

A Revived Disparate Impact Doctrine Under Biden's CFPB

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The Consumer Financial Protection Bureau is expected to undergo significant changes under President Joe Biden. We anticipate that, among those changes, the CFPB will scrutinize lending practices that result in racial disparities, and will revive the "disparate impact" doctrine to pursue such practices as violations of the Equal Credit Opportunity Act.

Under former President Barack Obama, the CFPB applied the doctrine aggressively, including where disparate racial impact was unintentional. The CFPB did not assert the doctrine under former President Donald Trump, but we expect that Biden's CFPB will revive it as a key piece of its ECOA enforcement agenda.

The doctrine — whose applicability under the ECOA we expect will be challenged in court — can potentially be used to render facially neutral lending practices that have a disparate impact on protected classes a violation of the ECOA. Accordingly, lenders and creditors should carefully review their programs and products to assess whether availability, terms and/or conditions are consistently and evenly applied across demographic groups.

Companies in the auto lending, student lending and mortgage industries should anticipate enhanced scrutiny, and the CFPB may specifically investigate whether lenders' use of educational attainment data disproportionately affects minorities.

Overview of the ECOA and Regulation B

The ECOA prohibits lender discrimination against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age or receipt of public assistance income.[1] The CFPB has promulgated Regulation B to "provide the substantive and procedural framework for fair lending." [2]

Pursuant to Section 6(a) of Regulation B, a lender evaluating an applicant's creditworthiness cannot consider any information that is "used to discriminate against an applicant on a prohibited basis." [3] Section 6(a) explicitly references legislative history "indicat[ing] that the Congress intended an 'effects test' concept



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... to be applicable to a creditor's determination of creditworthiness." [4]

According to the CFPB's official interpretation of Section 6(a), under that effects test, a creditor can be liable for a practice or policy "that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis, even though the creditor has no intent to discriminate and the practice appears neutral on its face." [5]

Such policies and practices may constitute ECOA violations absent "a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact." [6]

Under Obama, the CFPB repeatedly asserted that the ECOA allowed for liability premised on unintentional disparate impact. In 2012, the CFPB issued a bulletin "reaffirm[ing] that the legal doctrine of disparate impact remains applicable as the Bureau exercises its supervision and enforcement authority to enforce compliance with ECOA and Regulation B." [7]

In support of its commitment to the doctrine, Bulletin 2012-04 cited a 1994 policy statement by the Interagency Task Force on Fair Lending recognizing evidence of disparate impact — also known as the effects test — as a method of proving lending discrimination. [8] The following year, CFPB Bulletin 2013-02 affirmed the doctrine and applied it to the indirect automobile lending market. [9]

During the Obama administration, the CFPB brought at least six ECOA enforcement actions premised on disparate impact. In December 2012, the CFPB and the U.S. Department of Justice entered into a memo of understanding providing for coordination between the agencies on fair lending enforcement efforts for ECOA violations. [10]

Over the next four years, the CFPB and DOJ brought a series of joint enforcement actions against indirect automobile lenders for permitting dealers to impose a discretionary markup of the lender's interest rate, regardless of consumers' creditworthiness, resulting in minority buyers receiving less favorable interest rates. [11]

The CFPB and DOJ also applied the doctrine against companies that provided mortgage brokers the discretion to charge higher mortgage fees regardless of the applicants' creditworthiness or the terms of the loan. [12]

During the Trump administration, the CFPB brought no disparate impact enforcement actions. It rescinded Bulletin 2013-02, [13] and questioned the doctrine's validity by reexamining the requirements of the ECOA in light of a 2015 U.S. Supreme Court ruling, *Texas Department of Housing v. Inclusive Communities Project Inc.*, applying the doctrine under provisions of a different statute, the Fair Housing Act. [14]

In addition, a congressional resolution disapproving Bulletin 2013-02 purported to prevent the CFPB "from ever reissuing a substantially similar rule unless specifically authorized to do so by law." [15]

Expectations for the Doctrine

Biden's campaign statements suggest the CFPB will seek to revive the doctrine and make it a central piece of its efforts to address racial economic inequality. Biden has made clear that he favors application of the doctrine in the ECOA and Regulation B contexts to hold creditors accountable for facially neutral policies that disparately impact racial minorities — returning to the CFPB's approach during the Obama

administration.[16]

In addition, Vice President Kamala Harris and Sen. Elizabeth Warren, D-Mass., have urged the CFPB to apply the doctrine under the ECOA and Regulation B. In July 2020, they co-authored a letter to then-CFPB Director Kathy Kraninger urging the CFPB "to address potential violations of [the ECOA] and Regulation B due to lenders' use of educational data to make credit decisions," which "can result in unfair discrimination against minority borrowers." [17]

The letter expressed concern that one of the lenders failed to assess whether its underwriting practices have a disparate impact on minority applicants.[18]

As the CFPB revives the doctrine, it will need to grapple with legal challenges to its validity following the Supreme Court's ruling in *Texas Department of Housing v. Inclusive Communities*. *Inclusive Communities* upheld the doctrine as applied to provisions of the Fair Housing Act. But, critics have asserted that the court's rationale for upholding it under the Fair Housing Act undermines its application under the ECOA.[19]

Critics have asserted the doctrine should not be applied under the ECOA because, unlike the Fair Housing Act, the ECOA lacks language authorizing impact-based violations absent intent.[20] In response, proponents have argued that the ECOA's statutory language and legislative history support application of the doctrine under the ECOA.[21]

In addition, *Inclusive Communities* requires claimants to prove causation, and allows respondents to defend disparate impact claims by presenting a legitimate policy rationale.[22] In the wake of *Inclusive Communities*, the U.S. Department of Housing and Urban Development sought comment on,[23] and ultimately issued, more restrictive rules for analyzing disparate impact claims.[24]

A responsive comment letter drafted by a group of 17 Democratic attorneys general asserts that preexisting HUD rules, adopted in 2013, already squared with *Inclusive Communities*, [25] via a three-step burden-shifting process:

1. A claimant must show that defendant's policy or practice results, or will predictably result, in a disparate impact to a protected class.
2. The defendant can show that the questioned policy or practice is necessary to achieve one or more substantial nondiscriminatory goals.
3. If the defendant provides a legitimate goal, the claimant must show that the goal can be accomplished through an alternative approach with lesser disparate impact.[26]

Federal courts have interpreted this framework as consistent with *Inclusive Communities*, and the CFPB could adopt its use under the ECOA.[27] The Supreme Court has yet to weigh in.

Key Takeaways

Taken together, the statements by Biden, Harris and Warren signal that the CFPB will attempt to revive and rely on the doctrine, particularly as applied to practices that potentially perpetuate racial economic inequality.

We anticipate that questions concerning disparate impact will surface in inquiries from CFPB investigative staff and, once Biden's nominee for director, Rohit Chopra, is confirmed, enforcement actions should follow.

In the meantime, lenders and creditors should evaluate whether their practices, even if facially neutral, result in disparate impact. We recommend close examination of policies and practices for determining loan applicants' creditworthiness, as well as the terms and conditions on which credit is extended. In particular, we recommend that companies:

- Review for any disparate impact on members of a protected class.
- Consider whether use of borrowers' educational attainment data results in disparate impact.
- Incorporate statistical analysis of lending programs to help uncover unanticipated disparate impacts.
- Consider any risks posed by third-party providers or artificial intelligence assisting in the lending evaluation processes, and review any third-party policies or procedures undertaken on the company's behalf.

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[1] 15 U.S.C. §1691(a).

[2] U.S. Dep't of Just., Equal Credit Opportunity Act, <https://www.justice.gov/crt/equal-credit-opportunity-act-3> (last updated Jul. 22, 2020).

[3] 12 C.F.R. §1002.6(a).

[4] *Id.*

[5] Comment for 1002.6 - Rules Concerning Evaluation of Applications, Supp. I to Pt 1002 — Official Interpretations, <https://www.consumerfinance.gov/policy-compliance/rulemaking/regulations/1002/Interp-6/>.

[6] *Id.*

[7] CFPB Bulletin 2012-04 re Lending Discrimination at 1 (Apr. 18, 2012).

[8] *Id.* at 2.

[9] CFPB Bulletin 2013-02 re Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act (Mar. 21, 2013), https://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf (last accessed Nov. 12, 2020) (hereinafter "Bulletin 2013-02").

[10] See Memorandum of Understanding between the CFPB and the DOJ Regarding Fair Lending Coordination at 2 (Dec. 6, 2012), https://files.consumerfinance.gov/f/201212_cfpb_doj-fair-lending-mou.pdf.

[11] See, e.g., Press Release, CFPB, CFPB and DOJ Reach Resolution With Toyota Motor Credit To Address Loan Pricing Policies With Discriminatory Effects (Feb. 2, 2016)(hereinafter "CFPB Toyota Press Release"); Press Release, CFPB, CFPB Takes Action Against Fifth Third Bank for Auto-Lending Discrimination and Illegal Credit Card Practices (Sep. 28, 2015); Press Release, CFPB, CFPB and DOJ Reach Resolution with Honda to Address Discriminatory Auto Loan Pricing (Jul. 14, 2015); and Press Release, CFPB, CFPB and DOJ Order Ally to Pay \$80 Million to Consumers Harmed by Discriminatory Auto Loan Pricing (Dec. 20, 2013).

[12] See Press Release, CFPB, CFPB and DOJ Take Action Against Provident Funding Associates for Discriminatory Mortgage Pricing (May 28, 2015); and Press Release, CFPB, CFPB and DOJ Take Action Against National City Bank for Discriminatory Mortgage Pricing (Dec. 23, 2013).

[13] Bulletin 2013-02, *supra* note 10 (comment rescinding the bulletin and proclaiming it to have "no force or effect").

[14] See Press Release, CFPB, Statement of the Bureau of Consumer Financial Protection on Enactment of S.J. Res. 57 (May 21, 2018) (characterizing Bulletin 2013-02 as "Bureau overreach") (hereinafter "CFPB S.J. 57"). In 2020, the CFPB solicited comments on whether it should clarify "its approach to disparate impact analysis under ECOA and/or Regulation B[.]" Request for Information on the Equal Credit Opportunity Act and Regulation B, 5 FR 46600, 46601 (Aug. 3, 2020).

[15] CFPB S.J. 57, *supra* note 15.

[16] See The Biden Plan to Build Back Better by Advancing Racial Equity Across the American Economy, JOEBIDEN.COM ("[T]he Obama-Biden Administration codified a long-standing, court-supported view that lending practices that have a discriminatory impact can be challenged even if discrimination was not explicit. But now the Trump Administration is seeking to gut this disparate impact standard by significantly increasing the burden of proof for those claiming discrimination. In the Biden Administration, this change will be reversed.").

[17] See Letter from Sherrod Brown, Kamala Harris, and Elizabeth Warren, Senators, to Kathy Kraninger, CFPB Director at 1 (Jul. 30, 2020), https://www.warren.senate.gov/imo/media/doc/2020-07-30_Letter%20to%20CFPB%20re%20use%20of%20educational%20data.pdf.

[18] *Id.* In support, the Senators provided a review of lenders' use of educational data in making credit determinations. See Sherrod Brown, Kamala Harris, and Elizabeth Warren, Senators, Use of Educational Data to Make Credit Determinations (Jul. 30, 2020), <https://www.warren.senate.gov/imo/media/doc/Review%20-%20Use%20of%20Educational%20Data.pdf>.

[19] Texas Department of Housing v. Inclusive Communities, 576 U.S. 519 (2015).

[20] See, e.g., Catherine Brennan and Latif Zaman, CFPB Re-examination of Disparate Impact and ECOA, BUSINESS LAW TODAY (June 15, 2018).

[21] See Letter from Josh Stein, Att'y Gen., N.C., to Mick Mulvaney, Acting Director, CFPB (Sep. 5, 2018), available at <https://ncdoj.gov/attorney-general-josh-stein-leads-coalition-to-urg-d1/> (letter from 14 Democratic Attorneys General advocating for the application of the Doctrine).

[22] Inclusive Communities, 576 U.S. at 541-43.

[23] Reconsideration of HUD's Implementation of the FHA's Disparate Impact Standard, 83 FR 28560 (proposed Jun. 20, 2018) (to be codified at 24 C.F.R. pt 100).

[24] HUD's Implementation of the FHA's Disparate Impact Standard, 85 FR 60288 (Sept. 24, 2020).

[25] See Comment Letter from Josh Stein, Att'y Gen., N.C., to Office of Gen. Couns., HUD at 5 (Aug. 20, 2018), available at <https://www.law360.com/articles/1075430/17-ags-say-hud-shouldn-t-change-disparate-impact-rule> (citing 24 C.F.R. § 100.500(c)(1)-(3)).

[26] Implementation of the FHA's Discriminatory Effects Standard, 78 FR 11460 (Feb. 15, 2013).

[27] E.g., MHANY Mgmt., Inc. v. Cty. of Nassau, 819 F.3d 581, 618 (2d Cir. 2016) (Supreme Court "implicitly adopted HUD's approach").