Expectations For CFPB's Fair Lending Agenda Under Biden

By **David Ogden, Karin Dryhurst and Franca Harris Gutierrez** (February 23, 2021)

It is clear just a few weeks into the Biden administration that fair lending and racial equity will return as a central focus of regulators under President Joe Biden.

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Biden issued a memorandum his first week in office directing the U.S. Department of Housing and Urban Development to reassess Trump-era fair housing rules.[1] And Acting Consumer Financial Protection Bureau Director Dave Uejio recently wrote that "fair lending enforcement is a top priority and will be emphasized accordingly."[2]

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We expect that focus will reflect a renewed interest in the promise and risk of new technologies. Patrice Ficklin, head of the CFPB's fair lending office, previously noted the need to monitor the growing market for data-driven lending.[3]

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The CFPB under President Barack Obama appointee Director Richard Cordray issued a public request for information regarding the use of alternative data and modeling in the credit process. The ROI recognized the potential for new models to provide underserved communities access to credit, while noting that models may result in discrimination.

In 2017, the bureau issued a no-action letter to Upstart Network Inc. in the interest of making credit more accessible, after it worked to assess whether its models resulted in disparities.[4]

If confirmed as CFPB director, Rohit Chopra can be expected to pick up where Cordray left off, as previewed by Uejio.

In addition, Biden's nominees for the U.S. Department of Justice suggest a focus on advancing civil rights issues, to include fair lending and access to credit. For example, Biden nominated Vanita Gupta — head of the Leadership Conference on Civil and Human Rights and former head of the Civil Rights Division — for associate attorney general.

Legal Background on Fair Lending

The principal fair lending statutes are the Equal Credit Opportunity Act,[5] which prohibits discrimination in the extension of credit, and the Fair Housing Act,[6] which specifically prohibits discrimination in housing-related lending.

Liability under these statutes may attach under one of two theories: (1) disparate treatment, which requires showing that the defendant had a discriminatory intent or motive, and (2) disparate impact, which involves facially neutral policies that have an alleged discriminatory effect.

The U.S. Supreme Court held that disparate impact claims are actionable under the FHA in its 2015 decision in Texas Department of Housing & Community Affairs v. The Inclusive Communities Project Inc.[7]

Nevertheless, members of the Trump administration questioned the viability of disparate impact claims, and the CFPB under former acting Director Mick Mulvaney said that it was reexamining disparate impact under ECOA.[8]

However, the CFPB and DOJ previously pursued several enforcement actions for disparate impact liability under Obama, and the Biden administration is likely to take the position that disparate impact liability exists under both the FHA and ECOA.

The Supreme Court embraced a three-step framework for assessing such claims:

1. The Plaintiff's Prima Facie Burden

At step one, a plaintiff "has the burden of proving that a challenged practice caused or predictably will cause a discriminatory effect."[9]

This requires a plaintiff to: identify a particular policy or practice of the defendant that is being challenged; show a sufficiently large disparity in how this policy affects a protected class of persons compared with others; and prove "robust causality" between this disparity and the defendant's challenged policy.

Since Inclusive Communities, the "robust causality" standard appears to represent a significant barrier to disparate impact claims, as lower courts have interpreted the requirement in divergent, but generally stringent, ways.

For example, in Oviedo Town Center II LLLP v. City of Oviedo, Florida, the U.S. Court of Appeals for the Eleventh Circuit explicitly interpreted the "robust causality" requirement as a "means of cabining disparate-impact liability."[10]

At least one court of appeals, however, appears to have adopted a potentially less stringent view. In a 2018 decision, Giron de Reyes v. Waples Mobile Home Park, the U.S. Court of Appeals for the Fourth Circuit noted that "statistical disparities must be sufficiently substantial that they raise [the necessary] inference of causation."

The court also concluded that the fact that a challenged policy affected minority individuals more than nonminority individuals — because minorities constituted 64.6% of the impacted population — was enough to show robust causality.[11]

Nevertheless, the question what a plaintiff must do — and what kinds of evidence a plaintiff may or must present — to demonstrate causality between an identified policy and disparities remains unsettled.

For example, Connecticut Fair Housing Center v. CoreLogic Rental Property Solutions LLC, a U.S. District Court for the District of Connecticut case from last year, considered the various types of statistical evidence that have been accepted and in what contexts.[12]

In addition, courts have not resolved whether Inclusive Communities imposed a different standard than that adopted in the Obama administration's 2013 HUD disparate impact rule. In 2020, HUD adopted a new disparate impact rule that it asserted would "better reflect" the decision in Inclusive Communities.[13]

The U.S. District Court for the District of Massachusetts stayed the effective date of the new rule in an APA challenge in Massachusetts Fair Housing Center v. HUD.[14] Lenders should expect that HUD will soon reverse course on the rule, pursuant to Biden's directive to reassess the rule.[15]

2. A Valid Business Interest

Under the second step of the Inclusive Communities analysis, a defendant may counter a prima facie showing of disparate impact with evidence that the challenged policy is "necessary to achieve a valid interest."[16] The Supreme Court analogized to the "business necessity" standard under Title VII's prohibition on employment discrimination.[17]

Because courts since Inclusive Communities have dismissed disparate impact claims at Step 1, there has been little development of the "valid interest" standard in the fair lending context.

3. Available Alternatives

At the third step, a plaintiff can prevail by proving "there is an available alternative … practice that has less disparate impact and serves the [entity's] legitimate needs."[18]

In a Title II disparate impact case, Hardie v. NCAA, the U.S. Court of Appeals for the Ninth Circuit held that a plaintiff's proposed alternative must be equally effective as the defendant's policy at serving the stated interests, taking into account "[f]actors such as the cost or other burdens" the alternative policies would impose.[19]

Fair Lending Considerations for Nontraditional Credit Models

Recent research results may undermine disparate impact claims under the Inclusive Communities framework, as well as support policy arguments that the use of such models may improve access to credit.

Research from FinRegLab, an organization led by former CFPB staff, found that cash flow data was predictive of credit risk for short-term credit across demographic groups, suggesting that the data did not create disparate statistical impacts across protected classes.[20]

Notably, the research also suggests that certain nontraditional data may assist in predicting credit risk for underserved communities and consumers with a limited traditional credit history.[21]

And evidence of the predictive power of certain data has been growing in recent years, which would tend to support a credible business justification for using such data. For example, a 2018 Federal Deposit Insurance Corp. working paper suggests that digital footprint variables, such as operating system, "are highly valuable for default prediction," perhaps even more valuable than traditional credit scores, at least for short-term loans.[22]

However, there are important caveats to these results. First, as market conditions and borrower behavior change, these models may lose the ability to predict credit risk and therefore the fair lending analysis may change.[23] Second, these studies may not be replicated across other applicant and loan populations.[24]

Third, the results may not hold for all types of data. For example, although cash flow data may not result in statistical disparities in the context studied, more research needs to be performed on the use of digital footprints and other types of data.

Finally, studies have faced data limitations without full access to lenders' data and underwriting models. A lender with complete visibility into its own underwriting processes and data may be able to perform more robust analyses.

In any event, it is clear that lenders should ensure that fair lending considerations are part of their model risk management, consistent with the potential risk, and conduct independent studies of such models and document such review before implementing them.

Additional analysis should be performed where data appear correlated with protected groups or where there are statistical disparities for protected classes. Consistent with Federal Reserve guidance, such review should occur on a periodic basis as market conditions and borrower demographics change to ensure that models continue to accurately predict credit risk.[25]

As the U.S. Department of the Treasury has noted, many models were developed in a period of declining unemployment and "strong overall credit conditions," and were therefore "untested through a complete credit cycle."[26] The continued economic fallout from the COVID-19 pandemic therefore is likely the first time models have been tested in tough economic conditions.[27]

With Uejio announcing that his top two priorities are consumer relief from the COVID-19 economy and racial equity, lenders should carefully assess whether models adequately predict credit risk and whether the models have disparate effects on protected groups.

There is also an opportunity for regulators to provide additional guidance, including through no-action letters, so that lenders can continue to expand access to credit for underserved communities while managing the potential risk.

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[1] Memorandum on Redressing Our Nation's and the Federal Government's History of Discriminatory Housing Practices and Policies (Jan. 26, 2021), https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/26/memorandum-on-redressing-our-nations-and-the-federal-governments-history-of-discriminatory-housing-practices-and-policies/.

[2] Dave Uejio, CFPB, The Bureau is Taking Much-Needed Action to Protect Consumers,

Particularly the Most Economically Vulnerable (Jan. 28, 2021), https://www.consumerfinance.gov/about-us/blog/the-bureau-is-taking-much-needed-action-to-protect-consumers-particularly-the-most-economically-vulnerable/.

[3] N.Y. Times, Banking Start-Ups Adopt New Tools for Lending (Jan. 18, 2015), https://www.nytimes.com/2015/01/19/technology/banking-start-ups-adopt-new-tools-for-lending.html.

[4] Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process, Docket No. CFPB-2017-0005 (Feb. 21, 2017); Christopher M. D'Angelo, CFPB No-Action Letter (Sept. 14, 2017), https://files.consumerfinance.gov/f/documents/201709_cfpb_upstart-no-action-letter.pdf; CFPB Announces First No-Action Letter to Upstart Network (Sept. 14, 2017), https://www.consumerfinance.gov/about-us/newsroom/cfpb-announces-first-no-action-letter-upstart-network/.

[5] 15 U.S.C. 1691 et seq.

[6] 42 U.S.C. 3601 et seq.

[7] 135 S. Ct. 2507 (2015).

[8] Consumer Financial Protection Bureau, Statement of the Bureau of Consumer Financial Protection on Enactment of S.J. Res. 57 (May 21, 2018).

[9] Inclusive Communities, 135 S. Ct. at 2514 (quoting 24 C.F.R. §100.500(c)(1) (2014)).

[10] 759 F. App'x 828, 833–34 (11th Cir. 2018). See also Inclusive Communities Proj., Inc. v. Lincoln Prop. Co. , No. 17–10943, 920 F.3d 890, 906 (5th Cir. 2019); see also City of Los Angeles v. Bank of Am. Corp ., 691 F. App'x 464, 465 (9th Cir. 2017); Binns v. City of Marietta Ga ., 704 F. App'x 797, 802 (11th Cir. 2017); Boykin v. Fenty , 650 F. App'x 42, 44 (D.C. Cir. 2016); Burbank Apartments Tenant Ass'n v. Kargman , 474 Mass. 107, 48 N.E.3d 394, 412–13 (2016).

[11] 903 F.3d 415, 421, 425, 428 (4th Cir. 2018).

[12] See, e.g., 478 F. Supp.3d 259, 292 (D. Conn. 2020) (discussing types of statistics that may be used).

[13] HUD's Implementation of the Fair Housing Act's Disparate Impact Standard, 85 Fed. Reg. 60,288 (Sept. 24, 2020) (codified at 24 C.F.R. pt. 100).

[14] Mass. Fair Hous. Ctr. v. U.S. Dep't of Hous. , No. 20-11765, _ F.3d _, 2020 WL 6390143 (D. Mass. Oct. 25, 2020).

[15] Memorandum on Redressing Our Nation's and the Federal Government's History of Discriminatory Housing Practices and Policies (Jan. 26, 2021), https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/26/memorandum-on-redressing-our-nations-and-the-federal-governments-history-of-discriminatory-housing-practices-and-policies/.

[16] Inclusive Communities, 135 S. Ct. at 2523.

[17] Id. at 2522.

[18] Inclusive Communities, 135 S. Ct. at 2518 (internal quotation marks omitted).

[19] 876 F.3d 312, 320 (9th Cir. 2017).

[20] FinRegLab, The Use of Cash-Flow Data in Underwriting Credit: Empirical Research Findings 31 (July 2019), https://finreglab.org/wp-content/uploads/2019/07/FRL_Research-Report_Final.pdf.

[21] Id. at 27.

[22] FDIC, On the Rise of the FinTechs—Credit Scoring Using Digital Footprints 3 (Sept. 2018), https://www.fdic.gov/analysis/cfr/2018/wp2018/cfr-wp2018-04.pdf.

[23] FinRegLab, The Use of Cash-Flow Data in Underwriting Credit: Empirical Research Findings 10 (July 2019), https://finreglab.org/wp-content/uploads/2019/07/FRL_Research-Report_Final.pdf.

[24] FDIC, On the Rise of the FinTechs—Credit Scoring Using Digital Footprints 2 (Sept. 2018), https://www.fdic.gov/analysis/cfr/2018/wp2018/cfr-wp2018-04.pdf. The FDIC study relied on data from an e-commerce company in Germany.

[25] Board of the Governors of the Federal Reserve System, SR 11-7: Guidance on Model Risk Management (April 4, 2011), https://www.federalreserve.gov/supervisionreg/srletters/sr1107.htm.

[26] U.S. Dep't of Treasury, Opportunities and Challenges in Online Marketplace Lending 1 (May 10, 2016), https://www.treasury.gov/connect/blog/Documents/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf.

[27] FinRegLab, The Use of Cash-Flow Data in Underwriting Credit: Empirical Research Findings 22 (July 2019), https://finreglab.org/wp-content/uploads/2019/07/FRL_Research-Report_Final.pdf.