>26</sup> The Court has held that the Americans with Disabilities Act (ADA), which prohibits “utilizing standards, criteria, or methods of administration . . . that have the *effect* of discrimination,” permits disparate impact claims. The Court reached the same conclusion with respect to the Rehabilitation Act, which incorporates by reference the standards applicable under the ADA,<sup>27</sup> and the Voting Rights Act,<sup>28</sup> which prohibits any voting prerequisites or standards “*result[ing]* in a denial” of the right to vote “on account of race or color.”<sup>29</sup> In contrast, the Court has consistently held that statutes lacking “effects” or “results” language do not create a disparate impact cause of action.<sup>30</sup>

*City of Jackson* is but one in a continuing line of Supreme Court cases that reminded courts and litigants to look to the text of the statute when determining whether a particular cause of action exists.<sup>31</sup> The most recent reminder of this tenet came in May 2012, when

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the Supreme Court reiterated that “[v]ague notions of statutory purpose provide no warrant for expanding [a statute’s] prohibition beyond the field to which it is unambiguously limited[.]”<sup>32</sup>

**Application to Text of FHA and ECOA**

As demonstrated in the following chart, the FHA and ECOA contain similar language to the disparate treatment provisions of Title VII and the ADEA—which the Supreme Court has clarified require a showing of intent to discriminate. However, neither statute contains any language resembling the disparate impact provisions of those statutes.

The obvious similarities and glaring differences between the text of the FHA and ECOA and the text of Title VII and the ADEA are dispositive of Congress’s intent in enacting these statutes. The similarities and differences are even more significant considering that Congress enacted Title VII (1964), the ADEA (1967), the FHA (1968), and ECOA (1974) in quick succession. The Supreme Court has explained that “when Congress uses the same language in two statutes having similar purposes, particularly when one is enacted shortly after the other, it is appropriate to presume that Congress intended that text to have the same meaning in both statutes.”<sup>33</sup> The converse is also

Disparate Treatment Language:	Disparate Impact Language:
<b>Title VII</b>	
(a) It shall be an unlawful employment practice for an employer (1) to fail or refuse to hire or to discharge any individual, or otherwise to <i>discriminate against any individual</i> with respect to his compensation, terms, conditions, or privileges of employment, <i>because of</i> such individual’s race, color, religion, sex, or national origin; ...	(a) It shall be an unlawful employment practice for an employer ... (2) to limit, segregate, or classify his employees or applicants for employment in any way which would deprive or tend to deprive any individual of employment opportunities or <i>otherwise adversely affect</i> his status as an employee, because of such individual’s race, color, religion, sex, or national origin.
<b>ADEA</b>	
(a) It shall be unlawful for an employer: (1) to fail or refuse to hire or to discharge any individual or otherwise discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual’s age; ...	(a) It shall be unlawful for an employer: ... (2) to limit, segregate, or classify his employees in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual’s age[.]
<b>FHA</b>	
(a) In general. It shall be unlawful for any person or other entity whose business includes engaging in residential real estate-related transactions to <i>discriminate against</i> any person in making available such a transaction, or in the terms or conditions of such a transaction, <i>because of</i> race, color, religion, sex, handicap, familial status, or national origin.	None.
<b>ECOA</b>	
(a) It shall be unlawful for any creditor to <i>discriminate against</i> any applicant, with respect to any aspect of a credit transaction—(1) <i>on the basis of</i> race, color, religion, national origin, sex or marital status, or age ... ;	None.

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true. Then-Judge John Roberts explained that “[t]his use of different language in two statutes so analogous in their form and content, enacted so closely in time, suggests that the statutes differ in their meaning.”<sup>34</sup>

The ordinary meaning of the term “discriminate” further supports the position that the “discriminate . . . because of” and “discriminate . . . on the basis of” language in the FHA and ECOA requires a showing of intent. When terms are not defined in a statute, those terms are given their ordinary meaning.<sup>35</sup> The ordinary meaning of “discriminate” refers to the *intentional* treatment of one person differently than another.<sup>36</sup> Engaging in a certain practice that has a disparate impact without discriminatory intent is not “discrimination” in the ordinary sense of the word, and yet courts and government agencies have nonetheless permitted disparate impact under the FHA and ECOA. In fact, the plaintiff’s bar has argued that disparate impact liability can be found even for actions intended to *prevent* discrimination if those actions have a disparate impact.<sup>37</sup> Congress’s decision to use the term “discriminate” in the FHA and ECOA without any “effects” language signifies a deliberate decision to require a showing of intent to discriminate—not to permit disparate impact claims under the FHA and ECOA.

### **Misinterpretation of Supreme Court Precedent by Lower Courts**

No lower court has held that the text of either the FHA or ECOA permits disparate impact claims in the fair lending context. Nonetheless, several federal district courts have continued to rely on nonstatutory references—and appellate court opinions relying on nonstatutory references—to uphold use of the theory,<sup>38</sup> contrary to Supreme Court precedent. These district court decisions cannot be squared with the Supreme Court’s holding in *City of Jackson* and other cases. The language of the FHA is plain; accordingly, the analysis of the FHA must begin *and end* with the statutory text.<sup>39</sup> Resort to legislative history is unnecessary and unwarranted. Indeed, no federal court of appeals has addressed the issue since *City of Jackson*, and two have questioned whether use of the disparate impact theory in such cases remains appropriate, signaling an opportunity to return fair lending enforcement to the prohibition of intentional discrimination for an impermissible purpose contained in the statutory text.

Lower court decisions concluding that ECOA permits disparate impact claims similarly rest on a shaky foundation that has crumbled in light of *City of Jackson*. Instead of analyzing the language of ECOA, courts have relied on nonstatutory references to disparate impact under ECOA.<sup>40</sup> At the root of these nonstatutory references are two congressional committee reports related to a *subsequent* amendment to ECOA that did not alter the “discriminate against . . . on the basis of” language in ECOA.<sup>41</sup> The 1976 amendments to ECOA expanded the prohibited bases of ECOA to include race, age, and other attributes, but did not add “effects” language to ECOA or otherwise change the basic “discriminate against . . . on the basis of” structure of the statute.<sup>42</sup>

Reliance on contemporary legislative history is generally not appropriate when the language of the underlying statute is clear. It is never appropriate when, as here, the purportedly relevant congressional committee reports are from a *subsequent* Congress that did not even amend the relevant text of the statute. The Supreme Court has specifically noted that inferring the intent of an earlier Congress from the legislative history of a later Congress is “hazardous.”<sup>43</sup> Indeed, such uses of legislative history has been criticized as lending itself “to a kind of ventriloquism,” which can be employed “to make words appear to come from Congress’s mouth which were spoken or written by others (individual Members of Congress, congressional aides, or even enterprising lobbyists).”<sup>44</sup> Committee reports from a subsequent Congress ought to have no place in determining Congress’s intent in enacting ECOA.

### **Appellate Treatment Post-City of Jackson**

Although 11 of the 12 federal courts of appeal held prior to *City of Jackson* that the FHA and ECOA permit disparate impact claims,<sup>45</sup> decisions since 2005 have relied solely on pre-*City of Jackson* precedent that has since been discredited, without analyzing or otherwise acknowledging the Supreme Court’s *City of Jackson* opinion.<sup>46</sup> Further, the US Court of Appeals for the District of Columbia Circuit has signaled that ECOA does not permit disparate impact claims,<sup>47</sup> and five judges from the US Court of Appeals for the Eighth Circuit have argued that the issue of disparate impact under the FHA “is appropriate for careful review.”<sup>48</sup> In *Garcia v. Johanns*, the DC Circuit observed that “[t]he Supreme Court has held that this [‘effects’]

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language gives rise to a cause of action for disparate impact discrimination under Title VII and the ADEA,” citing to *City of Jackson*, but noting that “ECOA contains no such language.”<sup>49</sup> In *Magner v. Gallagher*, five judges dissented from a denial of *en banc* rehearing, noting that “recent developments in the law,” primarily *City of Jackson*, “suggest that the issue [of disparate impact under the FHA] is appropriate for careful review by the *en banc* court.”<sup>50</sup>

### **Supreme Court Attempts to Rule on Validity of Doctrine**

The Supreme Court nearly had the opportunity to address the threshold question of whether disparate impact claims are permitted under the FHA in *Magner v. Gallagher* and again in *Township of Mount Holly, New Jersey, et al. v. Mt. Holly Gardens Citizens in Action, Inc., et al.* However, in both cases, the petitioners withdrew their respective appeals shortly before the Court was scheduled to hear arguments, preventing the Supreme Court from deciding this longstanding issue. Luckily, a third case that raises issues substantially similar to those presented in *Magner* and *Mount Holly* may be headed to the Supreme Court.

The City of St. Paul, Minnesota—the Petitioner in *Magner*—filed a petition for *certiorari* that was granted by the Supreme Court last term,<sup>51</sup> after its petition for rehearing before the Eight Circuit *en banc* was denied.<sup>52</sup> Although the district court ruled for the City,<sup>53</sup> the Eighth Circuit reversed, holding that the respondents had stated a cognizable claim under the FHA.<sup>54</sup> After briefing, but before argument, the Supreme Court dismissed the case at the City of St. Paul’s request. However, there seems to be a general consensus that the Supreme Court would have sided with the City of St. Paul and held that the FHA does not permit disparate impact claims, in no small part because the Court took the case notwithstanding the lack of a circuit split on the issue. Indeed, the Mayor of the City of St. Paul stated as much in explaining the City’s decision to withdraw its appeal, noting that the City was confident it would win.<sup>55</sup> The City’s stated reason for withdrawing its case was concern that its victory in the Supreme Court could set back civil rights enforcement by eliminating the future use of the disparate impact theory. Civil rights advocates and government officials were similarly so concerned that they undertook great efforts to persuade the City of St. Paul to withdraw its appeal.<sup>56</sup>

In June 2013, the Supreme Court granted *certiorari* in *Mount Holly*. Though not a lending case, the *Mount Holly* appeal would have allowed the Supreme Court to rule on the same threshold question presented in *Magner*—that is, whether disparate impact claims are cognizable under the FHA. As in *Magner*, the New Jersey Township of Mount Holly withdrew its petition prior to oral argument after the Township settled its dispute.<sup>57</sup>

The Supreme Court may have yet another chance to address this issue in an action filed by two homeowners’ insurance associations earlier this year, which had been stayed in federal district court in D.C. pending the outcome of the *Mount Holly* appeal.<sup>58</sup> The lawsuit challenges the validity of the HUD Rule, alleging that it violates the Administrative Procedures Act by contradicting the plain language of the FHA. The associations argue that the HUD Rule, if applied to homeowners’ insurance, would require insurers “to consider characteristics such as race and ethnicity and to disregard legitimate risk-related factors,” thereby forcing insurers “to provide and price insurance in a manner that is wholly inconsistent with well-established principles of actuarial practice and applicable state insurance law.”

In light of the Supreme Court’s decision to hear the *Magner* and *Mount Holly* appeals—and the efforts by DOJ and other supporters of the broad use of disparate impact theory to avoid Supreme Court scrutiny of its application in fair lending matters—there is hope that courts will be more willing to carefully review *City of Jackson* and its impact on the validity of prior decisions under the FHA and ECOA.

### **Invalidity of Agency Attempts to Establish Disparate Impact Standard**

Despite Supreme Court precedent calling into question the appropriateness of disparate impact claims in the fair lending context—and despite the Supreme Court agreeing twice in as many terms to consider whether the FHA permits disparate impact claims—government agencies continue to assert the theory in policy statements, enforcement actions, and supervisory examinations. However, as discussed previously, neither the FHA nor ECOA contain the statutory language that permits disparate impact claims. Accordingly, these efforts to support disparate impact are contrary to controlling law.

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## Lack of Support or Authority for Actions

A close review of the positions asserted by HUD, DOJ, the FRB, and the CFPB shows that each is based on a now-discredited interpretation of law. HUD bases its position on the holdings by federal courts of appeals that the FHA permits disparate impact claims.<sup>59</sup> Similarly, DOJ—in the interagency Policy Statement on Discrimination in Lending—bases its position on the holdings by federal courts of appeal prior to *City of Jackson*,<sup>60</sup> despite the fact that *City of Jackson* now shows that these lower court decisions are incorrect and inconsistent with the language of the statute. In addition to basing its view on pre-*City of Jackson* cases,<sup>61</sup> the FRB also relied on the preenactment legislative history of ECOA in addressing the effects test in Regulation B.<sup>62</sup> The CFPB, which now has authority over Regulation B, followed suit.<sup>63</sup> As discussed previously, however, this legislative history post-dates the enactment of ECOA and cannot change the plain meaning of the statutory text. The FRB also relied on the Civil Rights Act of 1991, which amended Title VII but did not amend any other civil rights law.<sup>64</sup> But the Supreme Court has since clarified that the 1991 legislation only amended Title VII—and does not affect the interpretation of any other civil rights law.<sup>65</sup>

Furthermore, a regulatory agency is not authorized to attempt to effectuate an interpretation of a statute by prohibiting conduct the statute permits. As Justice O'Connor has explained: “an agency’s legislative regulations will be upheld if they are ‘reasonably related’ to the purposes of the enabling statute, ... [W]e would expand considerably the discretion and power of agencies were we to interpret ‘reasonably related’ to permit agencies to proscribe conduct Congress did not intend to prohibit.”<sup>66</sup> “[R]egulations that would proscribe conduct by the recipient having only a discriminatory effect ... do not simply ‘further’ the purpose of the [statute]; they go well beyond that purpose.”<sup>67</sup>

## Recent Precedent Limiting Agency Rulemaking

Recent Supreme Court precedent further signals that the HUD Rule adopting disparate impact under the FHA cannot stand. In *Freeman v. Quicken Loans*,<sup>68</sup> the Supreme Court unanimously rejected a HUD interpretation of the Real Estate Settlement Procedures Act that the Court found to be “manifestly inconsistent with the statute.”<sup>69</sup> Agency interpretations of statutes

are entitled to deference only when there is an ambiguity in the statute and only if the agency’s interpretation is reasonable.<sup>70</sup> The *Freeman* Court unanimously reminded HUD, however, that its interpretations are not entitled to deference when its interpretation “goes beyond the meaning that the statute can bear.”<sup>71</sup> The Court has previously explained that “‘regulations that would proscribe conduct by the recipient having only a discriminatory effect ... do not simply ‘further’ the purpose of [the statute]; they go well beyond that purpose’” and are not entitled to deference.<sup>72</sup> This analysis would be equally applicable to any final HUD rule. When a statute like the FHA does not permit disparate impact claims, such claims cannot be authorized by regulation. *Freeman* suggests that HUD should exercise caution before attempting to promulgate a rule inconsistent with the underlying statute.

## Unintended Consequences of Continued Application

The Supreme Court’s repeated decision to rule on the validity of the disparate impact doctrine in the FHA context reflects the serious public policy concerns raised by continued application of the theory in certain housing contexts, particularly from a lending perspective. Relying on disparate impact to establish discrimination in lending poses a real threat to market expansion and economic stability. Further, continued application of the theory could actually facilitate and institutionalize discriminatory practices and abate consumer protection efforts.

## Stifled Marketplace

The mortgage-lending market is sustained and advanced through innovation and growth. Exposing lenders to potential liability for lending activities based only on superficial statistical analysis showing differential impact on a particular group without meaningful controls for objective lending qualifications hinders lenders’ ability to create new products and extend business operations, thereby stifling market expansion. Nontraditional mortgage products have afforded access to mortgage financing to a wide spectrum of consumers that do not desire or otherwise qualify for a traditional mortgage. However, even if policies associated with such products are applied neutrally to all consumers, a lender may be forced to stop offering the product in order to equalize the effects of their lending activities on minority and nonminority borrowers. For example, certain loan products may be

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optimal for a limited subset of borrowers. If minorities are not proportionately represented in that subset of borrowers, offering the products—even on a demonstrably fair and nondiscriminatory basis to all qualified borrowers—could increase the lender’s exposure to liability, despite the complete absence of discriminatory intent or conduct, solely because proportionately more nonminority borrowers qualify for the product. Faced with the possibility of accusations of discriminatory lending, many lenders will choose not to offer such products, thereby depriving qualified borrowers, minority and nonminority alike, of good credit alternatives.

An outcome-driven approach to assessing discrimination likewise creates unreasonable risk for lenders that might otherwise seek to expand into new markets. For example, lending opportunities might be more limited in census tracts with greater minority populations, like urban areas, which increases lender exposure to accusations of redlining discrimination. A lender otherwise interested in growing its lending operations in an urban area with pronounced credit needs may thus choose not to do so because of the significant risk, effectively depriving *all* potential borrowers in the community of the benefits of an additional loan source.

### **Economic Instability**

Application of the disparate impact theory in fair lending matters also threatens to undermine traditional underwriting practices. The approach employed to determine whether discretionary loan pricing resulted in discriminatory impact focuses only on statistical outcomes, without regard to the factors most reliable in predicting default, such as credit scores, loan-to-value ratios, and debt-to-income ratios. Reducing emphasis on those factors may lead lenders to place less emphasis on traditional underwriting criteria in an effort to equally apportion mortgages among all groups of borrowers and avoid accusations of discrimination, notwithstanding that each group may not have precisely equal credit qualifications. For example, if a minority group is statistically less likely to qualify for a mortgage product or particular loan terms under a neutral policy, the lender would be forced to either stand by the policy and risk being accused of discrimination under a disparate impact statistical analysis or ease its underwriting standards to achieve equivalent market share among minority and nonminority borrowers. The substantial financial and reputational costs associated with discrimination allegations could incentivize

the latter option. If that choice is made, the likelihood of loan defaults with negative implications for borrowers and neighborhoods increase.

### **Consumer Protection Risks**

Discretionary pricing, when used appropriately, protects mortgage lenders and borrowers alike. A traditional mortgage is not a realistic option for a large segment of consumers. Through market innovation, nontraditional mortgage products were created that afford high-risk consumers the opportunity to obtain home loans. However, as discussed previously, continued use of the disparate impact theory could make lenders reluctant to offer mortgage products tailored to a particular type of borrower or set of circumstances, which by their nature invite differential application and thereby a potential disproportionate effect. The impact of such a market change would be felt most substantially by high-risk consumers who rely on nontraditional products for access to credit. If fear of liability discourages lenders from creating and offering products suitable for such borrowers, a large segment of consumers could be effectively denied access to responsible loan products. If this occurs, other less reputable lenders will step in and fill the vacuum with loan products bearing far more problematic terms and costs. Thus, well-intentioned but misguided efforts to prevent discrimination may in effect increase minority borrowers’ exposure to predatory lending practices.

### **Facilitate Discriminatory Practices**

Lastly, focus on equal ends rather than equal opportunity may actually facilitate discrimination by rendering quotas and preferential treatment as the only cost-effective means for limiting exposure to disparate impact liability. The Supreme Court has acknowledged that “[i]f quotas and preferential treatment become the only cost-effective means of avoiding expensive litigation and potentially catastrophic liability, such measures will be widely adopted.”<sup>73</sup> Further, the Supreme Court cautioned in the Title VII context that regulations which, as applied, give employers “little choice” but to adopt race-conscious measures can violate the Constitution.<sup>74</sup>

### **Conclusion**

Congress appropriately designed the FHA and ECOA to prohibit only intentional discrimination, which the text of both statutes makes clear. Arguments for incorporating the disparate impact theory into either statute are squarely inconsistent

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with the statutory texts and cannot be reconciled with the Supreme Court's precedent in *City of Jackson* and its progeny. Rule[makings, bulletins, and other agency guidance cannot prohibit what Congress has not, and such actions ultimately will not survive judicial scrutiny.

There is no question that inadequate access to credit in certain communities in the urban core is a real concern that needs to be addressed. However, recent years have seen a trend of discrimination allegations that are not justified and raise serious concerns for market sustainability and consumer protection. To effectively address this problem, regulatory and judicial focus must be on whether consumers are treated fairly in the lending process, rather than on accusing lenders of discrimination for not affirmatively bringing credit into such areas. Beware the law of unintended consequences.

## Notes

1. 508 F.2d 1179 (8th Cir. 1974).
  2. 558 F.2d 1283 (7th Cir. 1977).
  3. 564 F.2d 126 (3d Cir. 1977).
  4. *Arlington Heights II*, 558 F.2d at 1288 (acknowledging that a "narrow view of the phrase ['because of race']" in the statute would require intent to discriminate).
  5. The *Black Jack* court relied exclusively on constitutional equal protection cases to support its conclusion that the FHA permits disparate impact claims. *Black Jack*, 508 F.2d at 1185. Soon after, the Supreme Court effectively undermined *Black Jack* when it overruled the equal protection cases the *Black Jack* court had relied upon and held that equal protection violations require a showing of discriminatory intent. *Washington v. Davis*, 426 US 229, 238–39, 244 n.12 (1976). The *Arlington Heights II* court concluded that the FHA permitted disparate impact claims in spite of the plain language of the statute, relying on the broad purpose of the FHA. *Arlington Heights II*, 558 F.2d at 1288–89. The *Rizzo* court similarly concluded that the FHA permitted disparate impact claims by looking to the broad purpose of the statute rather than the plain language of the statute. *Rizzo*, 564 F.2d at 126. *Rizzo* also relied on *Black Jack* and *Arlington Heights II*. *Rizzo*, 564 F.2d at 147, 148 n.31. As discussed above, *City of Jackson* clarifies that disparate impact must be permitted by the language of the statute, not merely the broad purpose of the statute, and that therefore undermines the holding of *Arlington Heights II*. For a more detailed description of lower court cases that initially held that the FHA permits disparate impact claims, see Jensen, Kirk D. and Naiman, Jeffrey P., "The Fair Housing Act, Disparate Impact Claims, and *Magner v. Gallagher*: An Opportunity to Return to the Primacy of the Statutory Text," 129 *Banking L.J.* 99 (Feb. 2012).
  6. *Policy Statement on Discrimination in Lending*, April 15, 1994. Federal Reserve Regulatory Service, Page 6–58.1.
  7. 12 C.F.R. Part 202, Commentary 202.6 at 6(a)–2 (recodified at 12 C.F.R. Part 1002).
  8. *Policy Statement on Discrimination in Lending*, April 15, 1994. Federal Reserve Regulatory Service, Page 6–58.6.
  9. For example, Luther Burbank increased its 1–4 family residential mortgage lending by acquiring a jumbo single-family loan unit specializing in adjustable-rate mortgages (ARMs) and nontraditional mortgages (NTMs) that had been operating an identical program at another thrift for 10 years. The decision to expand into this niche market instead of offering 30-year fixed products was driven by safety and soundness concerns. Although the Bank was willing to expand its 1–4 family residential mortgage business, the Bank's legitimate concerns about the appropriateness of offering these products to unsophisticated borrowers through third-party brokers led the Bank to limit the availability of these products through the wholesale channel to borrowers seeking loans of \$400,000 or more. Despite the valid, nondiscriminatory reasons supporting the Bank's neutral minimum loan policy, the DOJ pursued a multimillion dollar action against the Bank based on an alleged disparate impact on African-American and Hispanic potential borrowers.
  10. Implementation of the Fair Housing Act's Discriminatory Effects Standard, 76 Fed. Reg. 70921 (proposed Nov. 16, 2011).
  11. Implementation of the Fair Housing Act's Discriminatory Effects Standard, 78 Fed. Reg. 11,460 (Feb. 15, 2013) (codified at 24 C.F.R. 100). See also *Wards Cove Packing Co., Inc. v. Antonio*, 490 US 642 (1989). The Supreme Court has clarified that *Wards Cove* continues to apply to civil rights laws other than Title VII. *Smith v. City of Jackson*, 544 U.S. 228, 240 (2005) ("While the relevant 1991 amendments expanded the coverage of Title VII, they did not amend the ADEA or speak to the subject of age discrimination. Hence, *Wards Cove*'s pre-1991 interpretation of Title VII's identical language remains applicable to the ADEA."). Similarly, because the Civil Rights Act of 1991 did not amend the FHA or ECOA, the *Wards Cove* standard is the standard that would apply to disparate impact claims under the FHA and ECOA if such claims can be brought at all.
  12. Implementation of the Fair Housing Act's Discriminatory Effects Standard, 78 Fed. Reg. 11,460 (Feb. 15, 2013) (codified at 24 C.F.R. 100).
  13. CFPB Bulletin 2012-04 (Fair Lending) (Apr. 18, 2012), available at [http://files.consumerfinance.gov/f/201404\\_cfpb\\_bulletin\\_lending\\_discrimination.pdf](http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf). The CFPB incorporated the FRB's Official Staff Commentary into its commentary to Regulation B. 12 C.F.R. Pt. 1002, Supp. I, Comment 6(a)–2.
  14. See, e.g., Perez, Thomas E., Speech to 15th Annual Community Reinvestment Act and Fair Lending Colloquium (Nov. 7, 2011), available at <http://www.justice.gov/crt/opa/pr/speeches/2011/crt-speech-111107.html> ("The Civil Rights Division will make use of all the tools in our arsenal to root out discrimination, including disparate impact theory if the facts support its application.").
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15. *Smith v. City of Jackson*, 544 US 228 (2005).
  16. 544 US 228 (2005).
  17. Title VII § 703(a), 42 U.S.C. § 2000e-2(a) (emphasis added).
  18. *City of Jackson*, 544 US at 234.
  19. *Griggs*, 401 US at 426 (quoting Section 703(a)(2), but omitting quotation of Section 703(a)(1)).
  20. *City of Jackson*, 544 US at 235–36 (emphasis in original).
  21. *City of Jackson*, 544 US at 234 (quoting *Griggs*, 401 U.S. at 432 (emphasis in original)).
  22. *City of Jackson*, 544 US at 235–36 (emphasis in original).
  23. *City of Jackson*, 544 US at 234.
  24. *City of Jackson*, 544 US at 236–38.
  25. *City of Jackson*, 544 US at 249 (O’Connor, J., dissenting).
  26. *Raytheon Co. v. Hernandez*, 540 US 44, 53 (2003) (emphasis added).
  27. *Alexander v. Choate*, 469 US 287, 299 (1985).
  28. *Chisom v. Roemer*, 501 US 380, 404 (1991).
  29. 42 U.S.C. § 1973(a) (emphasis added).
  30. *Jackson v. Birmingham Bd. of Educ.*, 544 US 167, 178 (2005) (Title IX); *Alexander v. Sandoval*, 532 US 275, 280–81 (2001) (Title VI); *Castenada v. Pickard*, 648 F.2d 989, 1001 (5th Cir. 1981) (Equal Education Opportunities Act); *Robinson v. Paragon Foods, Inc.*, 2006 WL 2661110, at \*6 (N.D. Ga. Sept. 15, 2006) (Title II).
  31. See, e.g., *Alexander v. Sandoval*, 532 US 275, 286–87 (2001) (“Without [statutory intent], a cause of action does not exist and courts may not create one, no matter how desirable that might be as a policy matter, or how compatible with the statute.”); *Wards Cove*, 490 US at 655 n.9; *Watson*, 487 US at 991.
  32. *Freeman v. Quicken Loans, Inc.* No. 10–1042, 2012 WL 1868063, at \*12–13 (U.S. May 24, 2012).
  33. Pub. L. 90–284, April 11, 1968, 82 Stat. 73 (FHA); Pub. L. 88–352, July 2, 1964, 78 Stat. 241 (Title VII); Pub. L. 90–202, Dec. 15, 1967, 81 Stat. 602 (ADEA); Pub. L. 93–495, Oct. 28, 1974, 88 Stat. 1510 (ECOA).
  34. *Aree v. Republic of Iraq*, 370 F.3d 41, 61 (D.C. Cir. 2004) (Roberts, J., concurring).
  35. See, e.g., *Asgrow Seed Co. v. Winterboer*, 513 US 179, 187 (1995).
  36. See, e.g., Random House Unabridged Dictionary, “Discriminate” (2006); *Jackson v. Birmingham Bd. of Educ.*, 544 U.S. 167, 175 (2005) (“‘Discrimination’ is a term that covers a wide range of intentional unequal treatment.” (emphasis added)).
  37. Relman, John P., *Housing Discrimination Practice Manual* § 2:24 (2005) (“A defendant with the best of intentions—indeed, even a defendant who undertakes a particular policy in the express hope of eliminating any possible discrimination—can still be held liable if a plaintiff pursues a disparate impact claim.” (emphasis added)).
  38. See, e.g., *National Community Reinvestment Coalition v. Accredited Home Lenders*, 573 F. Supp. 2d 70, 77–79 (D.D.C. 2008).
  39. See, e.g., *Alexander v. Sandoval*, 532 US 275, 288 (2001); see also *National Community Reinvestment Coalition*, 573 F. Supp. 2d at 77–79 (“We have never accorded dispositive weight to context shorn of text ... in interpreting statutes generally ... legal context matters only to the extent it clarifies text.”).
  40. Cubita, Peter, and Hartmann, Michelle, “The ECOA Discrimination Proscription and Disparate Impact—Interpreting the Meaning of the Words That Actually Are There,” 61 *Bus. Lawyer* 829, 836 (2006) (discussing cases).
  41. S. Rep. No. 94–589, at 4–5 (1976); H.R. Rep. No. 94–210, at 5 (1975); see also PCubita and Hartmann, *supra*, n.40, at 836–37 (2006) (discussing legislative history of ECOA). The 1976 amendments to ECOA expanded the prohibited bases of ECOA to include race, age, and other attributes, but did not add “effects” language to ECOA or otherwise change the basic “discriminate against ... because of” structure of the statute. Cubita and Hartmann, *supra*, n.40, 838 (2006).
  42. As originally enacted, ECOA contained an antidiscrimination provision using only the “discriminate against ... on the basis of” formulation found in Section 703(a)(1) of Title VII and Section 4(a)(1) of the ADEA: “It shall be unlawful for any creditor to discriminate against any applicant on the basis of sex or marital status with respect to any aspect of a credit transaction.” Pub. L. No. 93–495, tit. V, § 503, ECOA § 701(a), 88 Stat. 1500, 1521. An amendment to ECOA in 1976 expanded the prohibited bases, but did not add any “effects” language to the statute or otherwise alter the “discriminate against .... on the basis of” formulation.
  43. *Jones v. United States*, 526 US 227, 238 (1999) (quoting *Pension Benefit Guaranty Corporation v. LTV Corp.*, 496 US 633, 650 (1990) (internal quotations and citations omitted)).
  44. *Koons Buick Pontiac GMC, Inc. v. Nigh*, 543 US 50, 73 (Scalia, J., dissenting).
  45. Prior to *City of Jackson*, 11 of the 12 federal courts of appeal had permitted disparate impact claims in the fair lending context, notwithstanding lack of support for disparate impact liability in the text of the statute. See *Graoch Assocs #33, L.P. v. Louisville/Jefferson County Metro Human Relations, Comm’n*, 508 F.3d at 374; *Reinhart v. Lincoln County*, 482 F.3d 1225, 1229 (10th Cir. 2007); *Charleston Housing Auth. v. US Dep’t of Agric.*, 419 F.3d 729, 740–41 (8th Cir. 2005); *Langlois v. Abington Hous. Auth.*, 207 F.3d 43, 49–50 (1st Cir. 2000); *Simms v. First Gibraltar Bank*, 83 F.3d 1546, 1555 (5th Cir. 1996); *Jackson v. Okaloosa County, Fla.*, 21 F.3d 1531, 1543 (11th Cir. 1994); *Keith v. Volpe*, 858 F.2d 467, 484 (9th Cir. 1988); *Huntington Branch, NAACP v. Town of Huntington*, 844 F.2d 926, 938 (2d Cir. 1988), *aff’d*, 488 U.S. 15 (1988); *Resident Advisory Board v. Rizzo*, 564 F.2d 126, 149–50 (3d Cir. 1977); *Betsey v. Turtle Creek Assocs.*, 736 F.2d 983, 988–89 (4th Cir. 1984); *Metropolitan Housing Dev. Corp. v. Village of Arlington Heights (Arlington Heights II)*, 558 F.2d 1283, 1290 (7th Cir. 1977).
  46. *Cox v. City of Dallas, Tex.*, 430 F.3d 734, 746 (5th Cir. 2005); *Gallagher v. Magner*, 619 F.3d 823, 833–34 (8th Cir. 2010); *Charleston Hous. Auth. v. US Dept. of Agric.*, 419 F.3d 729, 740–741 (8th Cir. 2005) (stating that the FHA permits disparate
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- impact claims and citing *Black Jack* ); *Darst-Webbe Tenant Ass'n Bd. v. St. Louis Hous. Auth.*, 417 F.3d 898, 902 (8th Cir. 2005); *Affordable Hous. Dev. Corp. v. City of Fresno*, 433 F.3d 1182, 1194 (9th Cir. 2006); *Reinhart v. Lincoln County*, 482 F.3d 1225, 1229 (10th Cir. 2007); *Hallmark Developers, Inc. v. Fulton County*, 466 F.3d 1276, 1286 (11th Cir. 2006); *Graoch Assocs. # 33, L.P. v. Louisville/Jefferson County Metro Human Relations Comm'n*, 508 F.3d 366, 371 (6th Cir. 2007).
47. *Garcia v. Johanns*, 444 F.3d 625, 633 n.9 (D.C. Cir. 2006).
48. *Gallagher v. Magner*, 636 F.3d 380, 383 (8th Cir. 2010) (Colloton, J., dissenting).
49. 444 F.3d 625, 633 n.9 (D.C. Cir. 2006) (citations omitted).
50. *Gallagher*, 636 F.3d at 383.
51. Petition for Writ of Certiorari, 2011 WL 549171, \*i (Feb. 14, 2011); *Gallagher v. Magner*, No. 10-1032.
52. *Gallagher v. Magner*, 636 F.3d 380, 381 (8th Cir. 2010).
53. See *Steinhauser v. City of St. Paul*, 595 F. Supp. 2d 987 (D. Minn. 2008).
54. *Gallagher v. Magner*, 619 F.3d 823, 838 (8th Cir. 2010).
55. Press release, "City of St. Paul Seeks to Dismiss United States Supreme Court Case *Magner vs. Gallagher*" (Feb. 10, 2012), available at <http://www.stpaul.gov/index.aspx?NID=4874&ART=9308&ADMIN=1>.
56. See, e.g., Biskupic, Joan, "Analysis: Rights Groups Try to Avoid U.S. High Court Setback," *Reuters.com* (Mar. 2, 2012), available at <http://www.reuters.com/assets/print?aid=USTRE82117X20120302> (discussing efforts by civil rights advocates and government officials to persuade the City of St. Paul to withdraw its appeal out of concern that the Supreme Court would rule in favor of the City).
57. See, e.g., Stohr, Greg, "N.J. Housing-Bias Accord Scuttles U.S. Supreme Court Case," *Bloomberg* (Nov. 13, 2013).
58. American Insurance Ass'n v. U.S. Dep't of Housing and Urban Development, No. 1:13-cv-00966-RJL, Compl. filed in D.D.C. June 26, 2013.
59. 76 Fed. Reg. at 70923.
60. 59 Fed. Reg. 18266, 18268 (Apr. 15, 1994) ("The courts have recognized three methods of proof of lending discrimination under the ECOA and the FH Act: ..."); 59 Fed. Reg. at 18269 ("Although the precise contours of the law on disparate impact as it applies to lending discrimination are under development ...").
61. 12 C.F.R. § 202.6(a) n.2.
62. 12 C.F.R. Pt. 202, Supp. I, Comment 6(a)-2.
63. CFPB Bulletin 2012-04 (Fair Lending) (Apr. 18, 2012), available at [http://files.consumerfinance.gov/f/201404\\_cfpb\\_bulletin\\_lending\\_discrimination.pdf](http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf).
64. 12 C.F.R. Pt. 202, Supp. I, Comment 6(a)-2.
65. *Smith v. City of Jackson*, 544 US 228, 240 (2005) ("While the relevant 1991 amendments expanded the coverage of Title VII, they did not amend the ADEA or speak to the subject of age discrimination.").
66. *Guardians Ass'n v. Civil Serv. Comm'n*, 463 US 582, 614 (1983) (O'Connor, J., concurring); see also *Guardians Ass'n v. Civil Serv. Comm'n*, 463 US at 613 ("'Reasonably related to' simply cannot mean 'inconsistent with.'"); *American Federation of Gov't Employees, AFL-CIO v. Gates*, 486 F.3d 1316, 1321-22 (D.C. Cir. 2007) ("If the relevant statutory language is plain but is inconsistent with the [agency's] regulations, we must hold the regulations invalid.").
67. *Alexander v. Sandoval*, 532 US 275, 286 n.6 (2001) (quoting with approval *Guardians*, 463 US at 613 (O'Connor, J., concurring) (emphasis in original)).
68. *Freeman v. Quicken Loans, Inc.* No. 10-1042, 2012 WL 1868063, at \*12-13 (US May 24, 2012).
69. *Id.*, at \*5.
70. E.g., *Presley v. Etowah Cnty. Comm'n*, 502 US 491, 509-10 (1992).
71. *Freeman, supra*, n.68 at \*5.
72. *Alexander, supra*, n.67 at 286 n.6 (2001) (quoting with approval *Guardians Ass'n v. Civil Serv. Comm'n*, 463 US 582, 613 (1983) (emphasis in original)).
73. *Watson v. Fort Worth Bank & Trust*, 487 US 977, 993 (1988).
74. *Id.*, at 993.