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High Court Inclusive Communities Ruling: 1 Year Later

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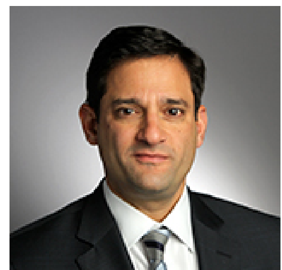

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Last summer the U.S. Supreme Court issued its much-anticipated decision in Texas Department of Housing and Community Affairs v. Inclusive Communities Project,[1] holding that disparate impact discrimination claims are cognizable under the Fair Housing Act (FHA). Disparate impact liability arises when a policy or practice that is facially neutral results in a disproportionate disadvantage to a protected class and the policy or practice cannot be justified by a legitimate, nondiscriminatory business purpose.

Because disparate impact does not require intent or evidence of overt differences in treatment, it is often employed to establish liability for a broader range of conduct than other theories of discrimination, including in matters involving credit transactions.

In this bulletin, we analyze the evolution of disparate impact doctrine since the court's Inclusive Communities decision, with a particular focus on how the decision appears to be affecting enforcement cases brought by the Consumer Financial Protection Bureau.

The Inclusive Communities Decision

In 2008, the Inclusive Communities Project, a Dallas-based nonprofit group that promotes racial integration, sued the Texas Department of Housing and Community Affairs alleging that the agency disproportionately allocated low-income housing tax credits in minority-concentrated areas. Inclusive Communities alleged that this practice was a form of disparate impact discrimination prohibited by the FHA.

The district court ruled for Inclusive Communities, holding that disparate impact claims were cognizable under the FHA. On appeal, the Fifth Circuit affirmed, adopting intervening regulations issued by the U.S. Department of Housing and Urban Development on disparate impact liability, but reversed and remanded the case for further consideration on the merits. Before the district court took up the issue on remand, the Department petitioned to the Supreme Court for review. As it reached the court, the only question was whether a disparate impact liability is available under the FHA.

In an opinion authored by Justice Anthony Kennedy and joined by Justice Stephen Breyer, Justice Elena Kagan, Justice Ruth Bader Ginsburg, and Justice Sonia Sotomayor, the court held that the statutory text of the FHA permits liability based on disparate impact. The court's decision relied on three core rationales:

- **Statutory Text and Prior Precedent:** The FHA prohibits individuals and entities from, among other things, refusing to "sell or rent ... [or] refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny, a dwelling to any person because of race."[2] Relying on its prior interpretations of language in Title VII of the Civil Rights Act[3] and the Age and Discrimination in Employment Act (ADEA)[4] — both of which prohibit

practices that constitute express disparate treatment or "otherwise adversely affect" an individual's status because of a prohibited factor — the court reasoned that the operative phrase "otherwise make unavailable" in the FHA similarly proscribes actions that result in disparate impact.

- **Congressional Intent:** The court relied upon congressional amendments to the FHA in 1988. The court concluded that Congress's action in retaining the "otherwise make unavailable" language in the FHA — at a point at which the nine federal courts of appeals to have considered the question had concluded that the FHA encompassed disparate impact claims — is strong evidence that Congress implicitly ratified the circuit courts' interpretation. In addition, the court noted that the 1988 amendments, which added safe-harbor provisions exempting certain types of impact claims, would have been "superfluous" if disparate impact liability did not exist under the FHA.

- **FHA's Purpose:** Finally, the court found that disparate impact liability is consistent with the FHA's "central purpose" of eradicating discriminatory practices in the housing sector.[5] The court explained that disparate impact claims empower plaintiffs to counteract "unconscious prejudices and disguised animus" that may hide disparate treatment, and has played an important role in uncovering discriminatory intent.[6]

In holding that disparate impact claims are cognizable under the FHA, the court emphasized several important limitations on disparate impact liability. For example, the court emphasized that at the prima facie stage, the plaintiff must allege facts or present statistical evidence that demonstrates a "robust causality" between the alleged disparity and the challenged practice.[7] Allegations of racial disparities are not enough at the pleading stage without allegations that causally connect that data with a "policy or policies *causing* that disparity."[8]

In addition, the court explained that a business justification defense remains "[a]n important and appropriate means of ensuring that disparate impact liability is properly limited."[9] Lenders, the court stated, must have "leeway to state and explain the valid interests served by their policies," and be "allowed to maintain" such policies when they are "necessary to achieve [that] valid interest."[10] Further, the court focused on the important role that carefully tailored remedies play in disparate impact cases. The court cautioned that race-conscious remedies "must be consistent with the U.S. Constitution," and must avoid, for example, "impos[ing] racial targets or quotas" that "might raise more difficult constitutional questions."[11]

The Inclusive Communities Decision: One Year Later

The court's recognition of disparate impact liability in Inclusive Communities was consistent with the position long held by federal regulators — including the CFPB. Bolstered by the decision, regulators have reaffirmed their commitment to enforcing anti-discrimination and fair lending laws like the FHA under disparate impact theories.[12] On the other hand, private litigants have successfully used the defenses outlined in the decision to defend against disparate impact claims.[13] As the impact of Inclusive Communities continues to make its way through the courts and regulatory enforcement, two ongoing developments are worth highlighting:

ECOA and Disparate Impact: In Inclusive Communities, the court relied on its interpretation of a phrase in the FHA — "otherwise make unavailable" — which the court explained bears on the consequences of an action instead of its intent. This reasoning left open the question of whether Inclusive Communities directly applies to the Equal Credit Opportunity Act (ECOA), a statute that governs all credit transactions. While both ECOA and the FHA have similar purposes — to prevent discrimination in lending — the statutes have distinct legislative histories and operative language. In particular, ECOA does not include the phrase "otherwise make unavailable or deny" or similar language. Instead, ECOA's text provides that it is "unlawful for any creditor ... to discriminate ... on the basis of race, color, religion, national origin, sex or marital status, or age ..."[14] Although no federal circuit has held that ECOA does not provide disparate impact liability, courts have recognized this distinction in the statutory language.[15]

Regulators and a number of federal district courts have taken the view that disparate impact liability is cognizable under ECOA.[16] Indeed, in April 2012 the CFPB issued a bulletin expressly "reaffirm[ing] that the legal doctrine of disparate impact remains applicable" under ECOA and Regulation B.[17] And CFPB Director Richard Cordray recently testified before Congress that Inclusive Communities supports a finding of disparate impact liability under ECOA, as the two statutes have been construed as "hand-in-glove for decades."[18] This is consistent with the view taken by many federal district courts that have either held or assumed without so ruling that disparate impact is cognizable under ECOA.[19]

Challenge to HUD's Burden-Shifting Rule and Proof of Business "Necessity": In early 2013, while the Inclusive Communities appeal was before the Fifth Circuit, HUD issued a rule recognizing disparate impact liability under the FHA. The rule also established a burden-shifting framework to determine whether a practice with discriminatory effect violates the FHA. Under the test: (1) a plaintiff has the initial burden of proving a challenged practice has or would predictably result in discriminatory effect; (2) once the plaintiff meets its prima facie case, the burden shifts to the defendant to prove that the practice is necessary to achieve a legitimate, nondiscriminatory interest; and (3) the burden then shifts back to the plaintiff, who may still prevail if it shows the defendant could serve the same interest through less discriminatory means.

In June 2013, in American Insurance Association, et al. v. HUD, two homeowner-insurance trade associations challenged HUD's rule in the U.S. District Court for the District of Columbia, arguing that HUD acted outside of its authority under the Administrative Procedure Act (APA) in issuing the rule.[20] The district court vacated the rule, and an appeal was held in abeyance while Inclusive Communities was pending before the Supreme Court. Following the Court's ruling, the associations moved the D.C. Circuit to vacate the district court's decision and remand for consideration in light of Inclusive Communities.

In April 2016, the two plaintiff associations filed an amended complaint challenging the rule on various grounds rooted in Inclusive Communities, including arguments that: (a) the rule impermissibly allows plaintiffs to make out a prima facie case solely by identifying a statistical disparity without identifying a particular practice; and (b) by requiring that defendants prove that the challenged practice is "necessary," the rule violates the Supreme Court's caution that disparate-impact liability not be used to "second-guess which of two reasonable approaches" an entity should follow or force defendants to "reorder their priorities."[21]

Given that at least one federal court of appeals has held that defendants must prove that a challenged practice was "necessary,"[22] a successful challenge in American Insurance Association could have implications not only for litigants contending with the HUD rule but also for FHA litigation more broadly.

American Insurance Association is currently being briefed. The plaintiff associations filed a motion for summary judgment on June 30, 2016, with the government's response and cross-motion due on Aug. 30.

Areas to Watch

While the CFPB and the U.S. Department of Justice have lately been the most active enforcers of fair lending laws, lenders should be aware that a number of agencies have supervisory and enforcement authority in this area:

- The CFPB has primary responsibility for supervision and enforcement of ECOA for nondepository and large depository institutions (those with $10 billion or more in assets). 12 U.S.C. §§ 5514, 5515.

- For smaller depository institutions, the prudential regulators (the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, National Credit Union Administration, and the Federal Reserve) have primary supervisory and enforcement responsibility for ECOA, with the bureau limited to a supporting role. See id. § 5516.

- The U.S. Department of Housing and Urban Development has primary enforcement authority over the FHA as to all depository institutions and nondepository lenders. 42 U.S.C. § 3612.

- The prudential regulators also have authority to bring actions against depository institutions of any size if the agency has "reasonable cause to believe that the depository institution … is about to violate, a law, rule or regulation," including the FHA, ECOA, and Regulation B. See 12 U.S.C. § 1818.

- The U.S. Department of Justice has enforcement authority over both ECOA and the FHA in certain circumstances, most critically when there is cause to believe that an entity has engaged in a pattern or practice of discrimination under either statute. See 15 U.S.C . § 1691e(g); 42 U.S.C. § 3614 .

- Finally, the FTC has authority to enforce ECOA as to entities not assigned to another government agency. See 15 U.S.C. § 1691c(c).

Areas in which there has been recent regulatory activity or that may otherwise trigger scrutiny from the CFPB (or other regulators) include the following:

Redlining: Redlining has reemerged as a central regulatory issue in the fair lending area. The CFPB and DOJ recently announced settlements with two private banks — Hudson City Savings Bank and BancorpSouth[23] — for engaging in alleged redlining. In reference to the Hudson City Savings Bank settlement, Cordray testified before Congress that the

settlement should be seen as "a shot across the bow" to the entire marketplace.

Notably, enforcement agencies use statistical disparities with peer banks as evidence of discrimination, even if allegations are not strictly characterized as involving disparate impact claims. According to officials' public statements, these disparities were ascertained by populating a map focused on certain high-population minority areas with mortgage lending information for a number of lenders. The process thus allowed the DOJ to identify areas where a particular lender had less activity as compared to its peers and to use that disparity as evidence of discrimination in its complaint.

Small Business Lending: The CFPB's recent fair lending report to Congress indicated that small business lending is a key priority for the fair lending office.[24] In addition, the CFPB has recently announced it intends to issue a rulemaking regarding the collection of loan data for women-owned, minority-owned and small business credit applicants. Once the rule is implemented and data collection commences, the collection program will provide a wealth of data upon which "disparate impact" claims under ECOA could be based. Historically, regulators and plaintiffs have been forced to rely on proxies for this data in the ECOA context, because financial institutions are prohibited from maintaining this sort of demographic information. Under the soon-to-be-issued rules, however, financial institutions will be required to inquire whether a loan applicant is woman-owned, minority-owned or a small business, and maintain a record of the response in connection with an application for business purpose credit. This information will create a trove of loan-level demographic data that can be analyzed for potential disparate impacts.

Big Data: Lenders increasingly turn to various methods to analyze "big data" — massive amounts of data that consumers generate, both off- and online — for marketing and other purposes. A major potential benefit of big data is reaching currently underserved populations, by allowing businesses to expand access to credit for borrowers with thin files or no credit at all and by allowing them to more effectively make proactive efforts to market to those populations. But the same data used to help underserved populations can be used to their disadvantage. Regulators may expect companies to take additional steps to monitor their business practices to ensure they comply with fair lending and anti-discrimination laws.

Both the CFPB and the FTC have expressed concerns about the fair lending/anti-discrimination implications of big data. The CFPB, in particular, has publicly expressed concern about the risk of disparate impact from its use. Big data allows a creditor to make lending decisions based on potentially thousands of different variables, including many that may correlate with protected group status. For example, ZIP code data, educational history, shopping habits and choice of social media platform could all be viewed in certain circumstances as a proxy for prohibited classification.

In this context, a statistically significant correlation between a customer characteristic and a business need (e.g., risk of default) may provide a legitimate business justification. But the creditor may experience difficulty showing that the data set and statistical model are both accurate and representative. Similarly, the creditor may have difficulty showing that the business need could not be achieved by less discriminatory impactful means. In light of these concerns, lenders should endeavor to regularly review their systems to ensure that they are still predictive and do not unduly impact protected groups.

Jumbo Loans and Other Affluence-Targeted Lending: Lenders are increasingly turning to high-dollar mortgage lending as a way to take on less financial risk, but recent reports suggest that this increased focus could raise disparate impact risk. In particular, a recent analysis by the Wall Street Journal found that as major banks approve more jumbo loans, they increasingly grant fewer mortgages to African Americans and Hispanics.[25] In addition, a recent report from the National Association of Real Estate Brokers, a trade group representing minority real estate agents and brokers, concluded that tightened underwriting requirements for conventional loans (due, in part, to lenders' concerns about the threat of loan buybacks from Fannie Mae and Freddie Mac) have contributed to a sharp decline in loans to African Americans that are eligible for purchase by Fannie or Freddie. At the same time, applications for higher-cost, government-backed mortgages have risen for African Americans.[26] Lenders focusing on jumbo loans and other low-risk markets, therefore, should evaluate their practices for fair lending risk.

Conclusion

Inclusive Communities provided clarity with respect to the contours of disparate impact liability under the FHA. Although the decision outlined important requirements necessary to state a disparate impact claim, the ruling also ensured that there will continue to be active regulatory scrutiny on practices that could give rise to lending disparities. Institutions should continue to monitor legal and regulatory developments to ensure compliance with fair lending laws.

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[1] 123 S. Ct. 2507 (2015).

[2] 42 U.S.C. § 3604(a) (emphasis added).

[3] Griggs v. Duke Power, 401 U.S. 424, 431 (1971).

[4] Smith v. City of Jackson, 544 U.S. 228, 236 (2005).

[5] 123 S. Ct. at 2511.

[6] Id. at 2522.

[7] Id. at 2523.

[8] Id. (emphasis added).

[9] Id. at 2512.

[10] Id. at 2523.

[11] Id. at 2523.

[12] See, e.g., Ariane de Vogue, Court upholds key tool to combat housing discrimination, CNN, (June 25, 2015) (quoting U.S. Attorney General Loretta Lynch as stating that "[b]olstered by this important ruling," the DOJ would "continue to vigorously enforce the Fair Housing Act with every tool at its disposal," including disparate impact); Sheridan, Terry, Indecision over Disparate Impact, Mortgage Banking (October 2015) (quoting CFPB Director Richard Cordray as stating that the decision would "help protect Americans from unlawful discrimination").

[13] See, e.g., Merritt v. Countrywide, No. 09-1179, 2015 WL 5542992, at *18 (N.D. Cal. Sept. 17, 2015) (dismissing pro se disparate impact claim after finding that the plaintiffs failed to "identify a specific policy that is causally linked to th[e] alleged disparity"); City of Los Angeles v. Wells Fargo, No. 13-9007, 2015 WL 4398858, at *13 (C.D. Cal. July 17, 2015) (granting summary judgment for Wells Fargo and stating the "City's claims" reflected the "exact theories of disparate-impact liability" the Supreme Court sought to prevent).

[14] 15 U.S.C. § 1691.

[15] See Garcia v. Johanns, 444 F.3d 625, 633 n.9 (D.C. Cir. 2006) (noting ECOA lacks "otherwise adversely affect language giving rise to disparate impact cause of action in Title VII").

[16] See, e.g., 12 C.F.R. Part 202, Supp. I (finding "Congressional intent" that "[t]he effects test" doctrine "appl[ies] in the credit area" to "prohibit a creditor practice that is discriminatory in effect ... even though the creditor has no intent to discriminate and the practice appears neutral on its face"); see also, e.g., Osborne v. Bank of Am., Nat'l Ass'n, 234 F. Supp. 2d 804, 811 (M.D. Tenn. 2002) (collecting cases).

[17] CFPB Bulletin 2012-04, at 1 (April 18, 2012).

[18] Hearings on “The Semi-Annual Report of the Bureau of Consumer Financial Protection” Before the H. Comm. on Financial Services, 114th Cong. (March 16, 2016).

[19] See, e.g., Garcia, 444 F.3d at 633 n.9; Golden v. City of Columbus, 404 F.3d 950, 963 (6th Cir. 2005) (assuming, without deciding, that disparate-impact claims are available under ECOA).

[20] See Complaint for Declaratory and Injunctive Relief, Am. Ins. Ass’n, et al. v. HUD, No. 13-cv-00966 (D.D.C. June 26, 2013), ECF No. 1.

[21] Inclusive Communities, 135 S. Ct. at 2512, 2522.

[22] See, e.g., Darst-Webbe Tenant Ass’n Bd. v. St. Louis Hous. Auth., 417 F.3d 898, 902-03 (8th Cir. 2005).

[23] See Press Release, Consumer Financial Protection Bureau And Department Of Justice Action Requires BancorpSouth To Pay $10.6 Million To Address Discriminatory Mortgage Lending Practices (June 29, 2016); CFPB and DOJ Order Hudson City Savings Bank to Pay $27 Million to Increase Mortgage Credit Access in Communities Illegally Redlined (Sept. 24, 2015).

[24] See Fair Lending Report of the Consumer Financial Protection Bureau 5-6, 18, 20 (April 2016).

[25] See Ensign, Overberg, & Andriotis, Banks’ Embrace of Jumbo Mortgages Means Fewer Loans for Blacks, Hispanics, Wall St. J., June 1, 2016.

[26] See Nat’l Ass’n of Real Estate Brokers, 2016 State of Housing in Black America (August 2016); see also Annamaria Andriotis, Tighter Underwriting Rules Cut Portion of Mortgages to Blacks, Report Says, Wall St. J., Aug. 15, 2016.