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SUPREME COURT UPHOLDS USE OF "DISPARATE-IMPACT" DISCRIMINATION TEST UNDER THE FAIR HOUSING ACT

Midst the general press frenzy over last week's Supreme Court opinions, a case of paramount interest to financial institutions was largely ignored by the print and online media. In *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.,* No. 13-1371, 576 U.S.___(2015), a five-four majority held that disparate-impact discrimination claims may be brought under the Fair Housing Act ("FHA"). *Disparate–impact theory holds that statistical analysis may be used to show that policies neutral on their face in fact result in discrimination on a prohibited basis, usually race or ethnicity.* Inclusive Communities sued the Texas Department of Housing and Community Affairs for disparate impact discrimination because the agency disproportionally approved low-income housing tax credits for developments in predominately minority neighborhoods. Fair housing activists had argued for a number of years that tax credit allocations were being used to perpetuate racially discriminatory housing patterns in major metropolitan areas (*See*, "Affordable Housing, Racial Isolation," *The New York Times*, June 29, 2015, A18).

Majority Opinion Uses Disparate-Impact Employment Cases as Precedent.

Writing for the majority, Justice Kennedy pointed out that the Supreme Court had previously held that disparate impact claims could be brought under two statutes contemporary with the FHA: Section 703(a)(2) of Title VII of the Civil Rights Act of 1964 and Section 4(a)(2) of the Age Discrimination in Employment Act of 1967 ("ADEA"). In *Griggs v. Duke Power Co.,* 401 U.S. 424 (1971), the Court held that Section 703(a)(2) prohibited not only overt discrimination but by the phrase "otherwise adversely affect " proscribed disparate impact discrimination as well. In *Smith v. City of Jackson,* 544 U.S. 228 (2005), the Court drew a similar conclusion from the "otherwise adversely affect" phrasing in the ADEA proscriptions. In Justice Kennedy's words, "Together, *Griggs* holds and the plurality in *Smith* instructs that antidiscrimination laws must be construed to encompass disparate-impact claims when their text refers to the consequences of actions and not just to the mindset of actors, and where that interpretation is consistent with statutory purpose." Justice Kennedy concludes that same "otherwise" language in the FHA looks to consequences of discrimination, in other words, disparate impact. Finally, Justice Kennedy points out that when Congress amended the FHA in 1988, it was aware that all nine federal Courts of Appeal that had addressed the question had concluded that the FHA permitted disparate-impact claims. Thus, when the 1988 Amendments provided three exemptions from liability: (i) real estate appraisals that used factors other than those prohibited by the FHA; (ii) conviction of a drug related offense; and (iii) the limitation of the number of occupants of a dwelling, Congress assumed the existence of disparate impact liability.

Presumption of Disparate-Impact Discrimination May Be Rebutted by Showing of Valid Business Purpose with No Available Alternatives.

Justice Kennedy is careful to point out that the two employment cases, *Griggs* and *Smith*, also held that disparate impact liability must not be permitted to preclude practical business choices unless the plaintiff can demonstrate that an identified policy of the defendant caused the disparate impact and there is an available alternative that would achieve the same results. Similarly, where disparate-impact claims are brought under the FHA, the defendant must be permitted to show that the criticized policy is consistent with a valid business purpose or necessary to achieve a valid governmental interest. Even where disparate impact is found, remedial orders should concentrate on eliminating the offending practice.

The Court remanded the case for further consideration.

Despite Criticism by Banking Trade Associations, the Federal Financial Regulators Have Employed Disparate-Impact Analysis in Fair Lending Compliance Examinations.

So, how does the Supreme Court's recognition of disparate impact discrimination under the Fair Housing Act affect financial institutions?

The federal financial regulators take the position that disparate-impact may be found under both the Fair Housing Act and the Equal Credit Opportunity Act (15 U.S.C. 1691 *et seq.*) Indeed, the Interagency Fair Lending Examination Procedures of August 2009 instruct examiners to look for disparate impact on a prohibited basis. Five conditions must be met before a disparate impact finding may be made. (1) There must be a specific policy or criterion so clear that a corrective action may be determined. (2) The policy or criterion on its stated terms is neutral for prohibited bases. (3) The policy or criterion falls disproportionately on applicants or borrowers in a prohibited basis group. (4) There is a causal relationship between the policy or criterion and the adverse result. (5) Either (a) the policy or criterion has no clear rationale, or appears to exist merely for convenience or to avoid minimal expense, or is far removed from common sense or standard industry underwriting considerations or lending practices; OR (b) Even if there is sound justification for the policy, it appears that there may be an equally effective alternative for accomplishing the same objective with a smaller disproportionate adverse impact.

Regulatory Referrals to the Department of Justice Have Resulted in Substantial Settlements.

Since 2009, when its Fair Lending Unit was established, the Department of Justice ("DOJ") has vigorously pursued referrals from the federal financial regulators and obtained settlements in the millions of dollars from some of the nation's largest lenders, for example, a settlement by SunTrust Mortgage for $21 million and by Countrywide in the amount of $355 million following referrals by the Federal Reserve and a settlement by Wells Fargo Bank, N. A. in the amount of $175 million following a fair lending investigation by the OCC. As Thomas E. Perez, Assistant Attorney General for the Civil Rights Division, pointed out in the May 31, 2012 DOJ SunTrust Press Release, in the "approximately 30 months since the Unit was established, the Division has filed or resolved 18 lending matters," compared to an average of two cases per year between 1993 and 2008. While only a few of the thirty cases involved disparate impact discrimination, fair lending compliance remains a serious concern for financial institutions.

The Consumer Financial Protection Bureau Has Adopted and Expanded Disparate-Impact.

In an April 18, 2012 press release issued not long after the agency's establishment, the Consumer Financial Protection Bureau ("CFPB") announced that it would use "all available legal avenues, including disparate impact, to pursue lenders whose practices discriminate against consumers." As CFPB Director, Richard Cordray, stated, "We cannot afford to tolerate practices, intentional or not, that unlawfully price out or cut off segments of the population from the credit markets" for auto loans, credit cards, student loans, mortgages or other consumer credit products. Simultaneously with the Press Release, the CFPB issued CFPB Bulletin 2012-04 (Fair Lending) to provide guidance for compliance with the fair lending requirements of the ECOA and other consumer protection statutes. The text of the Bulletin specifically states that consistent with the policies of other federal supervisory and law enforcement agencies, the "CFPB affirms that the legal doctrine of disparate impact remains applicable as the Bureau exercises its supervision and enforcement authority to enforce compliance with the ECOA and Regulation B."

Speaking at the National Community Reinvestment Act Coalition on the same day, Director Cordray pointed out that "the consequences of 'disparate impact' discrimination are very real and they affect consumers just as significantly as other forms of discrimination." He emphasized that the doctrine of disparate impact "is applicable for all of the credit markets we touch, including mortgages, student loans, credit cards and auto loans."

Financial Institutions Must Consider Disparate-Impact When Formulating Business Policies.

Notwithstanding vigorous criticism of the disparate impact theory by Justice Alito in Dissent ((“The business-necessity defense is complicated enough in employment cases; what it means when plopped into the housing context is anybody’s guess,” 576 U.S._____(2015), 31)), given the adoption of the disparate-impact theory by all the federal financial regulators, financial institutions must consider the fair lending implications of their loan underwriting, servicing and product placement criteria and be able to defend their policies as justified by “compelling” business necessity with no reasonably effective alternatives. At the very least, financial institutions should be leery of loan policies that allow individual loan officers the discretion to deviate from standard pricing criteria.

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