Supreme Court May Nix Disparate Impact in Fair Lending Enforcement

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In recent years, the Consumer Financial Protection Bureau (CFPB) and Department of Justice (DOJ) have increased fair lending enforcement under the disparate impact theory of liability. This term, however, the U.S. Supreme Court is set to rule in a case that could curtail or eliminate the use of disparate impact in the fair lending context.

In a disparate impact case, a lender can be held liable if a facially neutral policy has an adverse impact on a protected group, unless the practice serves a legitimate business need that cannot reasonably be achieved by means that have less impact.

The CFPB, DOJ and other agencies have embraced the disparate impact theory, applying it aggressively in numerous enforcement actions against banks, mortgage lenders, indirect auto finance companies and others. For example, in matters involving automobile financing, these agencies have used disparate impact in their efforts to hold finance companies liable for "markup" by automobile dealers. The CFPB and DOJ settled claims of this sort against Ally Bank in December 2013 and have since intensified their enforcement efforts.

The CFPB and DOJ have pursued disparate impact cases in other contexts as well, including coordinated enforcement actions against Synchrony Bank in June 2014 for allegedly excluding Spanish-speaking borrowers and residents of Puerto Rico from certain credit card debt settlement offers. Similarly, the DOJ and CFPB settled a matter with National City Bank in December 2013 relating to discretionary mortgage pricing by loan officers. Federal agencies have brought disparate impact actions relating to a number of other practices, including unsecured consumer loan pricing, mortgage loan underwriting, loan securitization and minimum loan amount policies.

While regulators have continued to pursue disparate impact actions, new questions have arisen as to whether the theory can withstand legal scrutiny. Many commentators have argued that the disparate impact theory of liability is not available under the two primary fair lending statutes — the Equal Credit Opportunity Act (ECOA) and Fair Housing Act (FHA) — because those statutes lack language that the Supreme Court has found supports the theory in the employment and other contexts.

In November 2014, a federal district court ruled that disparate impact is not a valid theory under the FHA, invalidating a recent rule by the U.S. Department of Housing and Urban Development. *American Ins. Ass'n v. HUD*, No. 13-00966, 2014 WL 5802283 (D.D.C. Nov. 3, 2014). In so holding, the district court relied on Supreme Court precedents that indicate that a statute permits disparate impact only when it clearly states this — for example, by prohibiting not only actions that discriminate, but those that have the "effect" of creating disparities. The District of Columbia Circuit is the only federal circuit that does not have a binding precedent recognizing the disparate impact theory under the Fair Housing Act, making the decision unique — for now.

On October 2, 2014, the Supreme Court granted *certiorari* in *Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc.*, No. 13-1371, to decide whether the disparate impact theory is valid under the FHA. In this case, a community organization challenged a state housing agency's allocation of low-income housing tax credits in the Dallas area, claiming that the allocation of more credits in predominantly minority neighborhoods than in predominantly Caucasian neighborhoods perpetuated racial segregation and constituted illegal disparate impact in violation of the FHA. Given that there is no circuit split to resolve, the Supreme Court's decision to hear the case suggests that the Court may be inclined to overrule the circuit courts and hold that disparate impact cannot be recognized under the FHA. Such a ruling would strongly support an argument that the disparate theory is likewise unavailable under ECOA. Oral argument in *Inclusive Communities* is scheduled for January 21, 2015, and a ruling is expected by the end of June.

Agencies likely will continue to use the disparate impact theory well into 2015. Should the Supreme Court, however, hold that this theory is no longer available, the agencies will lose a primary fair lending enforcement tool. They would still have available the theory of disparate treatment, however, meaning more cases potentially would be brought alleging intentional or willful discrimination.