NEWS

Supreme Court Upholds Disparate Impact: What are the Practical Consequences for Mortgage Lenders?

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The Supreme Court has held that disparate impact claims are valid under the federal Fair Housing Act (the "FHA"). In essence, this means that liability under the FHA can be proven by showing discriminatory effects of challenged conduct instead of by showing discriminatory intent. The Supreme Court's decision significantly affects mortgage lenders.

The first practical consequence for the industry is that disparate impact claims will be easy to plead but hard to prove. In a complaint, a plaintiff need only allege that a challenged lending practice caused, or predictably would cause, a discriminatory effect on the basis of race, color, religion, sex, disability, familial status, or national origin. 24 C.F.R. § 100.500. According to the Supreme Court: "[a] plaintiff who fails to allege facts at the pleading stage or produce statistical evidence demonstrating a causal connection cannot make out a prima facie case of disparate impact." *Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Communities Project, Inc.,* No. 13-1371, slip op. at 20 (June 25, 2015).

While the Supreme Court calls this a "robust causality requirement[,]" *id.*, for all practical purposes, it is a low bar. A plaintiff can meet this low bar at the pleadings stage by alleging, for example, that a lender's credit score cutoff caused a statistical disparity in the number of disqualified applicants. Notably missing from the Supreme Court's "robust causality requirement" is any expectation that a plaintiff allege facts showing that he or she otherwise would have qualified for the loan but for the lender's use of the challenged practice.

Once the plaintiff pleads that a challenged practice caused a discriminatory effect, the burden then shifts to the lender to show that the challenged practice is necessary to achieve one or more of its substantial, legitimate, and nondiscriminatory interests. 24 C.F.R. § 100.500. If the lender meets its burden, then the plaintiff may still prevail by proving that the substantial, legitimate, nondiscriminatory interests supporting the challenged practice could be served by another practice that has a less discriminatory effect. *Id*.

In the majority's view, this scheme leaves defendants free "to state and explain valid interests served by their policies[.]" *Texas Dep't*, slip op. at 18. *Missing from this statement, however, is the common sense recognition that even a successful defense against a disparate impact claim leaves a lender exposed to significant legal expenses and reputational harm.*

Still, a lender can and should defeat disparate impact claims early in the litigation, most likely on summary judgment, if it can clearly convey the substantial, legitimate, and nondiscriminatory reasons for

the challenged credit decision. Ideally, this would involve:

- Producing documents that clearly define the underwriting criteria for each loan product and establishing that loan officers and underwriters have ready access to these documents.
- Establishing that loan officers and underwriters rely entirely on objective credit-related factors with no individual discretion on credit decisions.
- Producing historic data on the performance of loans underwritten to its standards, coupled with testimony (through affidavit or declaration) that loans underwritten to this standard have comparatively low levels of delinquency. Here, the new ability-to-repay (ATR) rule could be a blessing in disguise if the challenged credit decision was caused by ATR compliance.
- Establishing a well-documented compliance program that includes FHA-specific training.

Evidence of this type should shift the burden back to the plaintiff, who would then be required to show that some other underwriting practice could have served the lender equally well without producing a disparate impact. The plaintiff would need an expert witness to offer this type of evidence, at which point the court would be forced to compare the lender's explanation of how it conducts business with an outside expert's opinion of how he or she thinks the lender should have conducted its business. Here, the outside expert should be at a disadvantage unless he or she has access to a significant amount of historic data showing low levels of delinquency for comparable loans underwritten without use of the offending practice.

Perhaps an even more significant risk facing mortgage lenders is the specter of an enforcement action by the Consumer Financial Protection Bureau ("CFPB"). The CFPB is empowered to enforce the entire array of federal consumer protection laws, including the FHA. Since its inception, the CFPB has proven to be an aggressive and tough regulator, and its interpretation of the substantive laws that it enforces uniformly favors consumers. The Supreme Court's ruling hands the CFPB an additional tool to enforce the FHA, which will certainly be used by CFPB to the fullest extent.

As lenders gauge potential litigation and regulatory enforcement risks, some important early lessons about FHA compliance emerge. Lenders should focus on the application of objective criteria in their lending practices, document appropriate procedures to apply such criteria, and ensure that they have robust compliance programs in place. Lenders should also develop approaches for analyzing their lending data and testing whether indicators of disparate impact exist.

At bottom, the Supreme Court's ruling significantly changes the landscape for the mortgage lending industry. The CFPB will enforce the FHA aggressively and will use disparate impact evidence to do so. Plaintiffs' attorneys, already incentivized to bring suit due to the possibility of an award of attorneys' fees under the FHA, likely will increase the number of suits filed against lenders. And lenders' FHA compliance programs now must examine the potential that otherwise neutral lending policies disparately impact protected classes. These factors send a clear, unmistakable signal that the mortgage lending industry must take a new look at FHA compliance risk.

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