The Direct Impact of Disparate Impact Claims on Banks

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Available at: http://scholarship.law.unc.edu/ncbi/vol20/iss1/11
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I. INTRODUCTION

One of the greatest challenges in the fight to eliminate discriminatory lending practices is proving that a party intended to create a racial imbalance or to discriminate against a protected class. Proving intent is especially tricky because it is mistakenly assumed that in the absence of overt discrimination a bank’s racial composition of customers would mirror that of society. Indeed, many racial imbalances in society today are created unintentionally. So, the question must be posed—is it the duty of the judiciary to police unintentional discrimination? In the summer of 2015, the U.S. Supreme Court answered this question in Texas Department of Housing and Community Affairs v. Inclusive Communities Project. The Court held that the Fair Housing Act (“FHA”) recognizes disparate impact claims and that the Texas Department of Housing’s distribution of FHA tax credits was done in a way that led to unintentional discrimination.

Even though Inclusive Communities did not directly involve lenders, its holding could significantly impact lenders in two ways. First, disparate impact claims may now be brought against lenders under an additional provision of the FHA. Second, this ruling could allow disparate impact claims to be brought in other fair lending causes of action such as those brought under the Equal Credit Opportunity Act.

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5. Id.
6. See infra Part II (arguing that disparate impact claims could be brought under 42 U.S.C. § 3605).
As a result, these expansions to discrimination claims against lenders could have a major impact on future bank litigation.8 Facially neutral lending practices that impact classes in a statistically disproportionate way could unintentionally violate the FHA.9 From the perspective of equal housing advocates, on the other hand, this ruling is a victory in fighting discrimination through the FHA because of the broadened recognition of disparate impact claims.10

Both the majority and dissent in Inclusive Communities expressed concerns that the Court’s holding could lead to abuse and ultimately undermine the FHA’s goal of eliminating discrimination and improving lending options for minority borrowers.11 In order to combat these concerns, the Court placed a number of limitations on disparate impact claims.12 These limitations are favorable to the defendant of an FHA claim, because they have tightened the requirements for a plaintiff’s prima facie case and loosened the standards for the business necessity rebuttal.13 Without this high burden of proof at the pleading stage, there could be a sizable increase in disparate impact claims against lenders, resulting in increased litigation costs.14 The threat of litigation and the accompanying expenses could force lenders to rely on racial statistics and unintentionally create quotas in hopes of avoiding litigation.15 Furthermore, the use of quotas or racial considerations in lending decisions brings about a number of constitutional questions.16

This Note will explain the importance of these limitations set

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8. See infra Part III (discussing how disparate impact claims could result into increased litigation costs for banks).
9. See Joe Adler, Supreme Court Backs ‘Disparate Impact’ Theory in Texas Case, AM. BANKER 2015 (discussing the ABA’s argument that disparate impact theory is not the correct way to achieve fairness and prevent discrimination in lending practices).
10. Id.
12. Id.
13. Id.
14. See id. (explaining that a low burden of proof at the pleading stage could lead to an increase in litigation costs); Christopher Roach, Supreme Court Takes on Housing Discrimination, JD SUPRA BUS. (Aug. 18, 2015), http://www.jdsupra.com/legalnews/supreme-court-takes-on-housing-49737/.
16. See Inclusive Cmty., 135 S. Ct. at 2523 (explaining that the use of racial consideration in lending decisions could be unconstitutional).
forth in *Inclusive Communities* and how this decision will impact banks.\(^{17}\) Part II of this Note discusses the history and evolution of disparate impact theory and how the rationale used in *Inclusive Communities* could have a major impact on lenders.\(^{18}\) Part III explains the limitations embedded in this ruling and how they may help mitigate many lenders’ concerns of unintentional FHA violations.\(^{19}\) Part IV reviews the most recent disparate impact cases and how these limitations are being applied in courts today.\(^{20}\) Lastly, Part V offers recommendations for banks to avoid potential liability from disparate impact claims under the FHA.\(^{21}\)

## II. The Fair Housing Act and the History of Disparate Impact

Lenders are most likely to unintentionally violate the FHA under 42 U.S.C. § 3605.\(^{22}\) The central purpose of this provision is to eradicate discriminatory practices in any “real estate-related transaction.”\(^{23}\) The statute states that:

> It shall be unlawful for any person or other entity whose business includes engaging in real estate-related transaction to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race, color, religion, sex, handicap, familial status, or national origin.\(^{24}\)

In *Inclusive Communities*, the Court found that the statutory language of §§ 3601–3619\(^{25}\) of the FHA required a results-oriented approach where the consequences of the action should be examined instead of the actor’s intent.\(^{26}\) This was the same conclusion found in

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17. See infra Part III & IV.
18. See infra notes 19–52 and accompanying text.
19. See infra Part III.
20. See infra Part IV.
21. See infra Part V.
22. Lenders would most likely violate this provision because of its focus on real estate related transactions. For example, when a lender provides the funding to purchase a house, he would be subject to this provision. See 42 U.S.C. § 3605 (2013).
23. Id.
24. Id.
both *Griggs v. Duke Power Co.*\(^{27}\) and *Smith v. City of Jackson*,\(^{28}\) where the Court discussed disparate impact under both Title VII of the Civil Rights Act of 1991 and the Age Discrimination in Employment Act of 1967 (“ADEA”).\(^{29}\) Both of these cases also held that when the statutory language refers to the consequences of actions and not just to the mindset of the actors, the statute should be read to encompass disparate impact claims.\(^{30}\) This precedent provided the support needed to conclude that the FHA encompasses disparate impact claims.\(^{31}\)

The standard for employment discrimination disparate impact claims was established in *Griggs*, which allowed claims for statistical disparities with very few limitations.\(^{32}\) This standard was then substantially limited in *Wards Cove Packing Co. v. Atonio*,\(^{33}\) as the Court required the plaintiff to point to a specific policy or practice that caused the discriminatory effect and allowed the defendant to raise the defense of business necessity.\(^{34}\) While Congress later expanded that standard for Title VII claims when it enacted the Civil Rights Act of 1991, the standard for claims under the ADEA has remained consistent with the standard set forth in *Wards Cove Packing Co.*\(^{35}\) The narrowest standard yet, however, was adopted in *Inclusive Communities* for FHA claims, as it requires everything needed for an ADEA claim\(^{36}\) but also tightens the requirements for a prima facie case and broadens the business necessity defense.\(^{37}\) This updated standard could help protect lenders from disparate impact claims brought under the FHA because of the difficulty

\(^{2507, 2510}\) (2015).


\(^{28}\) Smith v. City of Jackson, 544 U.S. 228 (2005).

\(^{29}\) See *Inclusive Cmtys.*, 135 S. Ct. at 2516–17 (discussing the court’s reasoning in *Griggs v. Duke Power Co.* and *Smith v. City of Jackson*).

\(^{30}\) Id. at 2518.

\(^{31}\) See id. at 2522–23 (concluding that disparate impact claims are cognizable under FHA).

\(^{32}\) Griggs, 401 U.S. at 436.


\(^{34}\) Id. at 650.


\(^{36}\) See *Wards Cove Packing Co.*, 490 U.S. at 656 (requiring the plaintiff to point to a specific policy that caused the discriminatory effect in order to meet the prima facie burden).

\(^{37}\) See Tex. Dep’t of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc., 135 S. Ct. 2507, 2522 (2015) (increasing the burden on the plaintiff in bringing a prima facie case and expanding the defendant’s ability to use the business necessity defense through additional limitations. The business necessity defense allows a defendant to defend their practice by arguing that the practice is necessary for a valid business reason).
a plaintiff is faced with in proving that a specific policy or practice caused the discriminatory impact. 38

Housing and Urban Development (“HUD”) has the responsibility of interpreting and enforcing the FHA and has the power to issue relevant FHA regulations. 39 In 2013, the Secretary of HUD issued a regulation interpreting the FHA to encompass disparate impact liability. 40 Along with formalizing the long-held recognition of disparate impact claims in this regulation, HUD also created a universal test, the “Burden Shifting Test,” 41 for determining whether a practice has an unjustified discriminatory effect. 42

The Burden Shifting Test first requires the plaintiff to make a prima facie showing of disparate impact by exhibiting a specific policy or practice that has caused a discriminatory effect. 43 This is different than proving that the defendant intended to discriminate, as it only requires the plaintiff to show that a policy resulted in a discriminatory effect. 44 If the plaintiff is able to establish a prima facie case for disparate impact, the burden then shifts to the defendant to prove that the practice or policy is necessary to achieve one or more substantial and legitimate nondiscriminatory interests. 45 If the defendant is able to meet this standard, the burden shifts back to the plaintiff to show that the interests served by the practice could be achieved by another practice with a less discriminatory effect. 46 The Burden Shifting Test places a high initial burden on the plaintiff and allows the defendant to defend its identified practice. 47 In Inclusive Communities, the Supreme Court adopted the

41. The name of the test comes from the fact that once a party meets their burden the burden then “shifts” to the other party. Id.
42. Id.
43. Id.
44. Id. at 2513.
45. Id. at 2515.
46. Id.
47. See Bankers to Obama: Stop ’Abusing’ Disparate Impact Charges, supra note 15 (discussing the importance of a high burden on disparate impact claims).
Burden Shifting Test and used it to determine if a specific practice or policy violated the FHA.\textsuperscript{48} This decision set the standard for claims arising under 42 U.S.C. §§ 3601–3619,\textsuperscript{49} but could very likely be expanded to claims under 42 U.S.C. § 3605, which deals specifically with real estate-related transactions.\textsuperscript{50} As lenders who are engaging in real estate-related transactions would be subject to § 3605 of the FHA, the standard for disparate impact claims is very important moving forward.\textsuperscript{51} \textit{Inclusive Communities} made a strong articulation of the FHA’s purpose, scope, and structure and that interpretation may be invoked in future cases involving other unresolved interpretations of the FHA.\textsuperscript{52} The Court in \textit{Inclusive Communities} argued that the wording “otherwise make unavailable” in §§ 3601–3619 requires a results-oriented approach, although these words are not found in the statutory language of § 3605.\textsuperscript{53} It follows that disparate impact claims may not be allowed under § 3605.\textsuperscript{54} As discussed in Part IV, in \textit{City of Los Angeles v. Wells Fargo & Co.},\textsuperscript{55} the Court said disparate impact claims are permitted to be heard under 42 U.S.C. § 3605.\textsuperscript{56} Thus, if disparate impact claims are allowed to be heard under 42 U.S.C. § 3605, the most likely standard would be the one established in \textit{Inclusive Communities}.

Another way this decision could have an impact on banks is if it is construed to allow disparate impact claims to be brought under other fair lending causes of actions. The Consumer Financial Protection Bureau (“CFPB”) is already doing so and has argued for some time now that disparate impact claims are cognizable under the ECOA in an effort

\textsuperscript{48} \textit{Inclusive Cmtys.}, 135 S. Ct. at 2514–15.
\textsuperscript{50} Id. at § 3605.
\textsuperscript{53} \textit{Inclusive Cmtys.}, 135 S. Ct. at 2510.
\textsuperscript{54} Since the statutory language of § 3605 does not include “otherwise make unavailable,” it does not require the results-oriented approach. Since § 3605 does not require the results-oriented approach, disparate impact claims would not be cognizable under the statute. \textit{Id.}
\textsuperscript{56} See \textit{id.} at *1.
to challenge discriminatory practices in the auto lending industry.\textsuperscript{57} \textit{Inclusive Communities} could help bolster the CFPB’s argument that disparate impact claims are cognizable under the ECOA, but the decision could also create new limits if the same standard is applied.\textsuperscript{58}

III. THE LIMITATIONS ON DISPARATE IMPACT CLAIMS

Although the U.S. Supreme Court held that disparate impact claims were cognizable under the FHA, it spent the majority of its analysis focusing on the importance of limitations and the proper way to ensure that these claims were not abused.\textsuperscript{59} It warned that if these limitations were not properly applied, disparate impact liability could undermine any benefit provided to minority low-income borrowers for fear of liability.\textsuperscript{60} In order to limit the abuse of disparate impact claims, the Court established the following limitations as guiding steps in the evaluation process: (1) claims for disparate impact should be examined with care at the pleading stage;\textsuperscript{61} (2) plaintiffs must identify a specific policy of the defendants that has caused the discriminatory effect;\textsuperscript{62} (3) policies being challenged under disparate impact theory must create an artificial, arbitrary, and unnecessary barrier to the protected class in order for it to meet the prima facie burden;\textsuperscript{63} (4) defendants must be allowed to explain the valid interests served by their practices;\textsuperscript{64} and (5) remedial orders for liability under the disparate impact theory must concentrate on the elimination of the offending practice through “race neutral” means

\textsuperscript{57} The House of Representatives passed a bill to nullify CFPB Bulletin 2013-02 dealing with the use of disparate impact against auto lenders. \textit{See} H.R. 1737, 114th Cong. § 2 (2015). The CFPB has been widely criticized for irresponsibly bringing disparate impact claims without proper support. \textit{Id}. The Senate has received the bill and it has been read twice but there has been no action yet. \textit{Id}.

\textsuperscript{58} \textit{See id.} (suggesting that since \textit{Inclusive Communities} held that disparate impact claims are cognizable under the FHA, they may also be cognizable under the ECOA but these claims are subject to a number of limitations in order to avoid abuse).

\textsuperscript{59} Hancock & Glass, \textit{supra} note 38.

\textsuperscript{60} \textit{Id}.

\textsuperscript{61} \textit{See} Tex. Dep’t of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc., 135 S. Ct. 2507, 2522 (2015) (examining with care at the pleading stage is used to tighten the requirements for a prima facie case by allowing the court to enforce a higher burden on the plaintiff).

\textsuperscript{62} \textit{Id}.

\textsuperscript{63} \textit{Id.} at 2524.

\textsuperscript{64} \textit{Id.} at 2518.
instead of punitive measures. These limitations were put in place to narrow the application of disparate impact claims in hopes of avoiding abusive claims and the creation of quotas.

A. Courts Should Examine Disparate Impact Claims with Care at the Pleading Stage In Order to Deter Excessive Litigation Costs

Assuming this decision applies to lenders through other provisions of the FHA or other fair lending causes of actions, the limitations placed on disparate impact claims may actually benefit lenders. The threat of disparate impact claims is nothing new to most lenders because the majority of courts have allowed its use and the Department of Justice (“DOJ”) and CFPB have consistently brought disparate impact claims under the FHA and ECOA. So, even though lenders took a hit with the Court’s finding that disparate impact was cognizable under the FHA, the narrow standard applied in Inclusive Communities could actually improve a banking lender’s ability to defend themselves.

Lenders will be concerned with the likely increase in litigation costs that may result from an increase in disparate impact claims. The DOJ and CFPB have already have used disparate impact theory and have been awarded hundreds of millions dollars from lenders. These increased litigation costs may push cost-conscious lenders to settle weak claims instead of risking greater losses through litigation. Further, the expenses will force lenders to make changes to their current lending

65. Id. at 2524.
66. Id. at 2523; see also Hancock & Glass, supra note 38 (showing the potential abuse that can result without the proper limitations).
67. See Bankers to Obama: Stop ′Abusing′ Disparate Impact Charges, supra note 15; Rachel Witkowski, CFPB Overestimates Potential Discrimination, AM. BANKER, Sept. 17, 2015 (discussing how for the past few years, mortgage lenders have been sued under disparate impact theory for racial bias based on no evidence but racial statistics).
practices by minimizing litigation or risk.\textsuperscript{71}

Justice Alito pointed out that \textit{Inclusive Communities} creates a standard that will inevitably force lenders to turn away more minority applicants because lenders will turn to more strict criteria in order to avoid violating the FHA.\textsuperscript{72} These increased costs might push lenders into shrinking their operation in order to reduce the risk of litigation, likely hurting the people the disparate impact claims aim to protect.\textsuperscript{73} To combat this uncertainty, lenders will most likely “either create cookie-cutter loans with rigid criteria” or completely remove certain credit products for which the financial risk of litigation outweighs the expected revenue.\textsuperscript{74} These adjustments will ultimately hurt the consumer who would no longer be able to receive traditional loans under strengthened criteria.\textsuperscript{75}

Another possible result of the increased litigation and the associated costs would be lenders unintentionally moving towards numerical quotas or considering race as a factor when making lending decisions.\textsuperscript{76} This unforeseen result would raise new constitutional issues and could make race a primary consideration, which may increase discrimination rather than mitigate it.\textsuperscript{77} These practices could potentially violate the Equal Protection Clause (“EPC”), as the Supreme Court has repeatedly said that the use of racial quotas is unconstitutional.\textsuperscript{78} Lenders would be forced to balance making profit-driven decisions and the threat of unintentionally violating either the FHA or the EPC.\textsuperscript{79} This cost/benefit analysis would create an unfair burden on lenders and

\textsuperscript{71} Adler, supra note 9.

\textsuperscript{72} See Tex. Dep’t of Hous. & Cmty. Affairs v. Inclusive Cmty. Project, Inc., 135 S. Ct. 2507, 2532 (2015) (Alito, J., dissenting) (arguing that this decision would actually hurt the very people it is attempting to protect); Mannino, supra note 70.

\textsuperscript{73} \textit{Inclusive Cmty.}, 135 S. Ct. at 2532 (Alito, J., dissenting).

\textsuperscript{74} Letter from Independent Bankers Association of Texas President and CEO Christopher L. Williston to the Department of Housing and Urban Development (Jan. 17, 2012) (on file with author) (letter expressing the comments of IBAT about the HUD proposed Regulation that was passed in 2013).

\textsuperscript{75} Id.

\textsuperscript{76} Hancock & Glass, supra note 38.

\textsuperscript{77} Inclusive Cmty., 135 S. Ct. at 2551 (Alito, J., dissenting) (arguing that the court recognizes by allowing these claims, lenders would inevitably make race a primary consideration in order to avoid potential liability and yet they still find that these claims are cognizable under the FHA).

\textsuperscript{78} Gratz v. Bollinger, 539 U.S. 244 (2003); Hancock & Glass, supra note 38.

\textsuperscript{79} Roach, supra note 14.
introduce new factors to the credit underwriting process unrelated to the borrower’s credit-worthiness or ability to pay the loan.\textsuperscript{80}

The risk of hurting minority low-income borrowers and the use of racial quotas in lending decisions can best be minimized by careful examination of a plaintiff’s prima facie case at the pleading stage.\textsuperscript{81} Disparate impact claims brought under the FHA or other fair lending causes of action should not be interpreted so broadly that findings of disparate impact liability forces racial considerations to be injected into every decision.\textsuperscript{82} The requirement of careful examination at the pleading stage empowers courts to come to a “prompt resolution to these cases”\textsuperscript{83} by dismissing frivolous claims early on in the process thereby minimizing the cost of litigation for the defendant.\textsuperscript{84} Lenders must be given the latitude and the freedom to make necessary business decisions without the threat of violating the FHA lurking around every corner.\textsuperscript{85} This careful examination makes it tougher for a plaintiff to meet the requirements for a prima facie disparate impact claim and should help lenders have weaker claims dismissed at the pleading stage.

B. Plaintiffs Have the Burden of Proving a Specific Practice Has Caused a Discriminatory Effect

Before Inclusive Communities, courts still required the plaintiff to identify a specific practice that caused the discriminatory effect to for disparate impact claims in order to help deter frivolous or abusive claims.\textsuperscript{86} This is particularly important when considering the recent concerns about the CFPB’s methods of bringing disparate impact claims based on faulty statistics.\textsuperscript{87}

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82. Allen et al., supra note 80.
83. See Inclusive Cmty., 135 S. Ct. at 2522 (stressing the importance of these claims to be resolved quickly in order to minimize the costs on the defendant).
84. Hancock & Glass, supra note 38.
86. See Wards Cove Packing Co. v. Attonio, 490 U.S. 642 (1989) (requiring a plaintiff to point to a specific policy or practice when bringing a disparate impact claim under Title VII of the Civil Rights Act).
A second major concern for lenders is the risk of being found liable for racial imbalances that they did not create.88 Racial imbalances may have many causes and lenders could be unfairly victimized if forced to accept liability for imbalances beyond their control.89 This risk is particularly worrisome because of the ease of disparate impact claims in finding an inadvertent bias in a seemingly neutral practice.90 The American Bankers Association (“ABA”) expressed the same concern in stating that “[d]own-payment requirements, debt-to-income requirements, loan-to-value requirements and other neutral, risk-based underwriting requirements can all affect various racial and ethnic groups differently.”91 Showing a racial imbalance from a facially neutral price model is not difficult because these inadvertent biases can be caused by almost anything.92

The Inclusive Communities Court addressed this concern by placing two burdens on the plaintiff.93 The first requirement is pointing to a specific policy of the defendant; the second is the burden of proving that that policy actually caused the discriminatory impact.94 Both burdens can be very tough for a plaintiff to meet because of the number of factors that go into lending decisions and the number of sources that can cause a racial imbalance.95

The requirement that a plaintiff point to a defendant’s specific policy ultimately helps to protect lenders, as a plaintiff’s pleading that merely notes a statistical disparity will be quickly dismissed.96 It is very

88. See Allen, supra note 80 (pointing out that the robust causality requirement protects defendants from being held liable for imbalances they did not create).
90. Kirchner, supra note 3.
92. See Inclusive Cmtys., 135 S. Ct. at 2530 (Justice Alito arguing that racial imbalances are everywhere in society, have existed throughout history, and can be caused by almost anything); See Kirchner, supra note 3 (analyzing the Princeton Review’s pricing for online SAT tutoring showed a racial imbalance that resulted from a neutral geographical pricing method).
94. Id.
95. Hancock & Glass, supra note 38.
96. Id.
difficult to prove the actual cause of a racial imbalance and the pleading standard should, in principal, help eliminate any liability for racial imbalances that lenders did not create.\textsuperscript{97} However, while the two burdens should assist defendants in weeding out the most unmeritorious claims, they do not completely eliminate the threat that lenders will be found liable for racial imbalances they did not create.\textsuperscript{98} 

The two requirements should also help dismiss claims that arise from inconsistent or faulty statistics, like in some of CFPB’s recent cases, because of the difficulty the causation requirement creates.\textsuperscript{99} This heightened standard should present a challenge to plaintiffs who choose to bring claims with invalid support.

C. Policy Must Create an Artificial, Arbitrary, and Unnecessary Barrier in Order to Violate the FHA

Disparate impact claims may be used as a powerful incentive to force a lender’s hand in certain business decisions and invalidate profitable and fair policies.\textsuperscript{100} Moving forward, lenders will need to state and explain why their practice or policy supports a valid interest in order to maintain a credit-based lending system.\textsuperscript{101} Overbroad application of these claims may cause lenders to make unprofitable business decisions in the hopes of avoiding liability.\textsuperscript{102} When the fear of unintentionally violating the FHA is greater than the desire to make a higher profit, the effect of disparate impact precedent may exceed its intended scope.\textsuperscript{103} Lenders will substitute profit considerations with racial considerations, which could result in completely eliminating certain high-risk lending

\textsuperscript{97} Id.

\textsuperscript{98} Mannino, supra note 70.

\textsuperscript{99} See H.R. 1737, 114th Cong. (2015) (criticizing the CFPB’s use of fault statistics when bringing disparate impact claims against the auto lending industry).

\textsuperscript{100} Allen, supra note 80.

\textsuperscript{101} Hancock & Glass, supra note 38.

\textsuperscript{102} Tex. Dep’t of Hous. & Cmty. Affairs v. Inclusive Cmtyys. Project, Inc., 135 S. Ct. 2507, 2510 (2015); See id (arguing that overbroad application of these claims could undermine the purpose of the FHA as well as the free-market system).

\textsuperscript{103} See Inclusive Cmtyys., 135 S. Ct. at 2524 (suggesting that “if the specter of disparate-impact litigation causes private developers to no longer construct or renovate housing units for low-income individuals, then the FHA would have undermined its own purpose” and that this would also be the case if the specter of disparate impact litigation caused lenders to no longer lend to low-income individuals in order to better protect themselves from liability).
practices. Some of these scrapped practices provide beneficial access to capital for low-income minority borrowers and the loss could be detrimental to the very borrowers these disparate impact claims are trying to protect.

To combat the fear of excluding low-income borrowers, the Inclusive Communities Court expanded the use of the business necessity defense so that only practices or policies that create an artificial, arbitrary, and unnecessary barrier to capital or a loan are liable under the FHA through disparate impact theory. When policies or practices discriminate against a protected class, they create barriers to fair treatment of that class when attempting to get a loan. However, certain prohibited behaviors may be necessary for continuing operations, and thus, should be encouraged as long as they are for a valid purpose. Barriers created for unnecessary or artificial reasons and are not necessary to the success of the business are the primary target of disparate impact claims. For example, a bank’s policy of allowing lower interest rates based on the borrower’s credit score should be permissible, because the interest rate coincides with the chances of repayment and is necessary for a lender to successfully run its business. On the other hand, a policy that takes into consideration where someone lives to determine an interest rate should not be allowed, because it is impermissible for determining the probability of repayment. This shows the purpose of the decision is to remove the intent barrier to thwart unintentional racial discrimination but only when the policy fails to serve a legitimate purpose or business need.

This limitation leaves intact lenders’ policies that serve legitimate business goals and will permit some leeway for making necessary business decisions. This is achieved by both lessening the requirements

104. See id. (arguing that over broad application of these claims could lead to an undermining of the free-market system and racial considerations being used in making business decisions).

105. See City of Los Angeles v. Wells Fargo & Co., No. 2:13-cv-09007-ODW(RZx), 2015 U.S. Dist. LEXIS 93451, at *33 (C.D. Cal. July 17, 2015) (criticizing plaintiffs for choosing to attack a policy that benefits low-income minority borrowers); Adler, supra note 9 (discussing ABA’s argument that these claims will inevitably result in lenders to shrink operations).


107. Hancock & Glass, supra note 38.


109. See id.
of the business necessity defense and refocusing claims on policies that have created barriers for unnecessary reasons. This added burden is a strong weapon in defending legitimate business practices or policies that lead to a statistical disparity.

D. Defendants Must Be Allowed to Explain the Legitimate Purpose a Policy or Practice Serves

One concern of lenders is that certain policies with legitimate business purposes will be criticized as creating racial barriers. While a policy may seem to create an artificial, arbitrary, and unnecessary barrier to receiving a loan or interest rate, it may actually serve a legitimate business purpose. These claims may force lenders to move to policies that consider race over objective credit risk factors or destroy legitimate business practices that were determined to have violated the FHA, even though someone or something else could have caused the racial imbalance. Courts will not have the same knowledge and understanding of the banking industry as the businesses at stake. Policies or practices that serve legitimate purposes may be found to violate the FHA because that purpose is not properly understood. Thus, these claims run the risk of punishing defendants for unintentional behavior without permitting them to defend the legitimate interest of the policy or practice.

To prevent the elimination of legitimate business practices, the Court adopted the “Burden Shifting Test,” which allows defendants to explain the purpose of a challenged practice or policy. If the defendant meets this requirement, the burden then shifts back to the plaintiff to show

110. Id. at 2522.
111. Hancock & Glass, supra note 38.
112. Inclusive Cmty., 135 S. Ct. at 2524; Adler, supra note 9.
114. See Kirchner, supra note 3 (“Because disparate impact theory is results-oriented, it would seem to be a good way to challenge algorithmic bias in court. A plaintiff would only need to demonstrate bias in the results, without having to prove that a program was conceived with bias as its goal.”).
that there is a less discriminatory way of achieving the goal than the current policy or practice.\textsuperscript{116} Using this test supports the Court’s reasoning that the FHA is only supposed to remove barriers to renting, buying, or securing financing for housing in three instances: (1) when they create a discriminatory effect, (2) when the barrier does not serve a legitimate purpose, or (3) when it serves a legitimate purpose but there is a less discriminatory way to achieve that purpose.\textsuperscript{117} This test allows lenders to defend and explain the legitimate business purpose of a policy or practice, and again, loosens the requirements for asserting the business necessity defense.

\textbf{E. Remedial Orders Must Concentrate on the Elimination of the Offending Practice through “Race Neutral” Means Instead of Punitive Measures}

Lenders should also be concerned about the expensive judicial awards for disparate impact liability.\textsuperscript{118} The Court suggests that the purpose of allowing FHA disparate impact claims is to eliminate practices that have unintentionally discriminated against a protected minority class, not to punish the actors that have unintentionally discriminated.\textsuperscript{119} As discussed above, lenders will likely face increased litigation costs after \textit{Inclusive Communities}, but punitive damages could be even more costly and burdensome.\textsuperscript{120} These judgments are particularly concerning because they would penalize banks or lenders who had no intention of discriminating, and in some cases, no knowledge of the discriminatory impact.\textsuperscript{121}

To help serve the purpose of the \textit{Inclusive Communities} ruling

\begin{footnotesize}
\textsuperscript{116} \textit{Id.}


\textsuperscript{118} See Bankers to Obama: Stop ‘Abusing’ Disparate Impact Charges, supra note 15 (pointing out the 1.2 billion dollar shakedown of the banking industry using disparate impact theory).

\textsuperscript{119} See Hancock & Glass, supra note 38 (pointing out that the Court stated that remedial orders must “concentrate on the elimination of the offending practice” and seems to suggest that cases of this type should not be subject to punitive sanctions).

\textsuperscript{120} See Hancock & Glass, supra note 38 (suggesting that the remedial orders should not include punitive sanctions. Punitive sanctions for discrimination would increase the financial risk for lenders).

\textsuperscript{121} Kirchner, supra note 3.
\end{footnotesize}
and to combat this concern, the Court said that when a defendant is found to have violated the FHA under the disparate impact theory, remedies must concentrate on eliminating the offending practice through “race neutral” means instead of punitive measures. This limitation should eliminate concerns of racial quotas and the risk of punishing defendants for unintentional discrimination. The standard should protect lenders from expensive damages awarded to punish the defendant and allow lenders to focus on appropriate remedies to the real issue—disparate impact of lending policies on protected classes.

IV. THE APPLICATION OF THE LIMITATIONS ON DISPARATE IMPACT LIABILITY

Since Inclusive Communities, a number of cases have discussed these limitations under other provisions of the FHA, but very few under other fair lending causes of actions. In City of Los Angeles v. Wells Fargo & Co., the plaintiff brought a disparate impact claim under another provision of the FHA. In dismissing the case, the U.S. District Court for the Central District of California adopted the test and held that the city failed to point to a specific policy that caused an artificial, arbitrary, or unnecessary barrier. Claims filed under ECOA and other fair lending cause of actions have not used Inclusive Communities standard as the court in Mora v. U.S. Bank N.A. seemed to follow the

122. Inclusive Cmty., 135 S. Ct. at 2524.
123. Id.
127. Id. at *14.
old standard for disparate impact claims under ECOA.\textsuperscript{130}

A. Claims Brought Under Other Provisions of the FHA

The \textit{City of Los Angeles v. Wells Fargo & Co.} case is a great example of how this decision can be applied to lenders under other provisions of the FHA. First, the court reaffirmed that to establish a prima facie case for disparate impact liability under the FHA, a plaintiff must point to a specific practice or policy that has “robustly caused”\textsuperscript{131} a disproportionately adverse impact on persons of a particular class.\textsuperscript{132} Second, the court reaffirmed the need to examine these claims with care at the pleadings stage in order to protect defendants from being punished for racial imbalances that they did not create.\textsuperscript{133} Third, the court reaffirmed that disparate impact liability should only be used to remove barriers that are artificial, arbitrary, or unnecessary.\textsuperscript{134} Finally, but most importantly, the court applied the standard set in \textit{Inclusive Communities} on a claim arguing a violation of a different provision under the FHA.\textsuperscript{135} By doing this, the court reaffirmed that this decision can impact lenders involved in real estate-related transactions.\textsuperscript{136}

In \textit{City of Los Angeles v. Wells Fargo & Co.}, the plaintiff claimed that the defendant had violated the FHA by engaging in discriminatory and predatory lending practices that resulted in a disparate number of residential home foreclosures for minority borrowers.\textsuperscript{137} The plaintiff claimed that Wells Fargo violated § 3605 of the FHA relying on disparate impact theory with two of their lending practices: issuance of high-cost

\begin{footnotesize}

\textsuperscript{130} Mora, 2015 WL 6681169, at *11–12.

\textsuperscript{131} City of Los Angeles 2015 U.S. Dist.LEXIS 93451, at *18.

\textsuperscript{132} Id. at 15.

\textsuperscript{133} Id. at 18.

\textsuperscript{134} Id. at 26.

\textsuperscript{135} Id. at 14.

\textsuperscript{136} By using \textit{Inclusive Communities} as the standard in a real estate-related transaction, the Court reaffirmed this decision can impact lenders. See id. at 12.

\textsuperscript{137} Id. at *2.
\end{footnotesize}
and USFHA loans. During the case, the court granted the Motion for Summary Judgment filed by Wells Fargo and stated that the undisputed facts demonstrated that Wells Fargo did not violate the FHA. The court looked to Inclusive Communities to determine the standard for FHA disparate impact claims and applied its precedent accordingly. In addition, the court found that high-cost loans did not violate the FHA, because the statistical disparity was not sufficiently substantial or significant.

This finding was especially important, because the court recognized the prohibition against weighing the evidence at summary judgment but said that the Supreme Court’s guidance in Inclusive Communities precluded it and that the court must examine the claim with care at the pleading stage. After examining the claim with care, the court concluded that there was not enough evidence to support it but nevertheless held that the plaintiff failed to identify a specific policy that caused the statistical disparity. With respect to the USFHA loans, the court found that once again Wells Fargo did not violate the FHA, because the plaintiff’s claim did not take into consideration the benefits of USFHA loans. The court’s holding emphasized the importance of examining these claims with care at the pleading stage and noted that the claim would have been dismissed for failing to identify a specific practice that caused the disparity.

If the Inclusive Communities standard is consistently applied to claims under the FHA, then this opinion could end up being a benefit to the lenders. Even faced with a potential increase in disparate impact claims, the requirements for a prima facie case under disparate impact is more stringent and the requirements for the defense of business necessity are easier to meet.

138. USFHA loans are United States Federal Housing Authority loans, which are described as loans with higher risk features. See id. at *4.
139. Id. at *5–6.
140. Id. at *12.
141. Id. at *24–25.
142. Id. at *25.
143. Id. at *26–27.
144. Id. at *32.
145. Id. at *25.
146. Id. at 11.
147. Id. at 12–13.
148. By placing new limitations on disparate impact claims, the Court made it more
City of Los Angeles v. Wells Fargo & Co. exemplifies the abuse that could arise from disparate impact claims. There, the judge admonished the plaintiff’s attorneys for taking an approach that would have actually hurt the very minority borrowers for whom they were advocating. This case reinforced many of the concerns noted in Inclusive Communities, particularly the Court’s statement, “[i]f the specter of disparate-impact litigation causes private developers to no longer construct or renovate housing units for low-income individuals, then the FHA would have undermined its own purpose as well as the free-market system.” The Los Angeles attorneys decided to argue that the USFHA loans violated the FHA because it was one of the only violations not barred by the statute of limitations. A success by the L.A. lawyers would have been unfortunate for minority borrowers; USFHA loans help them overcome barriers like strict credit requirements and support them in attaining the money needed for a down payment. If disparate impact theory is used to challenge policies or practices that actually discriminate in a way that helps minority borrowers, the very purpose of allowing these types of claims is destroyed.

B. Claims Brought Under Other Fair Lending Causes of Actions

To date there have been few cases using the Inclusive Communities standard to analyze other fair lending causes of action. Claims arising under the ECOA applied the same standards as claims under the FHA before Inclusive Communities and might adopt this new standard going forward. In Mora v. U.S. Bank N.A, the plaintiff

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149. Kang, supra note 128.
151. Id.
152. City of Los Angeles 2015 U.S. Dist.LEXIS 93451, at *43–44.
153. Id. at *46.
154. Kang, supra note 128.
155. See Stohr, supra note 69 (assuming that because claims arising under the FHA and ECOA before Inclusive Communities used the same standard, that ECOA claims will follow the standard set in Inclusive Communities).
claimed the defendant violated the ECOA by discriminating against them as minority status borrowers.\textsuperscript{157} Instead of using the \textit{Inclusive Communities} standard, the court looked back to the original standard used for both ECOA and FHA claims.\textsuperscript{158} The CFPB has maintained that the ECOA allows disparate impact claims and that they will continue to use it to fight discrimination.\textsuperscript{159} The recent uproar about abusive claims made by the CFPB may lead to a push for this narrower standard.\textsuperscript{160} As of now, though, it seems as if CFPB will use this ruling to support their position that disparate impact claims are cognizable under the ECOA, but there is currently a debate as to whether courts should apply the more stringent \textit{Inclusive Communities} standard set by the Supreme Court.\textsuperscript{161}

\textbf{V. THE BEST WAYS FOR BANKS TO AVOID POTENTIAL LIABILITY FROM DISPARATE IMPACT CLAIMS}

The holding in \textit{Inclusive Communities} creates a more favorable standard for the lender to establish a defense, but it also opens the door for an increased number of disparate impact claims. Given the recent fair lending cases, bankers are seemingly caught between trying to accurately price their credit products and avoid fair lending risk in providing access to credit.\textsuperscript{162} Bankers and experts at the ABA’s Regulatory Compliance Conference expressed four considerations that can help lenders navigate the murky waters of fair lending enforcement.\textsuperscript{163} The first consideration is for lenders to build a robust, data-driven fair lending compliance management system in order to help minimize potential liability.\textsuperscript{164} The second is for lenders to be aware of discretionary pricing, because it

\begin{itemize}
\item \textsuperscript{157} \textit{Id.} at *1–2.
\item \textsuperscript{158} \textit{Id.} at *2.
\item \textsuperscript{159} \textit{See} Chris Bruce, \textit{Fair Lending: Supreme Court Ruling Sets Framework For Disparate Impact Claims Under FHA}, [2015] Banking Daily (BNA) No. 123 (June 26, 2015) (discounting the statistics created by the CFPB; the court will likely tighten the requirements on claims under ECOA as well).
\item \textsuperscript{160} \textit{See} H.R. 1737, 114th Cong. (2015) (assuming that because of the abusive use of disparate impact claims arising under ECOA, the court is more likely to tighten the requirements on these type of claims as well).
\item \textsuperscript{161} The CFPB has argued that this case supports disparate impact claims being cognizable under the ECOA but also continue to argue that the old standard is applied to these type of claims. \textit{See} Mora, 2015 WL 6681169, at *1.
\item \textsuperscript{162} Evan Sparks, \textit{Four Tips for Threading the Fair Lending Needle}, 107 A.B.A. BANKING J. 49, 1 (2015).
\item \textsuperscript{163} \textit{Id.}
\item \textsuperscript{164} \textit{Id.}
\end{itemize}
establishes a presumption of discrimination. Third, lenders should monitor fair lending risks across all customer interactions, especially service, because discrimination does not always occur in the creation of loans. Fourth, lenders must accept that disparate impact claims are here to stay and track data accordingly. The last recommendation is especially important because of the increase in superficial analysis or faulty statistics. The safest option for a banking lender is to conduct their own data analysis to better defend themselves from these types of claims.

These recommendations will help better prepare banks to tackle the increasingly difficult task of avoiding fair lending discrimination. Once banking lenders accept that disparate impact claims are here to stay, they can begin to prevent and combat these claims. Moving forward, it will be important to monitor the impact Inclusive Communities has on other fair lending causes and how this new standard will impact disparate impact claims arising under different provisions of the FHA.

BALLARD J. YELTON

165. Id. at 2.
166. Id.
167. Id.
168. Id. at 3.
169. Id.
170. Id.