# Lending Industry Take Note: Federal Fair Housing Act Provides For Disparate-Impact Liability

The status quo stands, to a degree. By a 5-4 vote, the United States Supreme Court has concluded that the federal Fair Housing Act ("FHA") authorizes lawsuits not just for intentional discrimination, but for conduct taken without an intent to discriminate that nonetheless has a discriminatory effect on groups sharing certain characteristics, such as race, handicap, or gender ("disparate-impact"). As such, the Court's ruling in *Texas Department of Housing & Community Affairs v. Inclusive Communities Project, Inc.*, 2015 WL 2473449 (U.S. 2015), leaves the mortgage lending industry with a familiar compliance quandary, but not before offering some important clarifications and limitations on the scope of disparate-impact claims.

## The Fair Housing Act And Disparate-Impact Liability

The FHA makes it unlawful "for any person or other entity whose business includes engaging in residential real estate-related transactions 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." 42 U.S.C. § 3605. Residential mortgage lending falls within the purview of the FHA. *Id.* Unlike other federal civil rights statutes, the FHA prohibits intentional discrimination, but does not expressly provide for liability premised on the discriminatory "affect" of actions performed without discriminatory intent (*i.e.* disparate-impact). Lower federal appellate courts to consider the issue, nonetheless, agreed that the FHA provides for disparate-impact liability, but diverged as to how such liability could be established.

## HUD Interprets The FHA To Provide For Disparate-Impact Liability

In 2013, the U.S. Department of Housing and Urban Development ("HUD") promulgated 24 C.F.R. § 100.500 (the "HUD Rule") to resolve the disagreement and define the test that a claimant must satisfy to establish disparate-impact liability under the FHA. Under the HUD Rule, disparate-impact liability is established through a three-part test during which the burden of proof shifts from the claimant to the defendant and then back to the claimant. First, the claimant must show that the challenged practice caused or predictably will cause a discriminatory effect. *Id.* Second, if the claimant meets this burden, the defendant must then show that the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests. *Id.* Finally, if the defendant makes this showing, the claimant can still establish disparate-impact liability 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.*

## The Disparate-Impact Dilemma For The Mortgage Lending Industry

The existence of disparate-impact liability under the FHA presents mortgage lenders and those in related fields with a compliance quandary. The specter of disparate-impact liability rears its head when the outcome of a business's decisions has different demographic effects, despite the business's use of neutral standards. Lenders, for example, employ generally-accepted credit assessment standards (*e.g.* debt-to-income requirements, down-payment requirements, *etc.*) to evaluate an applicant's eligibility for a mortgage loan. Indeed, in many instances federal and state law obligates lenders to apply such factors. Use of these standards, however, can produce outcomes that can be connected with race, religion, sex, *etc.* and can impact people within those categories differently. And there is the rub. If the differences produced by neutral, legally-required underwriting protocols are statistically significant (*i.e.* not the result of coincidence), the lender risks disparate-impact exposure. Faced with such a threat, lenders may feel pressure to manage outcomes in their decision-making process and divert from neutral standards to curb potential disparate-impact liability. Doing so, however, would arguably constitute unlawful intentional discrimination under the FHA, thus leaving lenders and the like in a compliance bind.

## The Supreme Court's *Inclusive Communities* Decision

*Inclusive Communities* required the Supreme Court to resolve whether disparate-impact claims are cognizable under the FHA and had the potential to eliminate the thorny compliance issues that lenders faced as a result of the availability of such claims. That potential, however, went unrealized. By a 5-4 vote, the Court ruled that the FHA allowed for disparate-impact liability. In doing so, the Court likened the FHA's terms to other federal civil rights laws that it had previously interpreted to provide for disparate-impact. *Inclusive Communities*, 2015 WL 2473449, at *7-*10. Additionally, the Court reasoned that a long line of lower court rulings upholding disparate-impact liability under the FHA, as well Congress's decision to *not* amend the FHA to exclude such liability in the face of those rulings, supported the Court's decision. *Id.* at *10-*11. The decision affirmed an intermediate appellate court that had also held disparate-impact claims viable under the FHA and had relied on the HUD Rule to explain the process for adjudicating such claims. *Id.* at *5, *17.

## Silver Linings From *Inclusive Communities*

Although the Court did not rule against disparate-impact liability under the FHA, its decision contains some silver linings for the lending industry. First, the Court emphasized that disparate-impact liability was not meant to displace policies that served valid interests and were consistent with the necessities of the defendant's industry. *Id.* at *13-*14. "Government or private policies are not contrary to the disparate-impact requirement unless they are 'artificial, arbitrary, and unnecessary barriers.'" *Id.* at *15. Second, the Court made clear that statistics alone could not carry the claimants to victory. Instead, "a disparate-impact claim that relies on a statistical disparity must fail if the plaintiff cannot point to a defendant's policy or policies *causing* that disparity." *Id.* at *14.

Accordingly, *Inclusive Communities* may not be the cure-all to the disparate-impact related compliance issues that lenders had hoped for, but it is also hardly a disaster. As lenders apply generally accepted credit assessment standards in making their decisions, they should be able to avail themselves of the "artificial, arbitrary, and unnecessary barriers" and "causation" components of *Inclusive Communities* as defenses to disparate-impact claims. From a compliance perspective moreover, *Inclusive Communities* teaches that mortgage lenders can limit their exposure to disparate-impact claims by taking steps to ensure their lending determinations are (1) motivated by valid, non-discriminatory interests and (2) premised on factors consistent with the necessities of the industry. Post-*Inclusive Communities* therefore, it would appear that the old saying is true: a pinch of prevention is worth a pound of cure.

**Date Created**
July 15, 2015