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VIA ONLINE PORTAL AND U.S. MAIL

August 20, 2018

Office of the General Counsel
Rules Docket Clerk
Department of Housing and Urban Development
451 Seventh Street SW, Room 10276
Washington, D.C. 20410–0001

Re: Docket No. FR–6111–A–01: Reconsideration of HUD's Implementation of the Fair Housing Act's Disparate Impact Standard

To Whom It May Concern:

The Housing Policy Council[1] appreciates the opportunity to respond to the Department of Housing and Urban Development's ("HUD" or "Department") request for public comment in response to its Advance Notice of Proposed Rulemaking ("ANPR") on possible amendments to HUD's 2013 final rule implementing the Fair Housing Act's disparate impact standard, 24 C.F.R. § 100.500 (the "Rule"). HPC supports HUD's effort to determine what changes are appropriate to align the Department's Rule with the disparate impact standard of proof articulated by the Supreme Court in its 2015 landmark decision, *Texas Department of Housing and Community Affairs v. Inclusive Communities Affairs, Inc*. 135 S. Ct. 2507 (2015) (hereinafter, "*Inclusive Communities*"). We believe it is of the utmost importance to, among other things, amend the Rule to require a showing of causality and otherwise clarify the process for managing these claims, as articulated by the Supreme Court.

There are several issues with HUD's Rule in its current state. First, it fails to prescribe the robust causality requirement pronounced by the Court in *Inclusive Communities*. Additionally, it inappropriately allows plaintiffs to shift the burden of proof to the defendant upon a simple showing of a mere statistical disparity. This burden shifting scheme is in direct conflict with the Court's requirements stated in its earlier decision in *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642 (1989) (hereinafter *"Wards Cove"*) , that (1) showing mere disparity between racial groups was insufficient to raise a prima facie case of disparate impact; and (2) the plaintiff bears the burden of proof for all elements of the claim.

[1] The Housing Policy Council (HPC) represents 30 of the leading national mortgage lenders and servicers, mortgage and title insurers, data providers, and technology companies. HPC advocates for the mortgage and housing finance policy interests of its members in legislative, regulatory, and judicial forums.

Further, as discussed below, the Rule fails to address the fact that many of the policies and practices that may give rise to disparities—in particular, those related to lending—are not imposed by the specific lender, but rather, are required by federal, state, or local government agencies or instrumentalities thereof; government-sponsored enterprises (GSEs), including Fannie Mae, Freddie Mac and the Federal Home Loan Banks; public or private investors; insurers or other third-parties integral to the lending process. The Rule unfairly burdens lenders with the arduous task of defending requirements imposed by others.

Finally, the Rule allows plaintiffs to prevail on their disparate impact claims if they can show that the defendant's "substantial, legitimate, nondiscriminatory interests supporting the challenged practice could be served by another practice that has a less discriminatory effect." This provision simply goes too far: it allows plaintiffs to dictate a lender's business practices and unduly undermines the defendants' authority to exercise important business judgment. Simply stated, a plaintiff is ill-equipped to identify alternative practices that will fulfill the lender's legitimate business needs. Lenders should not be required to defer to the uninformed views of those with little industry or business experience.

We believe that the concepts proposed in this comment would help our members provide more effective lending services to disadvantaged communities and allow HUD to clarify our members' various roles and responsibilities in limiting discrimination in the housing and credit lending markets. We hope that the Department will consider our suggestions and further assist the mortgage industry in its efforts to provide consumers with fair and transparent access to homeownership.

I. Relevant Legal Background

In considering any amendments to the Rule, we urge HUD to revisit and consider the legal background in this area.

The *Wards Cove* Decision

In *Wards Cove*, the Supreme Court made clear that it was insufficient for plaintiffs to prevail in disparate impact cases by merely identifying an apparent disparity between racial groups. The Court held that *plaintiffs* in a disparate impact case had the burden of identifying a specific employer policy that lacked a "sufficient business justification" and caused the disparity they complained of.

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The Civil Rights Act of 1991

With passage of the Civil Rights Act of 1991, Congress effectively overturned the Court's decision in *Wards Cove* for the purposes of employment discrimination cases arising under Title VII of the Civil Rights Act. The Act featured the first use of a burden shifting scheme in the disparate impact context. The Civil Rights Act shifted the burden to the ***defendant*** to demonstrate a compelling business necessity. However, despite the fact that this legislative change only applied to employment discrimination cases in which the plaintiff did not seek money damages, HUD incorporated the Act's new burden shifting framework into its 2013 amendments to the Rule.

The HUD Rule (24 C.F.R. § 100.500)

In its 2013 final rule, HUD rejected the standard for governance of Fair Housing Act disparate impact claims pronounced in *Wards Cove*. Instead, the Rule adopted the standard articulated for employment discrimination cases pursuant to Title VII of the Civil Rights Act.

To date, the Department has cited no statutory or judicial authority for its decision to adapt the Civil Right Act standard to the housing context. As an executive agency, HUD had no independent authority to overrule or circumvent the Supreme Court's decision on the proper application of law without seeking recompense though the proper legislative channels. Just as an Act of Congress was required to institute the Title VII standard in the civil rights context, Congressional action was necessary to apply the same standard in the Fair Housing Act context. Even if HUD *did* have the authority to reject the Supreme Court's precedent and unilaterally promulgate a new standard, the Department elected to adopt only select portions of the Act. For example, HUD rejected Title VII's reasonable limits on the money damages which may result from a successful disparate impact claim. Title VII prohibits the recovery of compensatory and punitive damages in the Civil Rights Act, but the Rule sets no such limit on damages.

The rejection of *Wards Cove* and adoption of Title VII as the appropriate legal standard, resulted in a Rule that diverges from HUD's authority under the Fair Housing Act. The Rule states that "liability may be established under the Fair Housing Act based on a practice's discriminatory effect . . . even if the practice is not motivated by a discriminatory intent." However, the practice may still be lawful if it is supported by a "legally sufficient justification."

The Rule features a three-step standard that shifts the burden from the plaintiff to the defendant and back. First, the Rule allows a charging party or plaintiff to proceed simply upon a showing that the challenged practice "caused or predictably will cause a discriminatory effect." 24 C.F.R. § 100.500(c)(1). Accordingly, under the Rule, a plaintiff who establishes such a causal or predictable effect has established a prima

facie case of discrimination. Second, without any further evidence, the burden then shifts to the *defendant* to prove that "the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests of the respondent or defendant." *Id.* at § 100.500(c)(2). Last, once the defendant proves that the practice is necessary to fulfill a substantial, legitimate, nondiscriminatory interest, the plaintiff may still prevail by proving that the same interest could have been achieved by using another practice with a "less discriminatory effect," regardless of whether the defendant actually considered that alternate practice. *Id.* at § 100.500(c)(3).

The Rule's current burden of proof standards do not support the swift resolution of claims. In its preamble to the Rule, HUD wrote that requiring plaintiffs to show that, "prior to litigation, a respondent or defendant knew of and rejected a less discriminatory alternative" would "create an incentive not to consider possible ways to produce a less discriminatory result." We cannot find any reasonable rationale for the Department's fear of creating such a disincentive. On the contrary, we believe that the use of a similar method would increase efficiency in pleading and minimize the instance of frivolous claims and inefficient use of the judicial process.

Further in the preamble, HUD questioned whether *Wards Cove* applies to Fair Housing Act claims at all. The relevant case law firmly reflects that it does. Many Fair Housing Act disparate impact cases—including the *Inclusive Communities* decision—cite to *Wards Cove*, particularly during their analyses of causality.

The *Inclusive Communities* Decision

On June 25, 2015, the Supreme Court handed down its decision in *Inclusive Communities*, which held that disparate impact claims are cognizable under the Fair Housing Act. However, the case articulated a robust *causality* requirement that plaintiffs must meet in order to raise a proper and meritorious disparate impact claim.

To establish a prima facie case of disparate impact following the *Inclusive Communities* decision, plaintiffs must satisfy the "robust causality" requirement at the pleading stage by "produc[ing] statistical evidence demonstrating a causal connection" between a specific policy that is "artificial, arbitrary, and unnecessary" and the purportedly disparate impact. *Inclusive Communities*, 135 S. Ct. at 2521–22, 2523. Evidence of racial disparity or imbalance on its own is *not* sufficient. Additionally, if a statistical discrepancy is caused by factors *other* than the defendant's policy, a plaintiff cannot establish a prima facie case, and the defendant incurs no liability. *Id*. at 2514–15.

Citing *Wards Cove*, the court explained that the causality requirement would help protect defendants "from being held liable for racial disparities they did not create." *Id*. at 2523. The court intimated that cases should be dismissed where the purported disparate impact stems from the defendant's application of an externally-imposed

regulation or rule which "substantially limits" the defendant's discretion to act in a different way. *See id*. at 2524. The court suggested that such a limitation would, in some way, break the causal link between the defendant's policy and the disparate impact, and thus prevent plaintiffs from proving a prima facie case. *Id*.

II. HUD Should Bring Its Disparate Impact Rule into Compliance with the Court's Decision in *Inclusive Communities*

We believe that further rulemaking is warranted and necessary to ensure that HUD's Rule comports with the law, as interpreted by the Supreme Court in *Inclusive Communities*. The Rule should reflect that decision's emphasis on protecting and ensuring defendants' business discretion by incorporating the causality standard articulated in the case. Conversely, the Rule should make clear that defendants should not be penalized or held liable for engaging in practices over which they have no discretion—such as when they must adhere to regulatory, statutory, or externally-imposed guidelines or rules.

With respect to the six questions presented in the ANPR, HPC responds as follows:

Question 1: *Does the Disparate Impact Rule's burden of proof standard for each of the three steps of its burden shifting framework clearly assign burdens of production and burdens of persuasion, and are such burdens appropriately assigned?*

No, the Rule's burden of proof standards for each of the steps do not currently match up with the applicable case law.

The first prong of the Rule—which establishes the requirements to raise a prima facie case of disparate impact liability—should be amended to comport with the heightened standard articulated in *Inclusive Communities*.

Under the Rule, a plaintiff may establish a prima facie case by merely showing that the challenged practice "caused or predictably *will* cause a discriminatory effect" at some point in the future. By contrast, under *Inclusive Communities* and *Wards Cove*, a plaintiff must demonstrate the following four elements in order to establish a prima facie claim for a disparate impact violation of the Fair Housing Act:

1) Show statistically-imbalanced lending patterns which adversely impact a minority group;
2) Identify a facially-neutral policy used by defendant;
3) Allege that such policy was "artificial, arbitrary, and unnecessary;" and
4) Provide factual allegations that meet the "robust causality requirement."

The court in *Inclusive Communities* found that the imposition of a robust causality requirement is particularly important, because without such parameters at the prima facie stage, disparate impact liability "might cause race to be used and considered in a pervasive way and 'would almost inexorably lead' governmental or private entities to use 'numerical quotas,'" which would provoke "serious constitutional questions." *Inclusive Communities*, 135 S. Ct. at 2523 (quoting *Wards Cove*, 490 U.S. at 653). HUD should add the causality requirement to its Rule in order to honor the court's intentions to encourage greater equality in the lending process.

Regarding the second and third prongs of the Rule's burden shifting scheme, we believe that the burden of proof should remain, at all times, with the plaintiff, as the Court stated in *Wards Cove*. The burden should not shift to the defendant to prove its way out of a claim of discrimination. *Inclusive Communities*, 135 S. Ct. at 2518. Step two of the Rule requires the defendant to show that the "challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests of the respondent or defendant." Such a requirement denies the defendant the use of its own business judgment and discretion to determine what credit practices are consistent with the risk appetite of the company, as discussed above, and is also entirely contrary to the relevant case law. The *Inclusive Communities* court explained that before rejecting a defendant's business justification, courts must "determine that a ***plaintiff*** has shown that there is 'an available alternative . . . practice that has less disparate impact and serves the [entity's] legitimate needs.'" *Id*. (alterations in original) (quoting *Ricci v. DeStefano*, 557 U.S. 557, 578 (2009)). The Rule should be amended to reflect that mandate.

Question 2: *Are the second and third steps of the Disparate Impact Rule's burden-shifting framework sufficient to ensure that only challenged practices that are artificial, arbitrary, and unnecessary barriers result in disparate impact liability?*

No, the Rule does not sufficiently ensure that only "artificial, arbitrary, and unnecessary" barriers are the subject of litigation and liability. As explained above, the Rule permits a claim based solely on a prediction that a disparity will occur in the future. The Rule also puts the onus on defendants to prove that their business practices are "necessary" to achieve a "substantial" interest. However, such proof is not required of defendants under the Fair Housing Act or the *Inclusive Communities* decision. Defendants' actions must merely be legitimate - justifiable, reasonable, and valid - and not "artificial, arbitrary, and unnecessary." The Supreme Court made clear that entities must not be "prevented from achieving *legitimate objectives*," such as ensuring compliance with various externally-set requirements. Using the existing Rule's heightened threshold creates significant uncertainty amongst potential defendants regarding whether liability might be imposed. As the court warned, this heightened concern over potential liability would likely influence defendants to make business judgments based on racial considerations rather than on legitimate business objectives.

Moving forward, the Rule should prescribe that the plaintiff and not the defendant has the burden to prove that there is no legitimate reason for the challenged policy or practice and that the policy or practice is not valid.

Question 3: *Does the Disparate Impact Rule's definition of "discriminatory effect" in 24 C.F.R. § 100.500(a) in conjunction with the burden of proof for stating a prima facie case in 24 C.F.R. § 100.500(c) strike the proper balance in encouraging legal action for legitimate disparate impact cases while avoiding unmeritorious claims?*

No. Currently, the Rule unfairly tips the balance in favor of a plaintiff, thereby requiring the defendant to defend against claims without the requisite showing of robust causality.

As discussed at length above, the Rule should be revised to align with the precedent set in *Inclusive Communities*, including that case's requirements that a plaintiff must show the following four elements in order to establish a prima facie case of disparate impact:

1) Show statistically-imbalanced lending patterns that adversely impact a minority group;
2) Identify a facially-neutral policy used by defendant;
3) Allege that such policy was "artificial, arbitrary, and unnecessary;" and
4) Provide factual allegations that meet the "robust causality requirement."

Question 4: *Should the Disparate Impact Rule be amended to clarify the causality standard for stating a prima facie case under Inclusive Communities and other Supreme Court rulings?*

Yes, the first prong of the Rule should be amended to include a descriptive definition of "causality." The Department should update its prima facie case requirements, using the guidance and prescriptions articulated in *Inclusive Communities* as a guide. The Rule should incorporate the above-mentioned four-element standard of proof in order to establish a prima facie case for disparate impact. As mentioned above, the imposition of a robust causality requirement is particularly important, because without such parameters at the prima facie stage, disparate impact liability might influence defendants to use racial considerations to institute numerical quotas. *See Inclusive Communities*, 135 S. Ct. at 2523 (quoting *Wards Cove*, 490 U.S. at 653). Such drastic measures would surely pose "serious constitutional questions." *Id*.

It should make clear—as *Inclusive Communities* did—that causality is required for plaintiffs to move forward with and prevail in disparate impact proceedings, and that the "prompt resolution of these cases is important." *Inclusive Communities*, 135 S. Ct. at 2523.

Question 5: *Should the Disparate Impact Rule provide defenses or safe harbors to claims of disparate impact liability (such as, for example, when another federal statute substantially limits a defendant's discretion or another federal statute requires adherence to state statutes)?*

Yes, the Rule should provide a clear defense or safe harbor against claims of disparate impact where the defendant is merely following lending, eligibility, and/or pricing requirements established by a variety of third-party entities such as federal, state, or local government agencies or instrumentalities thereof; Government Sponsored Entities, including Fannie Mae, Freddie Mac and the Federal Home Loan Banks; public or private investors, insurers, or other third-parties integral to the lending process. There are several obvious examples:

- **MDCS Requirements**: The Federal Housing Administration imposes a minimum requirement of a Minimum Decision Credit Score (MDCS) of 500 and a maximum limit of 90% loan-to-value ratio for borrowers with an MDCS between 500 and 579. There is little doubt that a statistical case could be made that such limitations have a disparate impact against protected classes. As every FHA lender *must* comply with these standards in order to make FHA loans, a lender should not bear the burden of defending these criteria or these claims.

- **Safety and Soundness Requirements**: The imposition of safety and soundness requirements can also create tension and cause a disparate impact to occur. For instance, a lender may increase its MDCS due to a competing regulatory requirement in order to comply with safety and soundness standards regarding the lender's operations and controls. A lender should not have to defend against a claim for disparate impact liability simply for complying with these external standards.

- **Ability-to-Repay/Qualified Mortgage (ATR/QM) Requirements**: A statistical case could be made that the 43% limit on debt-to-income has a disparate impact on certain borrowers. When pressed, the BCFP ("Bureau"), along with the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of the Comptroller of the Currency, simply stated that these agencies do not "anticipate" that a creditor's decision to offer only Qualified Mortgages would elevate the creditor's fair lending risks, "absent other factors." *See* Interagency Statement on Fair Lending Compliance and the Ability-to-Repay and Qualified Mortgage Standards Rule, link. This is hardly sufficient to defend against such claims even though they arise from decisions made by government or quasi-governmental agencies. These governmental agencies are driving lenders to adhere to such

standards yet still failing to insulate them from injurious and costly disparate impact claims when the standards established by the agencies—and *not* the lenders—are simply followed by the lenders.

- **NCRC Litigation**: In 2010, the National Community Reinvestment Coalition (NCRC) filed 22 fair housing complaints with HUD against lenders for imposing minimum FICO scores on FHA loans. See link. While the NCRC ultimately dropped the HUD Complaints several years later, the lenders were forced to endure reputational harm and the considerable expense of the discovery stage of litigation. The lenders imposed the FICO limitation as a result of their investors' guidelines. Making loans to borrowers with lower FICO scores would have rendered the loans unsalable on the secondary market. The salability of loans is a vital component which is necessary for a lender to achieve its substantial, legitimate, nondiscriminatory interests: salability is *particularly* important for non-depository lenders who have no ability to portfolio loans.

- **State or Local Housing Programs:** State housing programs—particularly those involving mortgage revenue bond programs—typically contain a panoply of demographic, geographic, and credit-related lending restrictions that are imposed on the participating lender. HUD's Rule should protect lenders from lawsuits that are based on the lenders' application of eligibility requirements that are imposed by state housing programs and may cause a disparate impact to occur.

- **Various Federally-Imposed Supervisory Requirements**: Lenders' adherence to federally-imposed standards that may originate from a regulatory or supervisory point of view may also inspire disparate impact suits. For instance, the differences between the OCC's safety and soundness standards prescribed for prime loans versus those in place for "non-traditional" loans—i.e., required DTI levels, collateral allocation amounts, etc.—may arguably disparately impact certain demographic groups.

- **Loan Level Pricing Adjustments (LLPAs) and Similar Pricing Requirements**: Fannie Mae, Freddie Mac, and other secondary market participants impose mandatory pricing adjustments on loans with certain criteria or factors and may cause a disparate impact to occur. Here, again, lenders have no discretion as to whether to impose these pricing requirements; failing to include them would render the loans unsalable. Accordingly, lenders should not be placed in the position of having to defend these externally-imposed requirements.

Establishing a safe harbor would allow businesses to follow these and other government policies without fear of undue litigation and reputational harm.

While we believe that the creation of a safe harbor or affirmative defense is absolutely warranted in the above-described circumstances, HUD should also include in the Rule very explicit provisions stating that adherence to externally-imposed standards and requirements such as those discussed above are, by definition, ***not*** "artificial, arbitrary, or unnecessary" for the purposes of satisfying the third element of a prima facie case of disparate impact, as outlined in the responses to Questions 1 and 4 above.

Question 6: *Are there revisions to the Disparate Impact Rule that could add to the clarity, reduce uncertainty, decrease regulatory burden, or otherwise assist the regulated entities and other members of the public in determining what is lawful?*

Yes, there are several revisions to the Rule that could provide clarity and assist those in the marketplace with deciphering the law in this area. Fundamentally, guidance from HUD with respect to the Agency's interpretation of its own Rule is usually critical to those being regulated.

That being said, we believe that the following clarification would be most helpful to the lending industry:

- Ongoing written guidance on the application of the rule to particular circumstances including a means for regulated entities to request and receive guidance;

- Publication of any disparate impact analysis conducted by HUD;

- Prompt investigation of fair lending complaints. Under 24 C.F.R. § 6.11(a)(8), investigations must be resolved within 180 calendar days of the receipt of the complete complaint. That rarely happens, nor is the defendant/respondent provided any notice of the lapse of the deadline or any indication of when HUD will complete its investigation; and

- Greater clarity about the definition of "disparate treatment" and firmer lines drawn regarding the difference between disparate treatment and disparate impact claims. In *Inclusive Communities*, the court failed to directly address and/or differentiate between "disparate impact" and "disparate treatment." While the opinion's well-defined disparate impact standard is valuable, it will stand in contrast to a less- defined disparate treatment standard and could cause significant "claim-shopping" issues. Plaintiffs who wish to avoid proving *Inclusive*

Communities' "rigorous causality" standard in a disparate impact case may attempt to file claims for "disparate treatment" instead. In the interest of providing greater clarity for all parties and limiting frivolous and inefficient use of the judicial process, it would be useful for HUD to clarify the line between disparate treatment and disparate impact.

III. Conclusion

We believe that the recommendations articulated above for changes to the HUD rule will ensure justice for both claimants and defendants in the consideration of disparate impact claims under the Fair Housing Act. Consideration of these claims should winnow out arbitrary and unreasonable restrictions that harm protected classes without resulting in undue harm, costs, or perverse outcomes in the lending process such as quotas.

Thank you for seeking comments on this vitally important matter. If you have any questions or would like to follow up with us to discuss our comments, please contact me or Meg Burns, Senior Vice President for Mortgage Policy, at 202-589-1926.

Yours truly,

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