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# The Rise and Fall (Hopefully) of the Disparate Impact Theory of Fair Lending Liability

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# What is the “Disparate Impact” Theory?

- ▶ Also known as the “Effects Test”
- ▶ Almost all fair lending cases until the past 12 months have been brought as intentional discrimination or “disparate treatment” cases
- ▶ In the past year, numerous cases have been brought under the “disparate impact” theory

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# Historical Use of Disparate Impact Theory in Lending

- ▶ DOJ considered using the disparate impact theory in lending cases but ultimately did not do so.
- ▶ Many DOJ cases could be viewed as disparate impact cases but were brought as disparate treatment cases.
- ▶ Until recently, private plaintiffs generally have not brought discrimination claims under a disparate impact theory.
- ▶ Plaintiff's counsel did not want to make the substantial investment in economic and statistical analysis that is necessary to state a disparate impact claim.

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# What Changed?

- ▶ The HMDA pricing data was added and was made publicly available.
- ▶ Industry warned the Fed that the release of the new pricing data would bring a flood of baseless discrimination lawsuits.
- ▶ Industry was right.

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# Regulatory Guidance Regarding “Disparate Impact” in Lending

Brief filed by the U.S. Solicitor General before the Supreme Court

- ▶ The FHA does not permit, and was not intended to permit, disparate impact claims.

Interagency Policy Statement on Discrimination in Lending

- ▶ Interagency disagreement – principally between political and non-political agencies
- ▶ “The courts have recognized...”

Footnote in Regulation B

- ▶ “The legislative history of the Act indicates...”

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# Disparate Impact Claims Based on HMDA Data and Nationwide “Studies”

- ▶ Claims based not on the particular actions of any given lender, but on alleged nationwide pattern in industry that disparately impacts minority borrowers.
- ▶ Example: NAACP case.

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# Disparate Impact Claims Based on Particular Lending Practices

Example: row house/minimum property value litigation.

- ▶ NCRC has filed fair lending claims against multiple lenders for not making loans secured by row houses (among other types of property) or by properties appraised below a certain value.
- ▶ Some lenders forced to settle in order to gain regulatory approvals.
- ▶ Still at least two outstanding cases.

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# Disparate Impact Claims Based on Particular Lending Practices

Example: not lending in particular jurisdictions.

- ▶ Fair lending claims for not making or purchasing loans secured by properties located in Puerto Rico.
- ▶ Fair lending claims for not making or purchasing loans secured by properties located on Indian reservations.

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# Disparate Impact Claims Based on Particular Lending Practices

Example: discretionary pricing.

Claims based on allegations that racially-neutral discretionary pricing policies disparately impact minority borrowers.

- ▶ Alleged broker “mark-ups.”
- ▶ Does not address Reg. B “multiple creditor” rule.
- ▶ Assertion (without citation) that the lender has a “non-delegable duty” to ensure fair pricing by broker.
- ▶ Loan officer discretion in setting rates and fees.

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## Disparate Impact Under the FHA and ECOA

- ▶ The Supreme Court has not addressed directly.
- ▶ All federal circuits except the D.C. Circuit have endorsed disparate impact theory based on an adoption of the Title VII (employment discrimination) standard.
- ▶ Premised on understanding that *Griggs v. Duke Power* grounded disparate impact theory on broad purposes of statute.

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# Supreme Court Clarifies Disparate Impact Jurisprudence

In *Smith v. City of Jackson* (2005), the Supreme Court clarified that the disparate impact theory established in *Griggs* is grounded in the statutory text of Title VII.

- ▶ Disparate impact based on language prohibiting the limiting, segregating or classifying a person in a way that “*adversely affect[s]*” employment status because of race, color, religion, sex, or national origin.
- ▶ The Supreme Court was unanimous that the prohibition on “*discriminat[ing] against* any individual . . . *because of*” race, etc. supports disparate treatment claims but not disparate impact claims.

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# Disparate Impact: Is It Cognizable Under the FHA and ECOA?

- ▶ Neither the FHA nor ECOA contains the “effects” language the Supreme Court identified as creating the disparate impact cause of action.
- ▶ Both statutes contain only the “discriminate against . . . because of” or “discriminate against . . . on the basis of” language that the Court unanimously stated supports only disparate treatment – not disparate impact.
- ▶ No circuit court has revisited whether the FHA and ECOA permit disparate impact claims in light of *Smith v. City of Jackson*.
  - a) Dicta in D.C. Circuit opinion suggests ECOA does not.

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# Heightened Pleading Requirements After *Twombly*

- ▶ In *Bell Atlantic Corp. v. Twombly* (2007), the Supreme Court clarified the pleading standard in federal court.
  - a) Plaintiff must plead “*enough facts* to state a claim for relief that is *plausible* on its face.”
  - b) Expressly abrogated *Conley v. Gibson*’s “no set of facts” language.
- ▶ Allegations based on actions that are not lender-specific should fail under this standard.

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## Are the Borrowers Similarly Situated?

- ▶ A disparity may give rise to disparate impact liability only if the members of the protected class that are disparately impacted are similarly situated to other (generally non-minority) borrowers.
- ▶ Do the borrowers have similar indicia of creditworthiness (e.g., credit scores)?
  - a) Federal Reserve credit score report (available at <http://www.federalreserve.gov/boarddocs/RptCongress/creditscore/creditscore.pdf>)
- ▶ Did the borrowers engage in similarly aggressive shopping/negotiating efforts?

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# Legitimate Business Justification?

- ▶ Can a lender sell loans secured by properties such as row houses or that are appraised below a certain dollar value?
  - a) Would pricing necessary for profitability exceed a state's high-cost home loan threshold?
- ▶ Can a lender sell loans secured by properties in a particular jurisdiction?
- ▶ Is a lender or loan purchaser capable of making/purchasing loans in a particular jurisdiction?
  - a) For example, is the lender/purchaser capable of complying with Spanish language requirements?
- ▶ Do other aspects of the jurisdiction's laws make lending in the jurisdiction unduly risky or costly?

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# Is the Business Justification the Least Discriminatory Alternative?

- ▶ Secondary market investors will not purchase loans (e.g., row houses)?
- ▶ Laws in jurisdiction make lending and enforcing security interests difficult (e.g., Indian reservations)?
- ▶ Neutral criteria predictive of credit performance?

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