No. 10-1032

IN THE
Supreme Court of the United States

STEVE MAGNER, *et al.*,

Petitioners,

v.

THOMAS J. GALLAGHER, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE INDEPENDENT COMMUNITY BANKERS OF AMERICA, THE CONSUMER MORTGAGE COALITION, AND THE AMERICAN FINANCIAL SERVICES ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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STATEMENT OF INTEREST OF *AMICI CURIAE*[1]

The Independent Community Bankers of America ("ICBA"), the Consumer Mortgage Coalition ("CMC"), and the American Financial Services Association ("AFSA") (collectively, "*amici*") respectfully submit this brief as *amici curiae* in support of petitioners. ICBA is a trade association that represents nearly 5000 community banks of all sizes and charter types nationwide. ICBA member community banks seek to improve cities and towns by using local dollars to help families purchase homes. ICBA member community banks are actively engaged in the business of residential mortgage lending in the communities that they serve. CMC is a trade association comprised of national residential mortgage lenders, servicers, and service providers. CMC was formed in 1995 to pursue reform of the mortgage origination process. CMC members participate in every stage of the home financing process. AFSA is a national trade association for providers of financial services to consumers, including residential mortgage loans. AFSA seeks to promote responsible, ethical lending to informed borrowers and to improve and protect consumers' access to credit.

The Fair Housing Act prohibits discrimination in "residential real estate-related transactions." *See* 42 U.S.C. § 3605. *Amici*'s members are subject to the Fair

1. No counsel for any party authored this brief in whole or in part, and no counsel for any party made a monetary contribution intended to fund the preparation or submission of this brief. No person or entity other than *amici*, their respective members, and their counsel made a monetary contribution intended to fund the preparation or submission of this brief. Letters from the parties consenting to the filing of *amicus* briefs have been filed with the Clerk of the Court.

Housing Act and related laws that prohibit discrimination in lending. *Amici* support the Fair Housing Act, and they and their members devote substantial resources to the advancement of fair lending. *Amici* oppose the disparate treatment of individuals. The threshold issue before the Court, though, is whether the Fair Housing Act goes beyond prohibiting disparate treatment and creates a cause of action for disparate impact.[2]

Lending standards, by their very nature, have differential impacts that could be correlated with factors, such as race, that are listed in the Fair Housing Act as prohibited bases of discrimination. Lenders base credit decisions on multiple standards such as an applicant's credit score, the ability to provide a down payment, and the relationship between an applicant's debt and income. Although these standards, whether considered in isolation or combination, often impact groups of borrowers differently, they have been proven to be predictive of the likelihood of repayment.

The residential mortgage lenders represented by *amici* seek to ensure that their credit decisions are not made "because of" any factor prohibited by the Fair Housing Act. *Amici* wholeheartedly endorse this legal obligation. But if the legal focus is on the "impact" of a

2. "Disparate impact" is a phrase used to describe the differential results that arise from "practices that are facially neutral in their treatment of different groups but that in fact fall more harshly on one group than another." *Smith v. City of Jackson, Miss.*, 544 U.S. 228, 239 (2005) (plurality op.). "Disparate treatment" is a phrase used to describe an intentional act of discrimination against an individual "*because of* their protected characteristic." *Id.* at 249 (O'Connor, J., concurring) (emphasis in original) (internal punctuation omitted).

lender's neutral policy on applicants of different races or national origins, rather than the reasons for particular actions, the industry faces far more complex risks. Such risks arise simply because the demographic results of a lender's sound, neutral financial standards might show disparate statistical "impacts," or as this Court has termed it, might not satisfy "the laws of chance." *Watson v. Fort Worth Bank & Trust*, 487 U.S. 977, 992 (1988).

The disparate-impact approach, of course, can allow a lender to prevail at the "justification" stage, but the alleged "impact" itself can promote protracted litigation causing reputational damage, serious business disruption, and extraordinary financial expense, even when there is no reasonable inference that the disparities reflect discrimination "because of" a prohibited factor. Also, the procedures at the "justification" stage – such as the nature of the burden allocation and the standard of proof – if improperly applied, can further exacerbate the legal risks that lenders face.

The threat of a disparate-impact challenge may prompt efforts by businesses to bring end results more in line with demographics. Such efforts, though intended to avoid disparate-impact liability, raise other legal risks, as the Court has confirmed. *Ricci v. DeStefano*, 129 S. Ct. 2658, 2676 (2009); *id.* at 2682 (Scalia, J., concurring); *id.* at 2701 (Ginsburg, J., dissenting).

A disparate-impact standard under the Fair Housing Act, therefore, creates a "Catch-22" for the members of *amici*. Lenders are required by federal law to employ conservative lending standards. They must not make loans to applicants who cannot afford them. Yet, to try to minimize the threat of disparate-impact liability,

they would have to structure their lending operations to manage end numbers so as to avoid statistically-significant differences in outcomes across borrower groups, taking into consideration the factors that the Fair Housing Act bans.

The threat of litigation is not hypothetical. *See* Section III.B, *infra*. To stop this spiral of claims and claim avoidance, which is deleterious to borrowers as well as lenders, *amici* file this brief in support of petitioners. The intent standard that *amici* endorse advances the goal of the Fair Housing Act, fosters compliance programs long supported by *amici*, which are designed to prevent decision-making "because of" a prohibited factor, and makes unnecessary any well-intentioned but precarious efforts to compensate for the demographic consequences of sound, neutral financial standards.

SUMMARY OF THE ARGUMENT

1. The Fair Housing Act requires proof of intentional discrimination and does not envision a legal violation founded solely upon disparate impact. The Court has interpreted employment discrimination statutes that prohibit discrimination "because of" certain factors, as the Fair Housing Act does, as reflecting a congressional intent to address intentional discrimination only. *See Ricci v. DeStefano*, 129 S. Ct. 2658, 2672 (2009); *Smith v. City of Jackson, Miss.*, 544 U.S. 228, 236 n.6 (2005) (plurality op.). In contrast, the Court has found that a disparate-impact cause of action arises from the phrase "otherwise adversely affect," which phrase is not found in the Fair Housing Act. *See Ricci*, 129 S. Ct. at 2672-73; *Smith*, 544 U.S. at 235-36 (plurality op.); *Griggs v. Duke Power Co.*, 401 U.S. 424, 426 n.1, 429-30 (1971).

2. In conducting studies mandated by Congress under the Fair Housing Act, *see* 42 U.S.C. § 3608(e), the United States Department of Housing and Urban Development ("HUD") has defined the "nature" of housing discrimination addressed by the Act as "disparate treatment." A focus on "disparate impact" would differ markedly and might consider issues such as the justification for rent prices that could have differential impacts on certain groups. At no point, however, have HUD's studies sought to evaluate the impact of neutral policies on such groups.

3. Although the courts of appeals have found disparate-impact claims are cognizable under the Fair Housing Act, their holdings are premised on an incorrect analogy to this Court's Title VII jurisprudence. The decisions of the courts of appeals do not reflect key textual distinctions between Title VII and the Fair Housing Act. Moreover, the federal enforcement agencies have provided conflicting guidance on whether disparate impact is recognized under the Fair Housing Act. Some administrations have contended that proof of discriminatory intent is necessary to establish a violation of the Act, while others have opined that a violation can be established under the disparate-impact approach. In issuing notice and comment regulations in 1989, HUD declined to address the required standard of proof.

4. Administrations that have recognized the disparate-impact approach have not followed the Court's precedent regarding proper application of the theory. *Amici* view the controlling standard for a disparate-impact-type claim as set forth in *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642 (1989) ("*Wards Cove*"), a Title VII employment matter. Under *Wards Cove*, a defendant

may justify the challenged policy through articulating how it serves a legitimate business goal, and the ultimate burden of proof remains with the plaintiff. 490 U.S. at 659. Yet, in the lending context, enforcement agencies have sometimes articulated a contrary disparate-impact approach. HUD's recent proposed amendment to its rules implementing the Fair Housing Act, for example, would require a defendant to articulate a business necessity for the challenged policy and would shift the burden of proof to the defendant. Implementation of Fair Housing Act's Discriminatory Effects Standard, 76 Fed. Reg. 70,921, 70,925 (Nov. 16, 2011) (proposed to be codified at 24 C.F.R. § 100.500).

5. Applying a disparate-impact approach to residential mortgage lending has unintended consequences. While the disparate-treatment approach is well suited to rooting out discrimination in lending, the many neutral standards that are relevant to credit decisions may have differential impacts correlated with race, national origin, or other prohibited bases of discrimination under the Fair Housing Act. For instance, the application of neutral credit assessment policies, such as requiring a minimum credit score, can result in applicants of one racial group being rejected for financing at a greater rate than applicants of another racial group. If the differences in the rejection rates cannot be attributed to mere chance, the lender faces the prospect of a disparate-impact lawsuit. Lenders already face frequent disparate-impact suits based on superficial or inapposite data. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, lenders must employ even more conservative underwriting standards, which may lead to further differentials between various groups and an increased threat of disparate-impact suits. Though lenders may defend such suits on the basis that

their practices are undertaken in accordance with federal law, lenders will still face substantial defense costs and administrative burdens, and the outcome in any case is uncertain. Moreover, the failure of results to satisfy the laws of chance causes lenders to consider prophylactic measures to minimize risk, measures about which the Court has consistently expressed concern. *See Ricci*, 129 S. Ct. at 2675 (concern over use of "de facto quota system"). These measures are themselves undesirable and, perversely, can operate to the detriment of both lenders and borrowers. The Fair Housing Act should not be construed to force lenders to choose between two such untenable outcomes.

ARGUMENT

I. THE PLAIN LANGUAGE OF THE FAIR HOUSING ACT, PROHIBITING THE DISPARATE TREATMENT OF INDIVIDUALS, ADVANCES THE NATIONAL OBJECTIVE OF PREVENTING DISCRIMINATION IN HOUSING

The purpose of the Fair Housing Act is "to provide, within constitutional limitations, for fair housing throughout the United States."[3] 42 U.S.C. § 3601. To that end, the statute prohibits discrimination "because of race, color, religion, sex, handicap, familial status, or national origin," *id.* §§ 3604, 3605, in connection with, among other

3. Congress enacted the Fair Housing Act in 1968. Pub. L. No. 90-284, Title VIII, 82 Stat. 73, 81-89 (1968) (codified at 42 U.S.C. §§ 3601, *et seq.*). In 1988, Congress amended the Fair Housing Act to address, in part, discrimination in residential real-estate-related transactions. Fair Housing Amendments Act of 1988, Pub. L. No. 100-430, 102 Stat. 1619 (1988).

things, "residential real estate-related transactions,"[4] *id.* § 3605.

A. The Statutory Language Provides a Cause of Action for Disparate Treatment, Not Disparate Impact

The plain language of the Fair Housing Act requires proof of intentional discrimination and does not envision a violation founded on disparate impact. The Court has held that language prohibiting discrimination "because of" certain factors reflects a congressional intent to address intentional discrimination only. *See generally Ricci v. DeStefano*, 129 S. Ct. 2658 (2009); *Smith v. City of Jackson, Miss.*, 544 U.S. 228 (2005). In *Smith*, the Court was unanimous in the conclusion that the "because of" language in section 4(a)(1) of the Age Discrimination in Employment Act of 1967 ("ADEA"), 29 U.S.C. § 623(a)(1), "does not encompass disparate impact liability," but rather contemplates only intentional discrimination. *Compare Smith*, 544 U.S. at 236 n.6 (plurality op.) (section (a)(1) of ADEA makes it unlawful for an employer "to fail or refuse to hire … any individual … *because of* such individual's age," and "[t]he focus of the paragraph is on the employer's actions with respect to the targeted individual") (emphasis added); *with id.* at 246 (Scalia, J., concurring) ("the only provision of the ADEA that could conceivably be interpreted to effect [a disparate-impact]

4. A residential real-estate related transaction "means any of the following: (1) The making or purchasing of loans or providing other financial assistance – (A) for purchasing, constructing, improving, repairing, or maintaining a dwelling; or (B) secured by residential real estate. (2) The selling, brokering, or appraising of residential real property." 42 U.S.C. § 3605(b).

prohibition is § 4(a)(2)"); *and with id.* at 249 (O'Connor, J., dissenting) ("[n]either petitioners nor the plurality contend that the first paragraph, § 4(a)(1), authorizes disparate impact claims, and I think it obvious that it does not. That provision plainly requires discriminatory intent").

In *Ricci*, the Court reached a similar conclusion with regard to the "because of" language contained in section 703(a)(1) of Title VII of the Civil Rights Act of 1964 ("Title VII"), 42 U.S.C. § 2000e-2(a)(1). 129 S. Ct. at 2672-73. The Court reasoned:

> As enacted in 1964, Title VII's principal nondiscrimination provision held employers liable only for disparate treatment. That section retains its original wording today. It makes it unlawful for an employer "to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, *because of* such individual's race, color, religion, sex, or national origin."

Id. at 2672 (citing 42 U.S.C. § 2000e–2(a)(1)) (emphasis added).

By contrast, the Court has held that disparate-impact claims were cognizable under certain other provisions of the ADEA and Title VII because those statutes contain additional language, not found in the Fair Housing Act, directed to the effects of discrimination. *See Smith*, 544 U.S. at 235 (plurality op.); *Ricci*, 129 S. Ct. at 2672-73; *Griggs v. Duke Power Co.*, 401 U.S. 424, 426 n.1, 429-30

(1971). In *Smith*, the Court held that disparate-impact claims are available under the ADEA because, like Title VII, the ADEA prohibits actions by employers that "deprive any individual of employment opportunities or *otherwise adversely affect* his status as an employee, because of such individual's age." 544 U.S. at 235 (plurality op.) (emphasis in original) (comparing ADEA, 29 U.S.C. § 623(a)(2), with Title VII, 42 U.S.C. § 2000e-2(a)(2)). Congress intended the phrase "otherwise adversely affect" contained in both the ADEA and section 703(a)(2) of Title VII to address "the *consequences* of employment practices, not simply the motivation." *Smith*, 544 U.S. at 234-35 (plurality op.) (emphasis in original).

The Fair Housing Act proscribes only conduct undertaken "because of" certain factors, and in the context of the precedent discussed above, the Court has held that this language addresses only intentional conduct. Unlike certain employment discrimination statutes, the Fair Housing Act does not contain a provision proscribing lending practices that "otherwise adversely affect" protected classes, and thus, disparate-impact claims are not cognizable under the Act. *See* 42 U.S.C. §§ 3604, 3605; *see also Gross v. FBL Fin. Servs.*, 557 U.S. 167, 129 S. Ct. 2343, 2349 (2009) (Congress is presumed to act intentionally where it does not add language to one statute that it has included in another statute); *cf. Sale v. Haitian Ctrs. Council, Inc.*, 509 U.S. 155, 168 n.16 (1993) ("we may not add terms or provisions where [C]ongress has omitted them").

B. HUD's National Studies of the Nature of Housing Discrimination Confirm the Congressional Design Is Aimed at Intentional Discrimination

The United States Department of Housing and Urban Development ("HUD"), the federal agency with primary authority for enforcing the Fair Housing Act, has defined the "nature" of discrimination addressed by the Act as disparate treatment. The Fair Housing Act requires HUD to "make studies with respect to the *nature* … of discriminatory housing practices in representative communities … throughout the United States." 42 U.S.C. § 3608(e) (emphasis added). HUD conducted such studies in 1977, 1989, and 2000.[5] Each of these studies focuses exclusively on the extent to which racial minorities, among other groups, have been subjected to disparate treatment in their search for housing, namely, whether they encountered discrimination *because of* their race. For instance, in connection with its 2000 Housing Discrimination Study, the agency stated:

> HUD's goals for the study include rigorous measures of change in *adverse treatment* against blacks and Hispanics nationwide, site-specific estimates of *adverse treatment* for major metropolitan areas, estimates of *adverse*

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5. *See* Margery A. Turner, et al., for U.S. Dep't of Hous. & Urban Dev., *Discrimination in Metropolitan Housing Markets: National Results from Phase 1 of HDS2000*, Executive Summary, at i (Nov. 2002), *available at* http://www.huduser.org/portal/publications/pdf/Phase1_Report.pdf (referencing HUD's *1977 Housing Market Practices Study*, *1989 Housing Discrimination Study*, and *2000 Housing Discrimination Study*).

> *treatment* for smaller metropolitan areas and adjoining rural communities, and new measures of *adverse treatment* against Asians and Native Americans.

Margery A. Turner, et al., for U.S. Dep't of Hous. & Urban Dev., *Discrimination in Metropolitan Housing Markets: National Results from Phase 1 of HDS2000)*, Executive Summary, at i (Nov. 2002) (emphasis added), *available at* http://www.huduser.org/portal/publications/pdf/Phase1_Report.pdf ("HDS2000 Executive Summary"). Thus, in responding to the congressional requirement that HUD define the "nature" of housing discrimination, HUD always defined it to be "disparate treatment," consistent with the language of the statute.

A study of the "nature" of housing discrimination based on the impact of neutral policies on certain groups would differ markedly from HUD's studies focusing on the disparate treatment of individuals. While the treatment approach considers whether applicants of different races are provided, for example, with different information about the availability of a rental apartment, an impact approach might consider whether the rent charged disproportionately excludes minority applicants.[6] At no

6. If an assertion of disparate impact of this type were presented in a lawsuit, a business might be required to justify the challenged rent level. The allocation of the burden of proof and the standard for a business justification would be important to the outcome. The decision to charge a certain amount of rent, for example, might be related to a legitimate business interest, such as maintaining a certain profit margin, but it may be more difficult to establish such a legitimate interest constitutes a "business necessity."

point, however, have HUD's studies sought to evaluate the *impact* of neutral policies or practices that might impede achievement of the congressional design.

II. LOWER COURTS HAVE CONSTRUED THE FAIR HOUSING ACT IN A WAY THAT CONFLICTS WITH THIS COURT'S DISPARATE-IMPACT JURISPRUDENCE, WHILE EXECUTIVE AGENCIES HAVE OFFERED INCONSISTENT GUIDANCE

A. The Courts of Appeals Have Misapplied this Court's Title VII Jurisprudence

The courts of appeals have approved the application of the disparate-impact approach under the Fair Housing Act at least in certain circumstances.[7] Yet, their holdings are often incorrectly premised on the Court's Title VII jurisprudence, which recognizes the availability of a disparate-impact approach in Title VII based on language *not* found in the Fair Housing Act.[8] In particular, the

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7. The majority of these decisions address section 804 of the Fair Housing Act governing housing and not section 805 of the Act governing residential real-estate related transactions. Of the ninety-six federal courts of appeals decisions, available through a Westlaw search, addressing disparate impact under either or both sections, ninety-one decisions discuss section 804, whereas only thirteen discuss section 805.

8. *See, e.g., Graoch Assocs. # 33, L.P. v. Louisville/Jefferson County Metro Human Relations Comm'n*, 508 F.3d 366, 372 (6th Cir. 2007) ("[r]elying on the analogy between Title VII and the FHA, several other circuits have applied essentially this approach to disparate-impact claims under the FHA"); *2922 Sherman Ave. Tenants' Ass'n v. District of Columbia*, 444 F.3d 673, 679 (D.C. Cir. 2006) (noting that the Fair Housing Act's "language prohibiting

lower courts' decisions are wrong to the extent that they conclude *Griggs* held that the language "because of" reveals a congressional intent to allow a disparate-impact approach. As made clear by this Court's decisions in *Smith* and *Ricci*, this is not the proper lesson of *Griggs.* Rather, *Smith* and *Ricci* each confirm that the language "because of," including the provision in Title VII, does not permit a disparate-impact approach. *Smith*, 544 U.S. at 236 n.6 (plurality op.); *Ricci*, 129 S. Ct. at 2672-73.

Notably, neither in 1968, when it enacted the Fair Housing Act, nor in 1988, when it amended the Fair Housing Act, nor in 1991, when it amended Title VII to better articulate the disparate-impact theory available

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discrimination – 'because of ... race ... or national origin' – is identical to Title VII's, and since *Griggs*, every one of the eleven circuits to have considered the issue has held that the FHA similarly prohibits not only intentional housing discrimination, but also housing actions having a disparate impact"); *Langlois v. Abington Hous. Auth.*, 207 F.3d 43, 51 (1st Cir. 2000) (noting that "[i]n light of *Griggs* and the similarity of the statutes, it is a fair reading of the Fair Housing Act's 'because of race' prohibition to ask that a demonstrated disparate impact in housing be justified by a legitimate and substantial goal of the measure in question"); *Pfaff v. U.S. Dep't of Hous. & Urban Dev.*, 88 F.3d 739, 745 & n.1 (9th Cir. 1996) ("look[ing] for guidance to employment discrimination cases" in finding that FHA provides for disparate impact); *Resident Advisory Bd. v. Rizzo*, 564 F.2d 126, 146 (3d Cir. 1977) ("in [Fair Housing Act] cases, by analogy to Title VII cases, unrebutted proof of discriminatory effect alone may justify a federal equitable response"). *But see Latimore v. Citibank Fed. Sav. Bank*, 151 F.3d 712, 714 (7th Cir. 1998) (cautioning against the "wholesale transposition" of discrimination theories and standards of proof from the Title VII context to the unique area of "credit discrimination").

under that statute, did Congress choose to incorporate language into the Fair Housing Act analogous to that language under Title VII which the Court has interpreted as providing for a disparate-impact cause of action. As the Court has stated, "[w]e cannot ignore Congress' decision to amend Title VII's relevant provisions but not make similar changes to [other anti-discrimination statutes]. When Congress amends one statutory provision but not another, it is presumed to have acted intentionally." *Gross*, 129 S. Ct. at 2349. Moreover, Title VII and the Fair Housing Act are separate laws, passed by different acts of Congress in different years. Title VII is a part of the Civil Rights Act of 1964, while the Fair Housing Act is Title VIII of the Civil Rights Act of 1968. That both laws were designed to eliminate discrimination, one in employment and the other in housing, does not warrant identical construction, particularly in light of the Court's aforementioned observation in *Smith*. 544 U.S. at 236 n.6 (plurality op.).

B. The Executive Branch Has Offered Conflicting Opinions as to the Availability of a Disparate-Impact Approach in the Fair Housing Act

The seeming unanimity of the courts of appeals has not been convincing to all federal administrations that have shared responsibility for effectuating the congressional design encompassed in the Fair Housing Act. In some years, the executive branch has opined that the Fair Housing Act requires a showing of intentional discrimination to establish a violation, while in other years the executive branch has opined that a violation can be established under the disparate-impact approach without proof of intentional discrimination.

For instance, in 1988, the United States Solicitor General submitted an *amicus* brief to the Court asserting that a plaintiff must prove *intentional* discrimination to establish a violation of the Fair Housing Act. The government specifically stated that "[n]ot only do the statute's language and legislative history show that a violation of Title VIII [(i.e., the Fair Housing Act)] requires intentional discrimination, substantial practical problems result if this requirement is discarded," such as "the difficulties in placing meaningful limits on the discriminatory effect standard of liability." *See* Brief for United States as *Amicus Curiae*, *Town of Huntington, N.Y. v. Huntington Branch, NAACP*, 488 U.S. 15 (1988) (No. 87-1961), *available at* http://www.justice.gov/osg/briefs/1987/sg870004.txt. For these reasons, the Solicitor General urged the Court to find that a showing of discriminatory effect does not suffice to state a claim under the Act. That same year, in signing the Fair Housing Amendments Act, the President issued a statement saying that the amended Act "does not represent any congressional or executive branch endorsement of the notion, expressed in some judicial opinions, that Title 8 violations may be established by a showing of disparate impact or discriminatory effects of a practice that is taken without discriminatory intent.... Title 8 speaks only to intentional discrimination." "Remarks on Signing the Fair Housing Amendments Act of 1988," Public Papers of President Ronald W. Reagan, Ronald Reagan Presidential Library (Sept. 13, 1988), *available at* http://www.reagan.utexas.edu/archives/speeches/1988/091388a.htm.

HUD itself considered the issue in implementing the Fair Housing Amendments Act of 1988. The 1988 amendment provided that "[t]he Secretary [of HUD] may

make rules … to carry out this title" and in so doing, required that the Secretary "shall give public notice and opportunity for comment to all rules." *See* Pub. L. No. 100-430, § 8(2), 102 Stat. 1619 (codified at 42 U.S.C. § 3614a). In 1989, HUD issued a notice and comment rule (the "1989 Rule") but consciously determined not to resolve the issue of whether it is necessary to establish discriminatory intent to show a violation of the Fair Housing Act. In the section of the 1989 Rule describing the "Standard for Proving a Violation" under the Act, HUD states that the "regulations are *not* designed to answer the question of whether intent is or is not required to show a violation." Implementation of Fair Housing Amendments Act of 1988, 54 Fed. Reg. 3232, 3234-35 (Jan. 23, 1989) (emphasis added). By contrast, in 1994, HUD and other federal agencies issued a joint "Policy Statement on Discrimination in Lending" ("1994 Policy Statement"), not subject to the notice and comment rulemaking process, which opined that a violation of the Fair Housing Act can be established under a disparate-impact approach. 59 Fed. Reg. 18,266, 18,269 (Apr. 15, 1994). Even still, the 1994 Policy Statement noted that "the precise contours of the law on disparate impact as it applies to lending discrimination are under development." *Id.*

Most recently, after the Court granted *certiorari* in this case, HUD issued for comment a proposed amendment to the 1989 Rule to resolve the issue on which the agency had previously punted. The proposed rule would provide that a violation of the Fair Housing Act can be established through a disparate-impact approach. Implementation of Fair Housing Act's Discriminatory Effects Standard, 76 Fed. Reg. 70,921, 70,921 (Nov. 16, 2011). Despite its history of wavering on this very issue,

HUD claims in the summary of its proposed rule that it "has long interpreted the Act to prohibit housing practices with a discriminatory effect, even where there has been no intent to discriminate." *Id.*

In sum, there is no consistent executive-branch interpretation as to whether the Fair Housing Act encompasses a disparate-impact approach.

C. Federal Enforcement Agencies Have Not Followed the Court's Precedent in Applying a Disparate-Impact Approach

In the event the Court concludes that a violation of the Fair Housing Act can be established under a disparate-impact approach, an equally important issue is the proper standard for effectuating the approach. *Amici* believe that the Court articulated the controlling standard in *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642 (1989) ("*Wards Cove*"), and more recently in *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. ----, 131 S. Ct. 2541 (2011) ("*Wal-Mart*"), but federal agencies suggest a different approach.

1. The controlling disparate-impact standard

In *Wards Cove*, the Court articulated the necessary elements for stating a prima facie case for disparate impact in the Title VII employment context, namely that a plaintiff must (1) identify a specific policy or practice, (2) demonstrate an impact unfavorable to minorities, and (3) establish that the challenged policy or practice *caused* the impact. *See* 490 U.S. at 656 (citing *Watson v. Fort Worth Bank & Trust*, 487 U.S. 977, 994 (1988)). If the plaintiff makes a prima facie showing, the defendant can justify the challenged policy by articulating a

legitimate business goal that the policy serves. *Wards Cove*, 490 U.S. at 658-59 ("at the justification stage of … a disparate-impact case, the dispositive issue is whether a challenged practice serves, in a significant way, the legitimate employment goals of the employer"). The Court expressly disclaimed any requirement that the defendant establish that its policy was "essential" or "indispensable." *Id.* at 659. Having articulated a legitimate business goal, the defendant should prevail unless the plaintiff can demonstrate "that 'other tests or selection devices, without a similarly undesirable racial effect, would also serve the ... legitimate [business] interest[s]'" in an equally effective manner. *Id.* at 660 (citing *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 425 (1975)).[9] "[T]he ultimate burden of proving that discrimination against a protected group has been caused by a specific … practice remains with the plaintiff *at all times*." *Wards Cove*, 490 U.S. at 659 (emphasis in original).

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9. In response to *Wards Cove*, Congress altered the standard for future Title VII litigation with the passage of the Civil Rights Act of 1991. Specifically, Congress amended Title VII to allow plaintiffs to challenge a group of employment practices without having to identify a specific practice as being the cause of their alleged harm, as well as to require that the burden of persuasion shift to the defendant to articulate a "business necessity" for the challenged practices. *See* 42 U.S.C. §§ 2000e-2(k)(1)(A)-(B). Congress has never made any such amendments to the Fair Housing Act, and accordingly, if the Act recognizes a disparate-impact theory, it is the view of *amici* that the burdens and standards of proof articulated in *Wards Cove* would remain applicable to such claims under the Act. *See Smith*, 544 U.S. at 240 ("[w]hile the relevant 1991 amendments expanded the coverage of Title VII, they did not amend the ADEA or speak to the subject of age discrimination. Hence, *Wards Cove*'s pre-1991 interpretation of Title VII's identical language remains applicable to the ADEA").

In *Wal-Mart*, the Court narrowed the application of the disparate-impact theory in cases where discretion in decision-making is challenged.[10] In particular, *Wal-Mart* rejected the application of the disparate-impact theory to a company-wide policy of discretion. 131 S. Ct. at 2554-55. Where hundreds or thousands of persons independently exercise discretion in carrying out their job duties, that is "just the opposite of a uniform ... practice" which is normally the subject of a disparate-impact approach – such as the height and weight requirement applied uniformly to all prison guard applicants in *Dothard v. Rawlinson*, 433 U.S. 321, 323-24 (1977). *Wal-Mart*, 131 S. Ct. at 2554. Rather, the Court found the challenged conduct to be "a policy against having uniform employment practices." *Id.* In its reasoning, the Court opined, "[w]ithout some glue holding the alleged reasons for all those decisions together, it will be impossible to say that examination of all the class members' claims for relief will produce a common answer to the crucial question why was I disfavored." *Id.* at 2552.[11]

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10. The Court first recognized disparate-impact challenges to subjective policies, such as discretion in decision-making, in *Watson*. 487 U.S. at 989-91 (applying the disparate-impact approach to subjective decision-making regarding promotions, to address the "functional equivalent" of intentional discrimination). *Wal-Mart*, however, operates to limit the application of *Watson* in certain factual circumstances.

11. The Court further reasoned that granting employees discretion "is also a very common and presumptively reasonable way of doing business – one that we have said should itself raise no inference of discriminatory conduct." *Wal-Mart*, 131 S. Ct. at 2554 (quotations omitted).

2. Agency positions regarding disparate-impact liability in lending contradict the Court's jurisprudence

Where federal agencies have addressed disparate-impact liability for lending transactions under the Fair Housing Act, the agencies have, at least in some instances, articulated positions that are contrary to the controlling authority set forth in *Wards Cove* and *Wal-Mart*. For instance, the interagency 1994 Policy Statement states that once an agency finds that a lender's policy has a disparate impact, then the "lender will be required to justify the 'business necessity' for the policy," and the "justification must be manifest." 59 Fed. Reg. at 18,269.[12] Yet, in *Wards Cove*, the Court required that the burden remain with the plaintiff at all stages of the disparate-impact proceeding and ruled that a defendant prevails if "the challenged practice serves, in a significant way, the legitimate [business] goals of the [defendant]." 490 U.S. at 659. The agency standard, at least as articulated in the 1994 Policy Statement, can lead to different outcomes than the application of the *Wards Cove* standard.

HUD's recently proposed rule under the Fair Housing Act is also at odds with the Court's controlling jurisprudence regarding the standard and burden of proof under a disparate-impact theory, particularly at the justification stage. Similar to the 1994 Policy Statement's "business necessity" language, HUD's proposed rule

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12. It is possible that the issuing agencies borrowed the concept of "business necessity" from the language of Title VII as amended in 1991, but the Fair Housing Act contains no such language.

would require a defendant to articulate that its policy "has a necessary and manifest relationship to one or more of the housing provider's legitimate, nondiscriminatory interests." 76 Fed. Reg. at 70,925. HUD's proposal would also place the burden of proof on the defendant. *See id.* (noting that "the burden of proof shifts to the respondent or defendant to prove that the challenged practice has a necessary and manifest relationship to the legitimate business interest").[13]

III. THE THREAT OF LIABILITY UNDER A DISPARATE-IMPACT APPROACH WOULD FORCE LENDERS TO CONSIDER PROPHYLACTIC MEASURES, WHICH THEMSELVES PRESENT LEGAL RISKS AND DRAW RESOURCES AWAY FROM EFFORTS TO PREVENT DISPARATE TREATMENT

The disparate-impact approach originally was designed to challenge "practices, adopted without a deliberately discriminatory motive, [that] may in operation be functionally equivalent to intentional discrimination." *Watson*, 487 U.S. at 987. Were it recognized, however, as applying to the residential mortgage lending industry, the approach would have unintended consequences. The disparate-treatment approach is well suited to rooting out discrimination in lending, but the threat of a disparate-impact challenge inevitably causes lenders to consider prophylactic measures to minimize risk. These measures

13. The HUD proposal adopts the approach established by Congress in amending Title VII with the Civil Rights Act of 1991. It required an act of Congress to establish such a standard under Title VII. Congress has never made a comparable amendment to the Fair Housing Act.

are themselves undesirable and, perversely, can enhance rather than minimize legal risk to the detriment of lenders, hindering their efforts to serve borrowers.

A. Disparate Impact As a Cause of Action Creates Dilemmas When the Uniform Application of Sound, Neutral Financial Standards Has Different Demographic Results

The threat of disparate-impact liability arises when the end results of a lender's operations have different demographic results, despite the uniform application of sound, neutral financial standards. For instance, notwithstanding a lender's neutral credit assessment policies, applicants belonging to one racial group may be rejected for financing at a greater rate than applicants from another racial group. If the differences in the rejection rates are deemed statistically significant (that is, the results can not be attributed to mere chance), the lender faces the prospect of a disparate-impact lawsuit. The risk can arise regardless of the racial group impacted or whether men or women experience differential results.

In lending, generally-accepted credit assessment standards, which themselves raise no inference of discrimination, may produce differential results that can be correlated with factors such as race or national origin. For example, it is commonplace and accepted for lenders to consider applicants' credit scores as an important indicator of credit risk, because such a score is highly predictive of risk and costs relatively little to obtain. At the same time, the Federal Reserve Board has found that the "[d]ifferences in credit scores among racial or ethnic groups … are particularly large," with 52.6% of African-Americans in the sample appearing in the lowest two

score deciles, as compared to 16.3% of non-Hispanic whites. *See* Board of Governors of Fed. Reserve Sys., *Report to the Congress on Credit Scoring and its Effects on the Availability and Affordability of Credit*, at 80 (Aug. 2007) ("FRB Study"), *available at* http://www.federalreserve.gov/boarddocs/rptcongress/creditscore/creditscore.pdf. Similarly, the National Community Reinvestment Coalition ("NCRC") has stated that "our analysis finds that zip codes with concentrations of minorities contain a disproportionate percentage of consumers with [low] FICO scores between 580 and 620." Nat'l Cmty. Reinvestment Coal., *Working-Class Families Arbitrarily Blocked from Accessing Credit: NCRC's Fair Lending Investigation of Credit Score Restrictions by Federal Housing Administration-Approved Lenders*, Mortgage Lending Disparities Series Paper, at 15 (Dec. 2010), *available at* http://www.ncrc.org/images/stories/mediaCenter_reports/fha%20white%20paper-120810-final.pdf.

Down-payment requirements also impact various racial and ethnic groups differently. This result is reflected in examining census data on household wealth, because wealth (versus income) is the primary source for a down payment. In 2009, the median wealth of white households was 20 times that of African-American households and 18 times that of Hispanic households. *See* Pew Research Center, *Twenty-to-One: Wealth Gaps Rise to Record Highs Between Whites, Blacks and Hispanics*, at 1 (July 2011) (analyzing 2009 U.S. Census Bureau data and finding that average African-American and Hispanic households had $5,677 and $6,325 in wealth, respectively, while the average white household had $113,149 in wealth), *available at* http://www.pewsocialtrends.org/files/2011/07/SDT-Wealth-Report_7-26-11_FINAL.pdf. Debt-to-income

and loan-to-value requirements can also have a differential impact among various racial and ethnic groups.

These are simple examples of basic elements of assessing credit risk, and yet differences in their impacts could be expected to trigger at least the initial stages of a legal claim under a disparate-impact approach. In reality, the issues faced by lenders are far more complex in that the many elements related to credit risk assessment are usually layered in complex models or algorithms often developed by third parties. For example, the government-sponsored enterprises Fannie Mae and Freddie Mac require lenders to evaluate credit risk pursuant to automated underwriting systems containing models proprietary to those entities. The sum total of the elements in the model might have the same differential impact as the application of single assessment elements such as credit score and ability to make a down payment, yet lenders are not in a position to "justify" each element of the model much less the relationships among all the variables.

Amici recognize that liability under a disparate-impact approach would not attach unless the challenged policy or practice lacked a non-pretextual business justification. But the primary objective of most lenders, as with most businesses, is to minimize the risk of ever facing such a challenge. A lawsuit alleging lending discrimination on the basis of race or national origin is a very serious charge and can occasion an immediate reputational injury and business disruption. The allegation of a statistical impact is still newsworthy even if there is no reasonable inference that it is caused by an impermissible differential treatment. Moreover, defending allegations of disparate impact is typically very expensive.

In these circumstances, it is not unexpected that businesses would seek to manage the end numbers so as to avoid legal risk. The Court has recognized this result as it has allowed the expansion of the use of a disparate-impact approach in the employment discrimination field. *See Watson*, 487 U.S. at 992-93 (noting that "the inevitable focus on statistics in disparate-impact cases could put undue pressure on employers to adopt inappropriate prophylactic measures"). The Court has expressed concerns that a lender's efforts to avoid a disparate-impact legal challenge may themselves constitute intentional unlawful discrimination. *See, e.g., Ricci*, 129 S. Ct. at 2664 ("[w]e conclude that race-based action like the City's in this case is impermissible under Title VII unless the employer can demonstrate a strong basis in evidence that, had it not taken the action, it would have been liable under the disparate-impact statute"); *see also City of Richmond v. J.A. Croson Co.*, 488 U.S. 469, 499-500 (1989) (rejecting a set-aside program for minority contractors, since "an amorphous claim that there has been past discrimination ... cannot justify the use of an unyielding racial quota"). And the Court has cautioned that "[a]llowing employers to violate the disparate-treatment prohibition based on a mere good-faith fear of disparate-impact liability would encourage race-based action at the slightest hint of disparate impact. … That would amount to a de facto quota system." *Ricci*, 129 S. Ct. at 2675.

B. Lenders Face Disparate-Impact Challenges Now

It is not a merely hypothetical risk that lenders would face lawsuits, and the substantial reputational and monetary costs associated with being sued, based

on end results that go beyond the laws of chance. In the past several years, lenders have faced frequent disparate-impact suits[14] based largely on the public loan data reported by financial institutions under the federal Home Mortgage Disclosure Act ("HMDA"), 12 U.S.C. § 2801, *et seq.*[15] These lawsuits contend that the neutral

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14. *See, e.g.*, *In re Countrywide Fin. Mortgage Lending Practices Litig.*, No. 08-MD-1974, 2011 WL 4862174, at *3-4 (W.D. Ky. Oct. 13, 2011) (denying motion to certify disparate-impact class; under *Wal-Mart*, "statistical evidence of average disparities does not suffice to" establish commonality); *Rodriguez v. National City Bank*, --- F.R.D. ----, 2011 WL 4018028, at *5-7 (E.D. Pa. Sept. 8, 2011) (declining to certify class for settlement of disparate-impact claims because discretion provided to defendants' various loan officers precluded finding of commonality in light of *Wal-Mart*); *In re Wells Fargo Residential Mortgage Lending Discrimination Litig.*, No. 3:08-md-01930-MMC, slip op. at 5-8 (N.D. Cal. Sept. 6, 2011) (denying class certification on Fair Housing Act claim because, in part, claim relied upon discretion of individual brokers or branches).

15. HMDA itself is a disclosure law. It establishes neither unlawful lending terms nor a cause of action. HMDA requires most mortgage lenders to report information about their home-lending activities. 12 U.S.C. § 2803. Federal Reserve Board Regulation C implements HMDA and describes the information to be submitted to federal agencies, which subsequently is made public by the Federal Financial Institutions Examination Council ("FFIEC"). *See* www.ffiec.gov. Information regarding the disposition of all loan applications (that is, whether they were accepted or declined) is reported, but only limited information about loan pricing is reported. For example, at the time relevant to the lawsuits in note 14, *supra*, Regulation C required reporting as to the spread between certain higher-priced mortgage loans' annual percentage rate ("APR") and the yield on comparable Treasury obligations but not the actual APR, much less requiring that such spread be reported for all loans. 12 C.F.R. § 203.4(a)(12) (2008). In addition,

credit assessment policies of the defendants caused higher loan prices for minority borrowers. Yet, the HMDA data, which forms the sole basis for these lawsuits, do not even include the most relevant credit standards that lenders use in assessing risk. Indeed, the Federal Reserve Board has stated that "although the HMDA data include some detailed information about each mortgage transaction, many key factors that are considered by lenders in credit underwriting and pricing are not included. Accordingly, it is not possible to determine from HMDA data alone whether racial and ethnic pricing disparities reflect illegal discrimination." Robert B. Avery, et al., Div. of Research & Statistics, *The Mortgage Market in 2010: Highlights from the Data Reported under the Home Mortgage Disclosure Act*, 97 Federal Reserve Bulletin, at 39 (Sept. 22, 2011), *available at* http://www.federalreserve.gov/pubs/bulletin/2011/pdf/2010_HMDA.pdf. Despite the inconclusive nature of the data on which they are based, such lawsuits nevertheless put the defendants in a position of having to "explain[] the myriad of innocent causes that may lead to statistical imbalances," which burden the Court has expressly disavowed in the employment context. *Watson*, 487 U.S. at 992-93.

As another example, the NCRC filed Fair Housing Act complaints with HUD against twenty-two lenders alleging that the lenders' residential mortgage lending policies requiring a credit score above the Federal Housing Authority minimum have had a disparate impact on minorities. *See* Press Release, U.S. Dep't of Hous. &

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borrowers' credit scores, income and assets, and cash reserves, the debt-to-income ratio, and the loan-to-value ratio are not among the currently reported data. 12 C.F.R. § 203.4 (2011).

Urban Dev., HUD to Investigate Allegations that 22 Banks and Mortgage Lenders Discriminate against African American and Latino Seekers (Dec. 8, 2010), *available at* http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2010/HUDNo.10-266. There is no allegation that the lenders' credit score threshold was established "because of" race or national origin, and there can be little question that credit score is a valid predictor of credit risk. *See* FRB Study, *supra*, at 87 ("[r]egardless of the specific performance measure considered, each of the three credit scores used in this study predicts future loan performance"). But under the disparate-impact approach, and HUD's interpretation of the standard, a significant burden can be placed on the lender in avoiding liability.

C. Tight Credit Markets and Governmental Responses Increase the Threat of Disparate-Impact Claims

In the context of the recent financial crisis, Congress and other policy makers have created incentives and requirements for the lending industry to employ conservative underwriting standards. For instance, the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act"), and certain of its proposed implementing regulations, create two separate categories of residential mortgage loans – Qualified Mortgages ("QMs") and Qualified Residential Mortgages ("QRMs").[16]

16. The regulations that would establish QMs and QRMs have not yet been finalized. The Board of Governors of the Federal Reserve System issued proposed QM rules on May 11, 2011. *See*

The proposed QM rules would impose, among other things, liability for loans that do not meet the ability-to-repay requirements of the Dodd-Frank Act, while establishing a certain level of protection from scrutiny for conservatively underwritten QM loans. *See* Dodd-Frank Act § 1412 (amending section 129C of the Truth in Lending Act, 15 U.S.C. § 1639c). To be sure, assessment of a borrower's repayment ability is a routine part of underwriting, but to avoid the threat of liability under the ability-to-repay requirements, a lender's response will be to proceed very cautiously. More cautious underwriting may restrict the availability of loans to groups with less wealth and income and, correspondingly, to minority groups. Such differentials may prompt disparate-impact lawsuits. Even though lenders can defend such suits on the basis that their practices are undertaken in accordance with federal regulation, lenders will still face the reputational and monetary costs incurred in doing so.

The proposed QRM lending standards also may be characterized as quite conservative. In particular, to qualify for such a loan, a borrower would be subject to "maximum front-end and back-end debt-to-income ratios of 28 percent and 36 percent, respectively; a maximum loan-to-value (LTV) ratio of 80 percent in the case of a purchase transaction...; a 20 percent down payment

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Regulation Z, Truth in Lending, 76 Fed. Reg. 27,390, 27,396 (May 11, 2011). The comment period for the proposed rules closed on July 22, 2011. *See id.* at 27,390. The final QM rules will be issued by the newly-formed Consumer Financial Protection Bureau. Several agencies jointly proposed the rules to establish QRMs on April 29, 2011. *See generally* Credit Risk Retention, 76 Fed. Reg. 24,090 (Apr. 29, 2011). The extended comment period for the proposed rules closed on August 1, 2011. *See* Credit Risk Retention, 76 Fed. Reg. 34,010, 34,010 (June 10, 2011).

requirement in the case of a purchase transaction; and credit history restrictions." *See* Credit Risk Retention, 76 Fed. Reg. 24,090, 24,150 (Apr. 29, 2011). The incentive for lenders to make QRM loans would be to assure that their loans do not require "risk-retention" (which requirement would make non-QRM loans less marketable as securitizers will be forced to retain 5% of the economic credit risk for such loans under the Dodd-Frank Act). *See* Dodd-Frank Act § 941 (adding section 15G of the Securities Exchange Act of 1934, 15 U.S.C. § 78o-11) ("[t]he regulations prescribed under subsection (b) shall… (B) require a securitizer to retain – (i) not less than 5 percent of the credit risk for any asset – (I) that is not a qualified residential mortgage that is transferred, sold, or conveyed through the issuance of an asset-backed security by the securitizer"). There is no requirement for a lender to make any non-QRM loans, but if a lender were to underwrite only to meet the proposed QRM standards, the practice would likely restrict the availability of loans to less wealthy groups and those not in the top credit tiers, which would likely have a differential impact on minorities, increasing the risk of disparate-impact liability.

Moreover, in making QRM loans, HUD's proposed standard of proof under a disparate-impact approach would significantly augment the risk of liability to lenders. While a lender could certainly offer a legitimate business reason for making only QRM loans, namely, the ability to avoid the risk-retention requirement, it may be more difficult to establish that this constitutes a business necessity.

Thus, recognizing a disparate-impact approach under the Fair Housing Act may place lenders in the predicament of facing suit where they are attempting to comply with

law, no matter what they do. No matter how frivolous such suits may be, the threat of such suits may cause lenders to manage their end numbers, which creates another kind of risk, and the defense of such lawsuits would inevitability draw resources away from lenders' efforts to ensure the fair treatment of individual loan applicants and from lenders' ability to fund loans.

CONCLUSION

Amici read the Fair Housing Act as prohibiting intentional discrimination but not authorizing claims based on disparate impact. This interpretation is consistent with the intent of Congress as expressed in the Act and comports with HUD's studies of the nature of housing discrimination. The result of the Court's determination of the issue is of grave importance to the lending industry, and a finding that the Fair Housing Act does not encompass disparate impact would allow a proper focus on ensuring that employees treat all credit applicants on the basis of their qualifications and not on an impermissible basis as described in the Act. If the Court holds that the Fair Housing Act does encompass disparate impact, *amici* submit that *Wards Cove* establishes the proper standard for that type of claim.

Dated: December 29, 2011

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