Protecting Credit Since 1916
American Financial Services Association

June 25, 2018

Comment Intake
Bureau of Consumer Financial Protection
1700 G Street, NW
Washington, DC 20552

Re: Request for Information Regarding the Bureau's Inherited Regulations and Inherited Rulemaking Authorities
Docket No. CFPB-2018-0009

To Whom It May Concern:

The American Financial Services Association (AFSA)[1] appreciates the Bureau of Consumer Financial Protection's request for comment and information (RFI) regarding whether the Bureau should amend its prior regulations or exercise the rulemaking authorities that it inherited from certain other federal agencies.

The Bureau asks commenters to rank their suggestions in order of priority. AFSA believes that the following regulations or issues are ripe for review, in this order: (1) the Equal Credit Opportunity Act (ECOA) and Regulation B; (2) debt collection; (3) unfair, deceptive, or abusive acts or practices (UDAAP); and (4) electronic disclosures.

I. Equal Credit Opportunity Act / Regulation B

The Bureau has released guidance relating to compliance with the ECOA and its implementing regulation, Regulation B, in the form of two bulletins: CFPB Bulletin 2012-04 on Lending Discrimination and CFPB Bulletin 2013-02 on Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act. On May 21, 2018, the President signed a joint resolution passed by Congress disapproving Bulletin 2013-02. Consistent with the joint resolution, Bulletin 2013-02 now has no force or effect. Bulletin 2012-04, however, is still in effect, as of course, is the ECOA and Regulation B. Both Regulation B and Bulletin 2012-04 provide that under the ECOA, the "effects test" (also known as the disparate impact doctrine) may apply to credit transactions.

AFSA and its members abhor discrimination and are strongly committed to the prohibition of discriminatory treatment of protected classes in compliance with the ECOA. However, as detailed in the academic papers attached as Appendix I and II, there is no legal basis for creditors to be held liable under the disparate impact doctrine under the ECOA. The statutory language of the ECOA does not provide for disparate impact liability, and the proxy methodologies that have been used to allege that a creditor has engaged in unlawful discrimination under the disparate impact doctrine under the ECOA are seriously flawed. AFSA recommends that the Bureau withdraw Bulletin 2012-04, amend Regulation B and its official commentary, and revise its manual and examination procedures to reflect that the disparate impact doctrine is not applicable under the ECOA and Regulation B.

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[1] Founded in 1916, AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members provide consumers with many kinds of credit, including traditional installment loans, mortgages, direct and indirect vehicle financing, payment cards, and retail sales finance.

The ECOA prohibits disparate treatment, but does not provide for disparate impact claims under the statute. In comparison to other federal non-discrimination statutes, the ECOA contains language prohibiting discriminatory treatment, but does not contain language prohibiting discriminatory effects. This is further described in the paper attached as Appendix I by Peter N. Cubita and Michelle Hartmann, *The ECOA Discrimination Proscription and Disparate Impact—Interpreting the Meaning of the Words That Actually Are There.*[2] The paper compares the actual text of the ECOA with other statutes and finds that Congress has used very different language when it wishes to proscribe facially-neutral practices that have a disparate impact.

One of the most significant problems with applying the disparate impact doctrine to the ECOA is that allegations of unlawful discrimination rest on statistical analyses—analyses that are flawed. Under the ECOA, creditors are generally prohibited from collecting information on applicants' race, ethnicity and gender. To identify an alleged "disparate impact," proxy methodologies are applied to infer the likelihood that applicants belong to a particular protected class. Research has repeatedly shown that these proxy methodologies are imperfect and tend to overstate disparities. An example of such research is attached as Appendix III. We are including the introduction to a whitepaper titled, *Fair Lending: Implications for the Indirect Auto Finance Market,* prepared by Charles River Associates for AFSA.[3]

Notwithstanding the fundamentally flawed statistics that form the basis of disparate impact claims under the ECOA, regulators, particularly the Bureau under the prior director, have been very aggressive in asserting claims against creditors using disparate impact theories that likely would not hold up in court. Daniel Press, a policy analyst at the Competitive Enterprise Institute, elaborates:

> "Unfortunately, decades later, regulators have begun to stretch their authority beyond that noble goal to enact a policy agenda that Congress never intended. The [Bureau] … has been highly aggressive in enforcing ECOA. It has done so using dubious statistics and unfounded legal theories to bully firms into settlements rather than proving a case in federal court. In doing this, the Bureau's focus has been not on rooting out material discrimination, but on socially engineering outcomes for individuals who are members of protected groups under civil rights laws."[4]

Press goes on to explain the harm that this misreading of the statute has done to consumers:

> "Ultimately, this harms both businesses and consumers. New technologies, such as alternative credit scoring systems, have the potential to extend affordable credit to consumers who have long been shut out of the financial system. But overzealous enforcement of ECOA threatens these developments. If startup ventures risk prosecution or litigation because their otherwise neutral

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[2] Cubita, Peter N. and Michelle Hartmann, *The ECOA Discrimination Proscription and Disparate Impact—Interpreting the Meaning of the Words That Are Actually There.* The Business Lawyer. Vol. 61, No. 2. Feb. 2006.

[3] Baines, Arthur P. and Dr. Marsha J. Courchane, *Fair Lending: Implications for the Indirect Auto Finance Market.* Charles River Associates. Nov. 19, 2014. Available at: https://www.afsaonline.org/Portals/0/Federal/Issue%20Briefs/Fair%20Lending%20in%20the%20Indirect%20Auto%20Lending%20Market%20Study.pdf

[4] Press, Daniel, *The CFPB and the Equal Credit Opportunity Act – How Regulators Can Improve Consumer Protection and Access to Credit.* Competitive Enterprise Institute. On Point, No. 244. May 16, 2018. p. 1. Available at: https://cei.org/sites/default/files/Daniel%20Press%20-%20The%20CFPB%20and%20the%20Equal%20Credit%20Opportunity%20Act.pdf

> algorithms have unintended and largely unpredictable effects, innovation in this area will be chilled."[5]

Press' paper, like Cubita's and Hartmann's, explains the language of the ECOA and compares it to other non-discrimination statutes. The paper also illuminates the problems with the Bureau's enforcement of the ECOA, and thus we are attaching the paper as Appendix II.

Again, AFSA emphasizes that both the association and its members support fair lending and equal access to credit. We ask that the Bureau enforce the ECOA as it is written and as was intended by Congress. AFSA recommends the Bureau withdraw Bulletin 2012-04, amend Regulation B and its official commentary, and revise its manual and examination procedures to remove references to the disparate impact doctrine and otherwise clarify how the Bureau intends to enforce the ECOA and Regulation B. AFSA hopes to work with the Bureau as it considers potential changes to its enforcement and supervision of financial institutions' compliance with the ECOA and Regulation B.

II. Debt Collection

Congress enacted the Fair Debt Collection Practices Act (FDCPA) over 40 years ago in 1977. Since then, the technology used by financial institutions to communicate with their customers has changed. The time is ripe for the Bureau to modernize and clarify certain provisions of the FDCPA. At the same time, the Bureau should ensure that any regulations clearly treat creditors and third-party debt collectors differently. Moreover, any debt collection rules the Bureau promulgates should neither unduly restrict a creditor's ability to contact its customer, nor impose onerous and pointless validation requirements upon a creditor.

A. Modernize the FDCPA

In an effort to modernize the FDCPA, the Bureau should make clear that electronic communication is permissible in debt collection by either creditors or debt collectors. We also ask that the Bureau modernize the definition of "debt collector" to make it abundantly clear that creditors collecting their own debts are not "debt collectors."

B. Clarify Certain Provisions in the FDCPA

It would be beneficial for creditors and consumers alike for the Bureau to clarify certain aspects of the FDCPA. For example, clarity is need around terms such as, "location information," "reasonable period of time," and "reasonable parties."

Another section that needs clarification relates to servicers. Many companies securitize or turn over the servicing of accounts to servicers, virtually at the moment of credit extension. As a result, a consumer may never know the name of the creditor and may only know the name of the servicer in connection with the consumer's debt. If the servicer has to use its technical, financing entity name during debt collection, the consumer may not recognize the name or the debt. The Bureau should therefore allow the servicer to use the name the consumer knows.

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[5] *Ibid.*

In addition, AFSA asks that the Bureau specify that those collecting a debt are permitted to leave voicemail messages for consumers without the mini-Miranda disclosure[6] to avoid the risk of disclosing the debt to third parties. Also related to messages, the Bureau should clarify that those collecting a debt are permitted to leave messages with a third party that answers a communication to the consumer. A safe harbor message may include the employee's name, company's name if the name does not indicate it is a debt collector, phone number, and request to have the consumer call.

C. Separate Rules for Creditors and Debt Collectors

In any rulemaking on debt collection, the Bureau should separate the rules for creditors and debt collectors. Congress very clearly and statutorily recognize their completely different business models and very different collection incentives. Creditors have an incentive to maintain an ongoing relationship with their customers, and they risk losing the entire balance (as well as future business) when they cannot effectively communicate with their customers to collect amounts that have fallen delinquent. Debt collectors, on the other hand, generally only collect mature, static balances from consumers with whom they have no prior or ongoing relationship, and there is no expectation of ongoing future relationships with such consumers once the specific debt is paid. Due to Congress' distinction, a one-size-fits-all debt collection rule is detrimental to consumers and must be avoided.

D. Future Debt Collection Rules

Any debt collection rules the Bureau finalizes should neither unduly restrict creditors' ability to contact their customers, nor impose unnecessary validation requirements.

As an example, any limitations on contact frequency could be harmful for consumers. The Federal Reserve Bank of New York studied the effect of restrictive state-level legislation regarding debt collection practices, and concluded that restricting collection activities leads to decreased access to credit and deteriorated financial health, particularly for individuals with the lowest credit scores. To do this, it compared outcomes of consumers in states with statutes restricting contact with those of consumers in the remaining states. The Federal Reserve Bank of New York wrote, "We find consistent evidence that restricting collection activities leads to a decrease in access to credit and a deterioration in indicators of financial health."[7]

AFSA members' experience is that it often takes several phone calls to reach a customer who is delinquent, just as it does debt collectors. Creditors must be free to talk to their customer about the existing status of the account and ways to provide the consumer options to resolve the account.

If consumers know they just have to avoid, say, two calls a week, debts will not be paid, consumers' credit reports will continue to show the unresolved accounts, and creditors' losses will increase. At some point, if creditors cannot recover on defaulted debt, they will adjust and tighten their underwriting requirements, with the result that creditors tighten up credit and stop lending money to less creditworthy consumers. As the Federal Reserve Bank

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[6] The "mini-Miranda" disclosure is the following statement: "This is an attempt to collect a debt and any information obtained will be used for that purpose."

[7] The Federal Reserve Bank of New York concluded, "Hence, our analysis suggests that restricting collection activities leads to a decrease in access to credit across the full spectrum of borrowers and to a deterioration in indicators of financial health. Moreover, we find that the deterioration in financial health outcomes is concentrated on individuals with the lowest credit scores (prior to the legislation changes [restricting collection activity])." Fonseca, Julia, Katherine Strair, and Basit Zafar, *Access to Credit and Financial Health: Evaluating the Impact of Debt Collection*. Federal Reserve Bank of New York Staff Reports No. 814. May 2017. p. 2. Available at https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr814.pdf?la=en.

of New York concluded, creditors will have less incentive to lend to people who are not likely to pay the creditors back, which will negatively affect the financial marketplace.[8]

In addition to permitting reasonable contact between creditors and their customers, any debt collection rule must not impose unreasonable debt validation requirements upon creditors or debt collectors, although the validation requirements reasonably should be different for each category. We therefore disagree with those who urge that there are currently deficiencies with the quality and quantity of the information that creditors provide to debt collectors.

First, creditors collecting their own debts have the proof of debt and payment history that is and can readily be shared with customers. Second, AFSA members who do sell debt or who contract with debt collectors to collect debt can and do provide debt collectors and debt buyers much of the information in their systems of record, often by allowing direct access to their systems and/or by providing imaged account documents. Third, creditors test their systems to ensure the data is correct, and, as a result, the information and documentation provided to debt collectors and debt buyers to validate the debt has a high level of accuracy. Fourth, we agree that debt collectors and debt buyers should be required, upon request, to validate debts they collect, to include providing proof of the debt and payment history, but they should not be tasked with auditing creditors' handling of accounts or accounting methodology. Debt collectors and debt buyers should only be required to conduct additional research into the creditor's handling of accounts or accounting for the debt when a specific dispute is brought to their attention that the information the creditor has provided to validate the debt does not actually validate the debt. AFSA recommends that the debt collector's responsibility to assess the debt remain as part of its duty to validate the debt for consumers.

III. UDAAP Guidance

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), it is unlawful for any provider of consumer financial products or services or a service provider to engage in any unfair, deceptive, or abusive act or practice (UDAAP). The Dodd-Frank Act also provides the Bureau with rulemaking authority and, with respect to entities within its jurisdiction, enforcement authority to prevent unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. In addition, the Bureau has supervisory authority for detecting and assessing risks to consumers and to markets for consumer financial products and services.

The Bureau should, through formalized notice and comment under the Administrative Procedures Act, provide meaningful guidance as to constitutes an "abusive" act or practice, and clarify that such practices are limited to intentional behavior.

The Bureau should also clarify that an act or practice that complies with substantive laws and regulations cannot be a UDAAP violation. For example, compliance with TILA's "clear and conspicuous" disclosure standards should never result in a deceptive practice violation.

[8] *Id.* p. 15.

IV. Electronic Disclosures

AFSA believes that electronic disclosures can be more beneficial to consumers than paper disclosures for a number of reasons, including: helping the environment by saving paper, communicating quickly and efficiently, and helping consumers who need a larger font.

In the RFI, the Bureau asks for feedback on regulations that: (1) overlap or conflict with other laws or regulations in a way that makes it difficult or particularly burdensome for institutions to comply; and (2) are incompatible or misaligned with new technologies, including by limiting providers ability to deliver electronically, mandatory disclosures or other information that may be relevant to consumers. There are several regulations that we recommend the Bureau review in light of its request.

First, the Bureau should harmonize and amend Regulations X, Z, and DD to indicate that the prominence and proximity standards meet the "clear and conspicuous" standard for all applicable electronic advertisements and disclosures. Second, the Bureau should harmonize and amend Regulations B, E, X, V, Z, and DD to clarify that any required language (whether a disclosure or language related to an advertisement) can be provided via link in an electronic context. Third, the Bureau should issue similar binding guidance relative to disclosures required by the Homeowners' Protection Act. And fourth, the Bureau should issue similar binding guidance relative to privacy notices.

Along similar lines, the Bureau should amend and clarify certain requirements of the E-SIGN Act and modernize rules governing the delivery of disclosures provided electronically. AFSA recommends that the Bureau undertake a number of efforts. First, the Bureau should remove the requirement that creditors obtain e-consent under the E-SIGN Act prior to providing the adverse action notices required by the ECOA. Second, the Bureau should provide guidance on what consumer conduct constitutes "reasonable demonstration of access" to electronically receive and access information, especially when consumers consent to a bank's E-SIGN disclosure using bank technology (for example at a branch on a bank-provided device). Third, we suggest that the timing for delivery of electronic disclosures be more flexible and recognize that electronic delivery (whether in person or not) can qualify for the longer time periods permitted for delivery at the option of the financial institution when the consumer is not present.

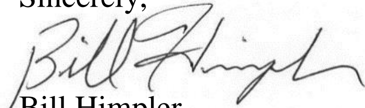
Finally, we recommend that the Bureau remove restrictions on providing adverse action notices and other disclosures that contain a credit score in such a way that co-borrowers may view each other's disclosures. In an effort to streamline the origination process, creditors are seeking to use online platforms. These platforms, in an effort to provide an efficient vehicle for providing disclosures, are creating environments that promote collaboration and the sharing of information. Obligating creditors to wall off certain disclosures undermines the utility of these online platforms and may even force creditors to continue to send out paper disclosures to consumers who have expressly requested that creditors communicate with them electronically. We understand that the Bureau strongly supports efforts to originate e-mortgages. Addressing regulatory obstacles like these will help make that goal a reality.

V. Conclusion

AFSA appreciates the opportunity to present the regulations and issues that we believe the Bureau should address to improve the consumer finance market for consumers and financial institutions. We hope that the Bureau: recognizes that the disparate impact doctrine is not applicable under the ECOA, modernizes and clarifies certain provisions of the FDCPA, provides meaningful guidance as to what constitutes an "abusive" act or practice, and reviews regulations regarding electronic disclosures.

Please contact me by phone, 202-466-8616, or email, bhimpler@afsamail.org, with any questions.

Sincerely,



Bill Himpler
Executive Vice President
American Financial Services Association

APPENDIX I

THE BUSINESS LAWYER

Section of Business Law • American Bar Association

ARTICLES

Further Progress in Defining Constitutional Constraints on Punitive Damages and Other Monetary Punishments
George Clemon Freeman, Jr. and Makram B. Jaber

Rescission and Restitution
Andrew Kull

Attorneys' Fees in Arbitration
Henry F. Minnerop and Kimberly A. Johns

Summary of Mendes Hershman Winning Article: Protecting Mutual Funds from Market-Timing Profiteers: Forward Pricing International Fund Shares
David Ward

REPORTS

Home Banking Services Agreement: Task Force Report and Related Articles

Home Banking Services Agreement
Task Force on Home Banking Services Agreement, ABA Section of Business Law

Consumer Perspective—Home Banking Agreements: Don't Bank on Them
Mark E. Budnitz, Donald F. Clifford, Michael Ferry, and Margot Saunders

Task Force Response to Consumer Perspective

Changes in the Model Business Corporation Act—Proposed Amendments Relating to Appraisal and Other Remedies
Committee on Corporate Laws, ABA Section of Business Law

Third-Party Closing Opinions: Limited Liability Companies
TriBar Opinion Committee

Attorney Liability Under Section 707(b)(4) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005
Ad Hoc Committee on Bankruptcy Court Structure and Insolvency Processes, Task Force on Attorney Discipline, ABA Section of Business Law

Framework for Control over Electronic Chattel Paper—Compliance with UCC § 9-105
Working Group on Transferability of Electronic Financial Assets, a Joint Working Group of the Committee on Cyberspace Law and the Committee on the Uniform Commercial Code of the ABA Section of Business Law and The Open Group Security Forum

Initial Report of the Joint Task Force on Deposit Account Control Agreements
Joint Task Force on Deposit Account Control Agreements, ABA Section of Business Law

SURVEY—CONSUMER FINANCIAL SERVICES LAW

Introduction to the 2006 Annual Survey of Consumer Financial Services Law
Alvin C. Harrell, Jeffrey I. Langer, and Fred H. Miller

Truth in Lending Developments—2005
Lynette I. Hotchkiss and Jacqueline A. Parker

Fair Lending and the New HMDA Pricing Disclosures
Jean Noonan

Dealer Rate Participation Class Action Settlements: Impact on Automotive Financing
Kenneth J. Rojc and Sara B. Robertson

The ECOA Discrimination Proscription and Disparate Impact—Interpreting the Meaning of the Words That Actually Are There
Peter N. Cubita and Michelle Hartmann

continued on back cover

February 2006 • Volume 61 • Number 2

The ECOA Discrimination Proscription and Disparate Impact—Interpreting the Meaning of the Words That Actually Are There

*By Peter N. Cubita and Michelle Hartmann**

INTRODUCTION

In recent years there has been a series of credit discrimination pricing cases in the automotive finance area predicated principally upon the assumption that the Equal Credit Opportunity Act (ECOA) prohibits certain facially-neutral practices that have a disparate impact or "effect" on a protected class.[1] Recent United States Supreme Court decisions examining whether other civil rights statutes prohibit disparate impact discrimination suggest a need to examine critically the foundations of this assumption. Courts concluding that the ECOA prohibits disparate impact discrimination that is not business-justified generally have done so without scrutinizing the text of the ECOA discrimination proscription.[2] They have tended

* Peter N. Cubita is a member of the New York bar and is a partner in the Litigation/Regulatory Department of Weil, Gotshal & Manges LLP in New York, New York. Mr. Cubita is a former Chair of the Personal Property Financing Subcommittee of the Consumer Financial Services Committee of the American Bar Association Section of Business Law. He, along with others at his firm, represented GMAC in connection with the *Coleman* case cited in this article. The editor of this Annual Survey was retained by GMAC as an expert witness in the *Coleman* case, and invites those with opposing views to submit articles for publication in future Surveys. Michelle Hartmann is a member of the Texas bar and is an associate in the Litigation/Regulatory Department of Weil, Gotshal & Manges LLP in Dallas, Texas. The authors acknowledge the assistance of Marshall T. Bell in the preparation of this article.

1. *See generally* Nicole F. Munro, Jean L. Noonan & R. Elizabeth Topoluk, *Recent Developments in Fair Lending and the ECOA: A Look at Housing Finance and Motor Vehicle Dealer Participation*, 60 BUS. LAW. 627, 635–44 (2005). The plaintiffs in these automotive ECOA cases have alleged that purchasers of retail installment sale contracts may be held liable, principally on a disparate impact theory, for the alleged discriminatory acts of automobile dealers in determining the annual percentage rates (APRs) on the retail installment sale contracts that they sell to banks, sales finance companies and other purchasers of installment sale contracts.

2. *See, e.g.*, Smith v. Chrysler Fin. Co., No. Civ. A. 00-6003 (DMC), 2003 WL 328719, at *6 (D.N.J. Jan. 15, 2003); Osborne v. Bank of Am. N.A., 234 F. Supp. 2d 804, 812 (M.D. Tenn. 2002); Wise ex rel. Wilson v. Union Acceptance Corp., No. IP 02-0104-C-M/S, 2002 WL 31730920, at *3–4 (S.D. Ind. Nov. 19, 2002) (citations omitted); Jones v. Ford Motor Credit Co., No. 00 Civ. 8330 (LMM), 2002 WL 88431, at *3–4 (S.D.N.Y. Jan. 22, 2002); Coleman v. General Motors Acceptance Corp., 196 F.R.D. 315, 326 & n.23 (M.D. Tenn. 2000) (collecting cases), *rev'd on other grounds*, 296 F.3d 443 (6th Cir. 2002); Cherry v. Amoco Oil Co., 490 F. Supp. 1026, 1030–31 (N.D. Ga. 1980). *Cf.* Garcia v. Johanns, 444 F.3d 625, 633 n.9 (D.C. Cir. 2006) ("We express no opinion about whether a disparate impact claim can be pursued under ECOA.") (citation omitted); Midkiff v. Adams County Reg'l Water Dist., 409 F.3d 758, 771–72 (6th Cir. 2005) ("[T]his Court [in *Golden*] assumed that disparate impact claims are permissible under the ECOA. We make the same assumptions and need not resolve the

to rely instead upon the following three non-statutory references to the "effects test": (i) excerpts from congressional committee reports issued in connection with the ECOA Amendments of 1976, which did not amend the relevant statutory text; (ii) a footnote to Federal Reserve Board (FRB) Regulation B (Regulation B) which, based upon these committee report excerpts, merely recites that "[t]he legislative history of the Act indicates that Congress intended an 'effects test' concept . . . to be applicable to a creditor's determination of creditworthiness;"[3] and (iii) a related Official Staff Commentary (Commentary) provision that effectively reiterates the point and cites the same committee reports. However, recent Supreme Court decisions involving alleged discrimination have stressed the primacy of the statutory text in determining what Congress proscribed and what it resolved to leave alone. This article examines the text of the ECOA credit discrimination proscription, and these non-statutory references to the "effects test," with a view toward discerning the meaning of the statutory text and the intent of the enacting Congress.

The Text of the ECOA Credit Discrimination Proscription Does Not Prohibit Discriminatory Effects

Numerous decisions of the United States Supreme Court have recognized that, "[i]n a statutory construction case, the beginning point must be the language of the statute, and when a statute speaks with clarity to an issue, judicial inquiry into the statute's meaning, in all but the most extraordinary circumstances, is finished."[4] Indeed, one distinguished jurist has stated that "the Supreme Court insists that we take statutes seriously, bending their language only when the text produces absurd results."[5] Although some courts have held that the ECOA proscribes disparate impact discrimination, surprisingly little judicial attention has

complex statutory questions that these issues present because the Midkiffs' proposed ECOA claim contains a fundamental flaw that renders an amendment to add this claim futile.") (citation omitted); Golden v. City of Columbus, 404 F.3d 950, 963 & n.11 (6th Cir.) ("Neither the Supreme Court nor this Court have previously decided whether disparate impact claims are permissible under ECOA. However, it appears that they are.") (*dicta*) (citations omitted), *cert. denied*, 126 S. Ct. 738 (2005); Rodriguez v. Ford Motor Credit Co., No. 01-C-8526, 2002 WL 655679, at *4 (N.D. Ill. Apr. 19, 2002) ("Ford Credit disputes whether plaintiffs may proceed under a disparate impact theory under the ECOA. Without deciding this open issue, the court evaluates plaintiff's motion for class certification under both theories."). Other commentators also have expressed opposing points of view without scrutinizing the text of the ECOA credit discrimination proscription. *See generally* Gwen A. Ashton, *The Equal Credit Opportunity Act from a Civil Rights Perspective: The Disparate Impact Standard*, 17 Ann. Rev. Banking L. 465, 478–81 (1998); Earl M. Maltz & Fred H. Miller, *The Equal Credit Opportunity Act and Regulation B*, 31 Okla. L. Rev. 1, 356–46 (1978).

3. 12 C.F.R. § 202.6(a) n.2 (2005).

4. *E.g.*, Estate of Cowart v. Nicklos Drilling Co., 505 U.S. 469, 475 (1992).

5. Neal v. Honeywell Inc., 33 F.3d 860, 862 (7th Cir. 1994) (Easterbrook, J.) (citations omitted), *abrogated on other grounds*, Graham County Soil & Water Conservation Dist. v. United States ex rel. Wilson, 125 S. Ct. 2444 (2005). Judge Easterbrook's observation was made in reviewing a lower court decision that had invoked the principle that remedial statutes should be construed broadly to achieve a result not sustainable under the statutory language. In so doing, he emphasized that "the essential question is not which way the statute points but how far it directs one to go" and concluded that "[n]o principle of statutory construction says that after identifying the statute's accommodation of competing interests, the court should give the favored party a little extra." *Neal*, 33 F.3d at 862.

been devoted to the actual text of the ECOA credit discrimination proscription. The credit discrimination proscription is contained in subsection 701(a) of the ECOA, which declares it "unlawful for any creditor *to discriminate against* any applicant . . . *on the basis of* race, color, national origin" or any other prohibited basis.[6] The Regulation B general rule against discrimination is phrased similarly, providing that "[a] creditor *shall not discriminate against* an applicant *on a prohibited basis* regarding any aspect of a credit transaction."[7] Neither the ECOA discrimination proscription nor its Regulation B counterpart references discriminatory or adverse effects.

A comparison with discrimination proscriptions of other statutes is illuminating. The language of the ECOA credit discrimination proscription is comparable to that contained in what the United States Supreme Court has identified as "the disparate treatment wing of Title VII," which prohibits discrimination "*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."[8] Indeed, the Supreme Court has held that comparable language in various other discrimination statutes prohibits only intentional discrimination and not conduct that merely has a discriminatory effect. For example, Title VI of the Civil Rights Act of 1964 provides that "no person . . . shall, on the ground of race, color or national origin . . . be subjected to discrimination under any program or activity" covered by Title VI.[9] The Supreme Court has held that this language prohibits only intentional discrimination.[10] Likewise, Title IX prohibits discrimination "on the basis of sex" and, consequently, the Court of Appeals for the Sixth Circuit has ruled that this provision does not allow an individual to bring a disparate impact claim.[11]

By contrast, Congress has used very different language when it wishes to proscribe facially-neutral practices that have a disparate impact. The disparate impact theory of discrimination had its genesis in *Griggs v. Duke Power Co.*,[12] a Title VII employment discrimination case decided several years before the ECOA was en-

6. 15 U.S.C. § 1691(a) (2000) (emphasis added).

7. 12 C.F.R. § 202.4(a) (2005) (emphasis added).

8. 42 U.S.C. § 2000e-2(a)(1) (2000) (emphasis added); *see* Lorance v. AT&T Techs., Inc., 490 U.S. 900, 915 (1989) (referring to "§ 703(a)(1) [of Title VII], 42 U.S.C. § 2000e-2(a)(1)," as "the disparate treatment wing of the statute"), *abrogated on other grounds by* Civil Rights Act of 1991, Pub. L. No. 102-166, § 112, 105 Stat. 1071, 1078-79 (codified as amended at 42 U.S.C. § 2000e-5(e)(2)). The holding in *Lorance* ultimately was superseded by the Civil Rights Act of 1991 with respect to seniority system claims under Title VII. Specifically, the Civil Rights Act of 1991 amended Title VII, 42 U.S.C. § 2000e-5(e)(2), to provide that "an unlawful employment practice occurs, with respect to a seniority system that has been adopted for an intentionally discriminatory purpose . . . when . . . a person aggrieved is injured by the application of the seniority system or provision of the system." Pub. L. No. 102-166, § 112, 105 Stat. at 1078–79.

9. 42 U.S.C. § 2000d (2000).

10. Alexander v. Choate, 469 U.S. 287, 293 (1985); Guardians Ass'n v. Civil Serv. Comm'n, 463 U.S. 582, 610–12, 642 (1983); Regents of Univ. of Cal. v. Bakke, 438 U.S. 265, 287, 328–40, 352 (1978); *see also* Alexander v. Sandoval, 532 U.S. 275, 280–81 (2001), discussed *infra* notes 39–45 and accompanying text.

11. Brindisi v. Regano, 20 Fed. App. 508 (6th Cir. 2001) (relying on *Sandoval*).

12. 401 U.S. 424 (1971).

acted in 1974. In holding that "the [disparate impact] objective of Congress in the enactment of Title VII is plain from the language of the statute," the United States Supreme Court relied statutorily on paragraph (2) of section 703(a) of Title VII of the Civil Rights Act of 1964.[13] Paragraph (2) of section 703(a), which appropriately is characterized as the disparate impact wing of Title VII, provides as follows:

> It shall be an unlawful employment practice for an employer . . .
> (2) to limit, segregate, or classify his employees . . . in any way *which would deprive or tend to deprive* any individual of employment opportunities *or otherwise adversely affect* his status as an employee, because of such individual's race . . . .[14]

In *Smith v. City of Jackson*, a recent United States Supreme Court case concerning whether the Age Discrimination in Employment Act of 1967 (ADEA) proscribes disparate impact discrimination, a plurality of the Court reiterated that this Title VII "text focuses on the *effects* of the action on the employee rather than the motivation for the action of the employer."[15]

More importantly, all three opinions in *Smith* also acknowledge that identical "effects" language in paragraph (2) of section 4(a) of the ADEA is the only possible statutory source for the ADEA disparate impact proscription.[16] Significantly, neither of these seminal disparate impact decisions relied upon, respectively, para-

13. 401 U.S. at 425 n.1, 429–30 (quoting 42 U.S.C. § 2000e-2(a)(2)); *see* Smith v. City of Jackson, Miss., 125 S. Ct. 1536, 1541–42 (2005) (Stevens, J.) ("We . . . squarely held [in *Griggs*[that § 703(a)(2) of Title VII did not require a showing of discriminatory intent. While our opinion in *Griggs* relied primarily on the purposes of the Act, buttressed by the fact that the EEOC had endorsed the same view, we have subsequently noted that our holding represented the better reading of the statutory text as well.") (footnote omitted) (citing Watson v. Fort Worth Bank & Trust, 487 U.S. 977, 991 (1998)). *But see Smith*, 125 S. Ct. at 1557 (O'Connor, J., concurring in judgment) ("As the plurality tacitly acknowledges, *ante*, at 1542, the decision in *Griggs* was not based on any analysis of Title VII's actual language. Rather, the *ratio decidendi* was the statute's perceived purpose, . . .").

14. *Griggs*, 401 U.S. at 425 n.1, 429–30 (quoting 42 U.S.C. § 2000e-2(a)(2)) (emphasis added); *see also Smith*, 125 S. Ct. at 1541–43 & n.6 (Stevens, J.) (counterpart ADEA disparate impact decision referring, *inter alia*, to "[o]ur unanimous interpretation of § 703(a)(2) of the Title VII in *Griggs* [as] . . . a precedent of compelling importance").

15. 125 S. Ct. at 1542 (Stevens, J.). *Smith* also considered the implications of an ADEA provision stating that it shall not be unlawful for an employer "to take any action otherwise prohibited under subsectio[n[(a) . . . where the differentiation is based on reasonable factors other than age discrimination . . . ." *Id.* at 1543–44 (quoting 29 U.S.C. § 623(f)(1)). In a separate opinion, Justice Scalia concurred in the judgment and in all except Part III of the plurality opinion. As to Part III, Justice Scalia "agree[d] with all of the Court's reasoning, but would find it a basis, not for independent determination of the disparate-impact question, but for deferral to the reasonable views of the" EEOC. *Smith*, 125 S. Ct. at 1546 (Scalia, J., concurring in part and concurring in judgment). *But see Smith*, 125 S. Ct. at 1549 (O'Connor, J., concurring in judgment) ("I would instead affirm the judgment below on the ground that disparate impact claims are not cognizable under the ADEA.").

16. *See Smith*, 125 S. Ct. at 1540–42 & nn. 6 & 7 (Stevens, J., joined by Souter, Ginsburg, and Breyer, JJ.); *id.* at 1548 (Scalia, J., concurring in part and concurring in judgment) ("of course, the only provision of the ADEA that could conceivably be interpreted to effect such a prohibition is § 4(a)(2)"); *id.* at 1549–50 (O'Connor, J., concurring in judgment, joined by Kennedy and Thomas, JJ.) (citation omitted) ("Neither petitioners nor the plurality contend that the first paragraph [of the ADEA discrimination proscription[, § 4(a)(1), authorizes [ADEA] disparate impact claims, and I think it obvious that it does not. That provision plainly requires discriminatory intent, for to take an action against an individual '*because of* such individual's age' is to do so 'by reason of' or 'on account of' her age.") (emphasis added). Chief Justice Rehnquist did not participate in the decision of the *Smith* case.

graph (1) of Title VII section 703(a) or paragraph (1) of ADEA section 4(a), which are comparable to the ECOA credit discrimination proscription insofar as they prohibit discrimination "against" an individual "because of" race, age and the like.[17] *Griggs* and *Smith* thus validate what is apparent from the plain language of the ECOA: the statutory text of ECOA section 701(a) contemplates only the proscription of disparate treatment with respect to credit transactions.

The ECOA credit discrimination proscription is substantially similar to its Title VI and IX counterparts and strikingly dissimilar to the Title VII and ADEA disparate impact proscriptions construed by the United States Supreme Court in *Griggs* and *Smith*. Unlike the Title VII and ADEA disparate impact proscriptions, the ECOA credit discrimination proscription does not speak in terms of the "effects" of a practice on an applicant nor does it speak in terms of practices that deprive, tend to deprive or otherwise adversely affect applicants because of their race, color, national origin or gender.[18] Indeed, the following juxtaposition of the ECOA credit discrimination proscription as originally enacted and the general Title VII employment discrimination proscriptions as originally enacted reveals a clear symmetry with respect to their disparate treatment proscriptions and a glaring distinction with respect to the proscription of disparate impact discrimination:

17. *See Smith*, 125 S. Ct. at 1542 n.6 (Stevens, J.) ("In reaching a contrary conclusion, Justice O'Connor ignores key textual differences between § 4(a)(1), which does not encompass disparate-impact liability, and § 4(a)(2). Section (a)(1) makes it unlawful for an employer 'to fail or refuse to hire . . . *any individual* because of *such individual's* age.' (Emphasis added.) The focus of the section is on the employer's actions with respect to the targeted individual.").

18. The D.C. Circuit recently noted as much in affirming the denial of a class certification motion, observing that the "ECOA contains no such [effects] language." Garcia v. Johanns, 444 F.3d at 633 n.9 ("Both Title VII and the Age Discrimination in Employment Act (ADEA) prohibit actions that 'otherwise adversely affect' a protected individual. *See* 42 U.S.C. § 2000e-2(a)(2); 29 U.S.C. § 623(a)(2). The Supreme Court has held that this language gives rise to a cause of action for disparate impact discrimination under Title VII and the ADEA. *See* Smith v. City of Jackson, 544 U.S. 228, 125 S. Ct. 1536, 1540, 161 L. Ed. 2d 410 (2005) (ADEA); Griggs v. Duke Power Co., 401 U.S. 424, 432, 91 S. Ct. 849, 28 L. Ed. 2d 158 (1971) (Title VII). ECOA contains no such language. We express no opinion about whether a disparate impact claim can be pursued under ECOA.") (citation omitted).

TITLE VII VS. ECOA AS ORIGINALLY ENACTED
COMPARISON OF RELEVANT STATUTORY PROSCRIPTIONS

Statute	Pub. L. No. 88-352, tit. VII, § 703(a), 78 Stat. 241, 255 July 2, 1964 (emphasis added)	Pub. L. No. 93-495, tit. V, § 503, ECOA § 701(a), 88 Stat. 1500, 1521 October 28, 1974 (emphasis added)
Section	DISCRIMINATION BECAUSE OF RACE, COLOR, RELIGION, SEX, OR NATIONAL ORIGIN Sec. 703. (a) It shall be unlawful employment practice for an employer—	TITLE VII—EQUAL CREDIT OPPORTUNITY § 701. Prohibited discrimination
Disparate Treatment Proscription	(1) 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; or	(a) It shall be unlawful for any creditor ***to discriminate against*** any applicant ***on the basis of*** sex or marital status with respect to any aspect of a credit transaction.
Disparate Impact Proscription	(2) ***to limit, segregate, or classify*** his employees ***in any way which would deprive or tend to deprive*** any individual of employment opportunities or ***otherwise adversely affect his status*** as an employee, ***because of*** such individual's race, color, religion, sex, or national origin.	**No Counterpart ECOA Provision**

Congressional silence is all that appears in the ECOA quadrant corresponding to the Title VII disparate impact proscription. The same illuminating comparison could be made of the ECOA discrimination proscription and the general ADEA discrimination proscriptions which, as the United States Supreme Court recently noted in *Smith*, were enacted shortly after Title VII and were modeled on the general Title VII employment discrimination proscriptions.[19]

When Congress enacted the ECOA in 1974, and when it amended the statute in 1976 to expand the prohibited bases, Congress was aware of its prior Title VII and ADEA enactments and it further was aware that the United States Supreme Court had concluded in *Griggs* that paragraph (2) of section 703(a) of Title VII

19. *See Smith*, 125 S. Ct. at 1540–41 (Stevens, J.).

was the statutory source of the Title VII proscription against employment practices that have a disparate impact on a protected class.[20] Indeed, one could not persuasively argue otherwise since Congress is presumed to legislate with an institutional awareness of existing statutory and decisional law.[21] Had Congress intended to proscribe facially-neutral credit practices that would adversely affect an applicant on the basis of his or her race, color, age or national origin, it would have included in ECOA section 701(a) an additional discrimination proscription modeled on paragraph (2) of Title VII section 703(a) and paragraph (2) of ADEA section 4(a). The Congressional failure to enact an ECOA counterpart to these Title VII and ADEA disparate impact proscriptions therefore is compelling evidence—indeed the best evidence—that the enacting Congress intended to limit the scope of the ECOA credit discrimination proscription to disparate treatment.[22] However, neither the courts that have addressed this issue nor the FRB appear to have noticed that the statutory text does not proscribe practices that merely have discriminatory effects.

Decisions Permitting Disparate Impact Claims are Premised Upon Non-Statutory Sources That Lack Any Apparent Statutory Foundation in the Discrimination Proscription

Sources of the Effects Test

Courts addressing the issue of whether disparate impact discrimination is proscribed by the ECOA generally have not analyzed the language of the ECOA

20. *See* S. Rep. No. 94-589, at 4–5 (1976), *reprinted in* 1976 U.S.C.C.A.N. 403, 406 (discussing the 1971 and 1975 Title VII decisions in, respectively, *Griggs* and *Albermarle*).

21. *See generally* West Virginia Univ. Hosps., Inc. v. Casey, 499 U.S. 83, 100–01 (1991) ("[I]t is not our function to eliminate clearly expressed inconsistency of policy and to treat alike subjects that different Congresses have chosen to treat differently."). *But see* Koons Buick Pontiac GMC, Inc. v. Nigh, 543 U.S. 50, 65–66, 125 S. Ct. 460, 470–71 (2004) (Stevens, J. concurring) ("In recent years, the Court has suggested that we should only look at legislative history for the purpose of resolving textual ambiguities or to avoid absurdities. It would be wiser to acknowledge that it is always appropriate to consider all available evidence of Congress' true intent when interpreting its work product."). The decision in *Casey* that expert fees were not recoverable "costs" under 42 U.S.C. § 1988 ultimately was superseded by Congress, which amended 42 U.S.C. § 1988 in 1991 to authorize the recovery of expert fees by a prevailing party. Pub. L. No. 102-166, § 113, 105 Stat. 1071, 1079 (1991) (codified at 42 U.S.C. § 1988(c)). Its reasoning, however, regarding clearly expressed inconsistency of policy remains valid.

22. *See* Latimore v. Citibank Fed. Sav. Bank, 151 F.3d 712, 714–15 (7th Cir. 1998) (refusing to apply tests derived from Title VII to ECOA); Castaneda v. Pickard, 648 F.2d 989, 1000–01 (5th Cir. 1981) (rejecting disparate impact claim under 20 U.S.C. § 1703(d) of Title VI because statutory language prohibiting discrimination "on the basis of race" did not resemble counterpart proscriptive language in Title VII); Alvin C. Harrell & Laurie A. Lucas, *Equal Credit Opportunity in the 1990s: Implications for Creditors' Institutions*, 49 Consumer Fin. L. Q. Rep. 83, 87 (1995) ("In *Washington* [v. *Davis*, 426 U.S. 229 (1976)], the Supreme Court concluded that extensions of the effects test . . . beyond those areas specifically governed by the applicable statute . . . should await legislative prescription.") (footnote omitted). In their article, Professors Harrell and Lucas note that "the *Griggs* and *Albermarle* cases were carefully distinguished from the rules of general applicability that controlled in *Washington* on grounds that *Griggs* and *Albermarle* were decided under a limited statutory provision currently found in Title VII of the Civil Rights Act of 1964." Harrell & Lucas, 49 Consumer Fin. L. Q. Rep. at 87.

discrimination proscription. They have tended to rely instead upon the following three non-statutory references to the effects test: (i) post-enactment references to the "effects" test in congressional committee reports relating to the ECOA Amendments of 1976; (ii) a reference to those committee reports in a footnote to Regulation B; and (iii) a Commentary provision referring to those committee reports.[23]

THE NON-STATUTORY REFERENCES TO THE EFFECTS TEST ARE BASED UPON EXCERPTS FROM SUBSEQUENT COMMITTEE REPORTS

The FRB Commentary to Regulation B contains the following reference to the effects test and the aforementioned congressional committee reports:

> *Effects test.* The effects test is a judicial doctrine that was developed in a series of employment cases decided by the U.S. Supreme Court under Title VII of the Civil Rights Act of 1964 (42 U.S.C. 2000e *et seq.*), and the burdens of proof for such employment cases were codified by Congress in the Civil Rights Act of 1991 (42 U.S.C. 2000e-2). *Congressional intent that this doctrine apply to the credit area is documented in the Senate Report that accompanied H.R. 6516, No. 94-589, pp. 4–5; and in the House Report that accompanied H.R. 6516, No. 94-210, p.5.* The Act and regulation may prohibit a creditor practice that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis, even though the creditor has no intent to discriminate and the practice appears neutral on its face, unless the creditor practice meets a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact . . . .[24]

A footnote to Regulation B similarly states that: "[t]he legislative history of the Act indicates that the Congress intended an 'effects test' concept, as outlined in the employment field by the U.S. Supreme Court in the cases of *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971), and *Albermarle Paper Co. v. Moody*, 422 U.S. 405 (1975), to be applicable *to a creditor's determination of creditworthiness.*"[25]

23. *See, e.g., Osborne*, 234 F. Supp. 2d at 812; *Wise*, 2002 WL 31730920, at *3–4; *Chrysler Fin.*, 2003 WL 328719, at *6; *Jones*, 2002 WL 88431, at *3–4; Coleman v. GMAC, 196 F.R.D. 315, 326 (M.D. Tenn. 2000), *rev'd on other grounds*, 296 F.3d 443 (6th Cir. 2002) (citations omitted). *See generally* 15 U.S.C. §§ 1691b(a)(1), 1691e(e) (2000). *But see Smith*, 125 S. Ct. at 1560 (O'Connor, J., concurring in judgment) ("Of course, it is elementary that 'no deference is due to agency interpretations at odds with the plain language of the statute itself.'") (quoting Public Employees Ret. Sys. of Ohio v. Betts, 492 U.S. 158, 171 (1989)).

24. 12 C.F.R. pt. 202, Supp. I, ¶ 6(a)-2, at 55 (2005) (emphasis added). The "effects test" comment proceeds, by way of example, to discuss a minimum income requirement.

The Official Staff Commentary to Regulation B, including the "effects test" comment, was adopted in 1985. 50 Fed. Reg. 48,018, 48,050 (Nov. 20, 1985). Subsequently, on June 7, 1995, the Board added to the effects test comment language relating to the burdens of proof for Title VII employment cases in the aftermath of the Civil Rights Act of 1991. 60 Fed. Reg. 29,965, 29,968 (June 7, 1995). To the extent that this Comment may be intended to suggest that the amended Title VII disparate impact burdens of proof are applicable to the ECOA, it is plainly inconsistent with the recent United States Supreme Court decision in *Smith*.

25. 12 C.F.R. § 202.6(a) n.2 (2005) (emphasis added). This footnote does not purport to extend beyond creditworthiness determinations. *But see, e.g., Coleman*, 196 F.R.D. at 326–27 & n.23.

These two administrative references to the effects test are themselves derived, in turn, from Senate and House Committee Reports dated January 21, 1976 and May 14, 1975, respectively. The Senate Committee Report states that "courts or agencies are free to look at the effects of a creditor's practices as well as the creditor's motives or conduct in individual transactions" and, therefore, "judicial constructions of anti-discrimination legislation in the employment field, in cases such as *Griggs* . . . and *Albermarle Paper Company* . . . are intended to serve as guides in the application of this Act, especially with respect to the allocations of burdens of proof."[26] The House Committee Report contains an even more attenuated reference to *Griggs* and the "effects test."[27] Thus, the notion that the ECOA credit discrimination proscription prohibits certain facially-neutral practices that have a discriminatory effect is premised ultimately upon these excerpts from congressional committee reports.

THE COMMITTEE REPORTS WERE ISSUED DURING A SUBSEQUENT CONGRESS THAT DID NOT AMEND THE TEXT OF THE CREDIT DISCRIMINATION PROSCRIPTION IN RELEVANT PART

Excerpts from congressional committee reports are a slim reed upon which to erect a disparate impact edifice. Indeed, this situation illustrates the danger inherent in resorting to legislative history without first inquiring whether the statutory text is ambiguous or whether unambiguous statutory text might produce an absurd result. As Justice Scalia recently explained, legislative history "lends itself to a kind of ventriloquism" pursuant to which "[t]he Congressional Record or committee reports are used to make words appear to come from Congress's mouth which were spoken or written by others (individual Members of Congress, congressional aides, or even enterprising lobbyists)."[28] The distinguished scholar Professor Laurence Tribe has echoed these sentiments in his criticism of "the *statutory* interpreter who would have us substitute unexpressed and unenacted thoughts for whatever text actually passed through the fires of bicameral approval and presentment to the president for signature or veto."[29] In short, "[t]he text of the law is not just evidence about how much one interest . . . should be preferred

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26. S. REP. NO. 94-589, at 4–5 (1976), *reprinted in* 1976 U.S.C.C.A.N. 403, 406. The judicial construction of employment discrimination legislation referenced in the Senate Report was, as *Griggs* and *Smith* make clear, a judicial interpretation that the effects language of paragraph (2) of Title VII section 703(a) proscribes certain facially-neutral practices that have a discriminatory effect. Thus, to the extent that *Griggs* was intended to serve as a guide with respect to the ECOA, a review of the judicial construction of the Title VII discrimination legislation at issue in *Griggs* would have revealed that it was premised on a discrimination proscription for which there was no counterpart in the ECOA.

27. H.R. REP. NO. 94-210, at 5 (1975).

28. *See Koons*, 543 U.S. at 73–74, 125 S. Ct. at 474 (Scalia, J., dissenting).

29. Laurence H. Tribe, *Comment*, *in* ANTONIN SCALIA, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 74–75 (Amy Gutmann ed., 1997) (emphasis added); *accord*, W. David Lawson, *Legislative History and the Need to Bring Statutory Interpretation Under the Rule of Law*, 44 STAN. L. REV. 383, 383–84 (1992) ("Members of Congress can make law by 'manufacturing' legislative history, thereby evading the Constitutional requirements for legislating that assure that laws receive the appropriate representative consent.").

over another . . . ; the text is the *decision* about what to do" with respect to the accommodation of competing interests — "a decision approved by the Constitution's own means, bicameral approval and presidential signature."[30]

Here, however, a close examination of the related ECOA Amendments of 1976 reveals an even more fundamental issue with respect to the asserted legislative history. These statements were made in committee reports issued during a subsequent Congress that did not amend the ECOA credit discrimination proscription in relevant part. Your authors submit, therefore, that it is unclear how these statements properly could be characterized as "history" with respect to the prior enactment or as probative of the intent of the enacting Congress.

The ECOA was enacted by the 93rd Congress and signed into law on October 28, 1974. The initial enactment declared it "unlawful for any creditor to *discriminate against* any applicant *on the basis* of sex or marital status with respect to any aspect of a credit transaction."[31] The House and Senate committee reports that have been relied upon as indicia of congressional intent were dated, respectively, May 14, 1975 and January 21, 1976 and were issued during the 94th Congress. They accompanied amendatory bills, introduced in the *subsequent* Congress that enacted the ECOA Amendments of 1976. Those amendments, *inter alia*, expanded the prohibited bases beyond sex and marital status to include race and other personal attributes.

Significantly, however, the nature of the underlying credit discrimination proscription was not amended in relevant part—it continued to declare it "unlawful for any creditor *to discriminate against* any applicant, with respect to an aspect of a credit transaction . . . *on the basis of*" specified personal attributes or other prohibited bases. The 1976 ECOA Amendments did not add to the credit discrimination proscription disparate impact language, comparable to that contained in Title VII and the ADEA, that would encompass practices that merely have a discriminatory effect.[32] Thus, because the subsequent Congress did not amend the ECOA in relevant part, the discussion in the 1975 and 1976 committee reports may not fairly be characterized as part of the legislative "history" of the statutory proscription, enacted by the prior Congress, that prohibited discrimination "on the basis of" specified personal attributes.[33]

The United States Supreme Court repeatedly has declined to treat comments by a subsequent Congress as "history" because it is "a hazardous basis for in-

30. *See Neal*, 33 F.3d at 862–63 (emphasis in original) ("[A]ll laws . . . are compromises among competing interests. . . . whether one of these interests triumphs over the other, or whether instead they coexist uneasily, is determined not by natural justice but by the political process, which created a text.") (Easterbrook, J.).

31. Amendment to the Consumer Credit Protection Act, Pub. L. No. 93-495, tit. V, § 503, 88 Stat. 1500, 1521–22 (current version codified at 15 U.S.C. § 1691(a)).

32. *See* Equal Credit Opportunity Act Amendments of 1976, Pub. L. No. 94-239, § 2, 90 Stat. 251, 251–55 (current version codified at 15 U.S.C. § 1691(a)).

33. *Cf. Osborne*, 234 F. Supp. 2d at 811 n.3 (referring to "contemporaneous" House and Senate Reports).

ferring the intent of an earlier Congress."[34] Indeed, in a civil rights case involving distinctions in the "costs" provisions of various fee-shifting statutes, the Supreme Court has noted that "[t]he 'will of Congress' we look to is not a will evolving from Session to Session, but a will expressed and fixed in a particular enactment. Otherwise, we would speak not of 'interpreting' the law but of 'intuiting' or 'predicting' it."[35] In so doing, the Court explained that the statutory text is the touchstone of statutory interpretation and not even contemporaneous comments in committee reports may be invoked to override unambiguous statutory language:

> [Plaintiff] further argues that the congressional purpose in enacting Section 1988 must prevail over the ordinary meaning of the statutory terms. . . . As we have observed before, however, *the purpose of a statute includes not only what it sets out to change, but also what it resolves to leave alone. The best evidence of that purpose is the statutory text* adopted by both Houses of Congress and submitted to the President. *Where that contains a phrase that is unambiguous*—that has a clearly accepted meaning in both legislative and judicial practice—we *do not permit it to be expanded or contracted by the statements of* individual legislators or *committees during the course of enactment process.*[36]

While various courts have relied upon the committee reports relating to the ECOA Amendments of 1976, your authors are aware of only one decision addressing the assertion that "this post-enactment legislative history cannot override the explicit statutory text and is irrelevant to determining the intentions of the enacting Congress."[37] Although that decision rejected this argument based upon two Supreme Court cases that relied on subsequent legislative history, your authors respectfully submit that those Supreme Court decisions are distinguishable.[38]

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34. *See* Jones v. United States, 526 U.S. 227, 238 (1999). *See also* Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc., 447 U.S. 102, 117 (1980); Longview Fibre Co. v. Rasmussen, 980 F.2d 1307, 1311–12 (9th Cir. 1992) (refusing to consider conference report of a subsequent Congress).

35. *Casey*, 499 U.S. at 101 n.7 (emphasis added).

36. *Id.* at 98–99 (emphasis added) (citations omitted).

37. Coleman v. GMAC, No. 3:98-0211, slip op. at 10 (M.D. Tenn. Aug. 21, 2003) (on file with *The Business Lawyer*).

38. *Id.* ("(the views of a Congress engaged in the amendment of existing law as to the intent behind that law are 'entitled to significant weight')") (quoting Seatrain Shipbuilding Corp. v. Shell Oil Co., 444 U.S. 572, 596 (1980); *see also* Zipes v. Trans World Airlines, Inc., 455 U.S. 385, 394–95 (1982) ("Although subsequent legislative history is not dispositive . . . the legislative history of the 1972 amendments also indicates that Congress intended the filing period to operate as a statute of limitations instead of a jurisdictional requirement."). Although *Seatrain* stated that the views of subsequent Congresses "are entitled to significant weight," that statement was qualified both by the observation that this is "particularly so when the precise intent of the enacting Congress is obscure" and by the express acknowledgment that "the view of subsequent Congresses cannot override the unmistakable intent of the enacting one . . . ." *Seatrain*, 444 U.S. at 596 (citations omitted).

Seatrain involved the question of whether the Secretary of Commerce had the authority to terminate the foreign-trade-only restriction associated with a construction-differential subsidy when the vessel owners agreed to repay the subsidy in full. Although a discussion of the bases for distinguishing *Seatrain* is beyond the scope of this Article, we note that subsequent history was used in *Seatrain* for the limited purpose of buttressing the "conclusion that Congress did not forbid the transactions here at issue" after the Court: (i) initially noted that "[o]n the face of the statute, the [Commerce] Secretary's broad contracting powers and discretion to administer the [Merchant Marine] Act seemed to com-

The Statutory Text as an Administratively Unexpandable Reflection of What Congress "Resolved to Leave Alone"

United States Supreme Court decisions of recent vintage have scrutinized statutory text when considering the question of whether disparate impact claims are cognizable under other discrimination statutes.[39] Consistent with this statutory focus, the Supreme Court, and certain of the Justices, have suggested that administrative agencies may not be at liberty to "effectuate the purposes" of statutes that proscribe only intentional discrimination by adopting regulations that expand upon those purposes by prohibiting facially-neutral practices that have a disparate impact. For example, the Supreme Court decision in *Alexander v. Sandoval*[40] held that a disparate impact regulation, adopted by the Departments of Justice (DOJ) and Transportation (DOT) under Title VI of the Civil Rights Act of 1964 could not be invoked by a private party to challenge an Alabama policy of administering driver's license examinations only in English. The *Sandoval* decision was premised on the conclusion that the regulation could not create such a private right because, "[f]ar from displaying congressional intent to create new rights," the congressional delegation of administrative authority in "[section] 602 limits agencies to 'effectuat[ing] rights already created by [section] 601,'" which proscribed only intentional discrimination.[41]

Although a more detailed examination of *Sandoval* and its implications is beyond the scope of this article,[42] *Sandoval* serves to frame the fundamental question of whether an administrative agency validly may adopt a regulation proscribing disparate impact discrimination pursuant to a statute whose text proscribes only intentional discrimination or disparate treatment. Because the petitioners did not challenge the validity of the DOJ and DOT disparate impact regulation, *Sandoval* "assumed for the purposes of deciding th[e] case that the DOJ and DOT regulations proscribing activities that have a disparate impact on the basis of race are valid."[43] The Court remarked *in dicta*, however, that statements in its prior decisions suggesting that regulations promulgated under Title VI may validly proscribe activities that have a disparate impact "even though such activities are permissible under [section] 601" are "in considerable tension with the rule in *Bakke* and *Guardians* that [section] 601 forbids only intentional discrimination . . . ."[44]

prehend the authority urged by petitioners here"; and (ii) found that "[t]here is no language suggesting that Congress intended to rule out permanent releases of the type at issue here." *Seatrain*, 444 U.S. at 588, 594–95.

In *Zipes*, a case involving the question of whether the Title VII administrative filing requirement was jurisdictional, subsequent legislative history was used for the limited purpose of confirming a conclusion that was apparent from the language and structure of Title VII and legislative history from the enacting Congress. *Zipes*, 455 U.S. at 394–95.

39. *See Sandoval*, 532 U.S. at 280–81; *Guardians Ass'n*, 463 U.S. at 610–12, 642.

40. 532 U.S. 275 (2001).

41. *Id.* at 289–90.

42. A few district court decisions have addressed *Sandoval*-based arguments with respect to the ECOA. *See, e.g., Wise*, 2002 WL 31730920, at *3–4; *Osborne*, 234 F. Supp. 2d at 811–12 & nn.3–4; *Chrysler Fin.*, 2003 WL 328719, at *6 (distinguishing *Sandoval* on various bases).

43. 532 U.S. at 281–82.

44. *Id.* at 281–82 (citing *Guardians Ass'n*, 463 U.S. at 612–13 (O'Connor, J., concurring in judgment)).

The *Sandoval* Court further observed how odd it seemed for the dissent to suggest that a disparate impact regulation may effectuate the purpose of an intentional discrimination statute by prohibiting conduct which the statute permits:

> We cannot help observing, however, how strange it is to say that disparate-impact regulations are "inspired by, at the service of, and inseparably intertwined with" [section] 601, post, at 1531, when [section] 601 permits the very behavior that the regulations forbid. *See Guardians*, 463 U.S. at 613, . . . (O'Connor, J., concurring in judgment) ("If, as five Members of the Court concluded in *Bakke*, the purpose of Title VI is to proscribe *only* purposeful discrimination . . . , regulations that would proscribe conduct by the recipient having only a discriminatory *effect* . . . do not simply 'further' the purpose of Title VI; they go well *beyond* that purpose").[45]

Indeed, Justice O'Connor's concurring opinion in *Guardians* aptly noted that, although "an agency's legislative regulations will be upheld if they are 'reasonably related' to the purposes of the enabling statute, . . . we would expand considerably the discretion and power of agencies were we to interpret 'reasonably related' to permit agencies to proscribe conduct that Congress did not intend to prohibit."[46] Justice O'Connor thus concluded that "'[r]easonably related to' simply cannot mean 'inconsistent with.'"[47]

The issue of the scope of the administrative authority conferred by ECOA section 703(a) is arguably premature because the FRB has not included in Regulation B a provision affirmatively proscribing certain facially-neutral practices that produce a discriminatory effect. Thus, assuming *arguendo* that the FRB possesses the requisite statutory authority, one might legitimately argue that it has not exercised that authority by adopting a Regulation B analogue to paragraph (2) of section 703(a) of Title VII or its ADEA counterpart. Instead, the FRB has adopted a footnote to Regulation B that merely recites the fact that "[t]he legislative history of the Act indicates that Congress intended an 'effects test' concept . . . to be applicable to a creditor's determination of creditworthiness" and a related Commentary provision that effectively reiterates this point.[48] These repetitive administrative references to the post-enactment history are not equivalent to making a considered administrative determination that "the purposes of this title," as reflected in the text of its discrimination proscription, include the eradication of discriminatory effects.[49] Indeed, as one commentator has noted previously, "[t]here is no apparent statutory basis for these references."[50]

45. *Id.* at 286 n.6 (emphasis in original).

46. *Guardians Ass'n*, 463 U.S. at 614 (O'Connor, J., concurring in judgment) (distinguishing Mourning v. Family Publ'ns Serv., Inc., 411 U.S. 356, 369 (1973)).

47. *Guardian Ass'n*, 463 U.S. at 614 (O'Connor, J., concurring in judgment).

48. *See supra* notes 24–25 and accompanying text.

49. The notion that these administrative references to the effects test speak authoritatively to what the statutory language actually proscribes brings to mind Justice O'Connor's recent observation, in *Smith v. City of Jackson, Miss.*, regarding an EEOC regulation relating to the ADEA: "This discussion serves to illustrate why it makes little sense to attribute to the agency a construction of the relevant statutory text that the agency itself has not actually articulated so that we can then 'defer' to that reading. Such an approach is particularly troubling where applied to a question as weighty as whether a statute does or does not subject employers to liability absent discriminatory intent. This is not, in

In any event, however, the foregoing discussion of the ability of administrative agencies to expand upon statutory discrimination proscriptions suggests that one should resolve the threshold question of whether the text of the ECOA credit discrimination proscription prohibits only disparate treatment without resort to the "effects test" footnote to Regulation B and/or the related Commentary provision. Only by doing so can one properly determine "the purpose of" the ECOA credit discrimination proscription and whether any related administrative action is effectuating that purpose or going well beyond it. Otherwise one is effectively putting the administrative cart ahead of the statutory horse despite the fact that "[a]n administrative agency is itself a creature of statute" which "may play the sorcerer's apprentice but not the sorcerer himself."[51]

Conclusion

An eloquent jurist observed that statutory "interpretation . . . is a process whereby we figure out the meaning of the words that are actually there; interpreting the sounds of silence is a euphemism for rewriting."[52] Although the statutory language should be the starting point in a statutory construction exercise, there has been a tendency to assume that the ECOA proscribes disparate impact discrimination without pausing to examine carefully the text of the ECOA credit discrimination proscription and to consider whether textual differences in employment discrimination proscriptions reflect clearly expressed differences in policy. "Yet there is no rule that all statutes addressing related topics mean the same thing . . . ."[53] Your authors submit that an examination of the text of the ECOA credit discrimination proscription, and a comparison of the language used in the counterpart Title VII and ADEA discrimination proscriptions, reveals that Congress chose to treat employment discrimination and credit discrimination differently in this respect. There is only statutory silence where an ECOA disparate impact proscription should be found had Congress intended to proscribe discriminatory effects.

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my view what *Chevron* contemplated." *Smith*, 125 S. Ct. at 1559–60 (O'Connor, J., concurring in judgment).

50. *See* Harrell & Lucas, *supra* note 22.

51. *Sandoval*, 532 U.S. at 291; *Guardians Ass'n*, 463 U.S. at 614 (O'Connor, J., concurring in judgment).

52. Graham v. United States, 96 F.3d 446, 450 (9th Cir. 1996) (Kozinski, J., dissenting).

53. *Neal*, 33 F.3d at 863 (Easterbrook, J.).

The Emerging Law of Starter Interrupt Devices
Thomas B. Hudson and Daniel J. Laudicina

Predatory Lending Law Changes in 2005
Therese G. Franzén and Leslie M. Howell

A Renewed Federal Focus on Credit Card Disclosures
Julie L. Williams and Michael S. Bylsma

Survey of Consumer Financial Privacy Developments in 2005
Elena A. Lovoy and Andrew V. Podzolka

Consumer Privacy Litigation and Enforcement Actions in the United States
Stephen F. Ambrose, Jr. and Joseph W. Gelb

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Robert M. Jaworski and Robert H. Jackson

Developments in Cyberbanking
Mark T. Gillett, Obrea O. Poindexter, and Rachel Howell

Is JAMS in a JAM Over Its Policy Regarding Class Action Waivers in Consumer Arbitration Agreements?
Alan S. Kaplinsky and Mark J. Levin

Recent Developments in Class Actions: The Fair Credit Reporting Act
David L. Permut and Tamra T. Moore

The Federal Fair Debt Collection Practices Act: 2006 Review of Appellate Cases
Laurie A. Lucas and Alvin C. Harrell

The 2005 Bankruptcy Reform Act
Jon Ann Giblin, Stephen P. Strohschein, Jeffrey E. Tate, and Alvin C. Harrell

Financial Institution Insurance Activities 2005—Do the Risks Outweigh the Rewards?
James M. Cain and Daphne G. Frydman

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APPENDIX II

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The CFPB and the Equal Credit Opportunity Act

How Regulators Can Improve Consumer Protection and Access to Credit

By Daniel Press[*]

Freedom, equality, and justice are all bedrock principles of the American experiment. Yet it is no secret that the U.S. has not always lived up to these values. Discriminatory treatment has plagued the United States since its founding, whether toward women, immigrants, or African Americans.

A series of landmark civil rights laws were enacted during the 1960s to address such discrimination. One of these laws, the Equal Credit Opportunity Act (ECOA), was intended to ensure that all consumers have equal opportunity in credit applications. Credit discrimination based on race and gender was widespread in the early 20th century.[1] The ECOA attempted to fix that.

Unfortunately, decades later, regulators have begun to stretch their authority beyond that noble goal to enact a policy agenda that Congress never intended. The Consumer Financial Protection Bureau (CFPB)[2], a federal regulator established under the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act, has been highly aggressive in enforcing ECOA. It has done so using dubious statistics and unfounded legal theories to bully firms into settlements rather than proving a case in federal court.[3] In doing this, the Bureau's focus has been not on rooting out material discrimination, but on socially engineering outcomes for individuals who are members of protected groups under civil rights laws.

The CFPB has shifted from the long-held belief that companies should be prosecuted for actual discriminatory treatment to prosecuting companies for perceived discriminatory effect. Specifically, the CFPB has gone after firms whose policies result in outcomes that diverge statistically from the average. Under this novel theory of what constitutes discrimination, the government does not need to prove that a firm had any intent to discriminate. Claims can be brought based solely on statistical calculations that suggest a facially neutral policy disparately affects individuals in protected classes—even if that company had no intent to discriminate and undertook no action to do so.

Ultimately, this harms both businesses and consumers. New technologies, such as alternative credit scoring systems, have the potential to extend affordable credit to consumers who have long been shut out of the financial system. But overzealous enforcement of ECOA threatens these developments. If startup ventures risk prosecution or litigation because their otherwise neutral algorithms have unintended and largely unpredictable effects, innovation in this area will be chilled.

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On May 8, 2018, Congress voted to overturn one of the Bureau's most harmful guidance documents relating to the ECOA liability of auto lenders. While this was a step in the right direction, to date, there has been no Congressional or regulatory action to address the underlying problems with how the CFPB has interpreted the ECOA. With new leadership at the Bureau, the regulator has an opportunity to correct its course. Fair lending is a noble goal, but it must be enforced appropriately.

The Equal Credit Opportunity Act. The Equal Credit Opportunity Act was enacted during a period that saw two seemingly unrelated but extremely significant events—the explosion of consumer credit and the civil rights movement. Beginning largely in the 1950s, consumer credit became an essential tool of economic mobility for working and middle class Americans. But not all groups shared in this prosperity, with members of certain minority groups subject to discrimination in the provision of credit.

In response to these concerns, Congress established the National Commission on Consumer Finance in 1968 to investigate the industry. At its first hearings, the Commission heard largely anecdotal evidence of prejudice against single women and racial minorities. For example, witnesses testified that lenders were often unwilling to extend credit to divorced women.[4] Interestingly, the Commission's final report in 1972 did not recommend federal regulation as the answer. Instead, its members concluded that cultural change and market forces would largely do away with most discrimination.[5]

Nevertheless, Congress established the Equal Credit Opportunity Act in response to the report. Originally passed in 1974 and subsequently amended in 1976, the ECOA prevents discrimination in the granting of credit on the basis of race, color, religion, national origin, sex, marital status, age, receipt of income from any public assistance program, or because a person has exercised certain legal rights under a consumer protection statute.[6] Under ECOA, a lender is generally prohibited from inquiring about these variables or using them in making lending decisions if learned.[7] ECOA's implementing regulation requires that credit scoring systems be "empirically derived, demonstrably and statistically sound."[8]

What ECOA Does Say, and What It Does Not Say. The premise of ECOA—to ensure fair, equitable, and nondiscriminatory access to credit—is clear. But there is debate as to how this premise is to be applied in practice. Does the law require only equal opportunity or equal outcomes? Two dueling models of how to enforce the ECOA, the legal theories of disparate treatment and disparate impact, lead to different approaches.

Disparate treatment occurs when a lender treats a consumer differently because of a characteristic that defines a protected category.[9] Under this theory, a firm must have the intent to discriminate against a protected class. For example, a bank cannot exclude customers who meet the qualifications of a credit card promotion offer simply because they are Hispanic.[10]

Disparate impact occurs when a lender's policy has a disproportionate effect on a certain class, even if the lender had no intent to discriminate and the practice appears to be neutral—unless that policy meets a legitimate business necessity like cost or profitability.[11]

In this case, even companies with policies explicitly designed to prevent discrimination could be charged with discrimination if there is an adverse statistical result.[12] Unsurprisingly, aggrieved parties are often difficult to find in these cases.

The ECOA itself, however, does not address disparate impact. Its language only includes the prohibition of discriminatory treatment, not the discriminatory effect of a certain policy.[13] Instead, the ECOA broadly prohibits discriminatory treatment, stating:

> It shall be unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction—on the basis of race, color, religion, national origin, sex or marital status, or age …

In defining the scope of the law, Congress used the term "discriminate" to prohibit discriminatory treatment or intent. The ECOA includes no language relating to the consequences of a given policy, which would impose disparate impact liability. As the late Supreme Court Justice Antonin Scalia commented regarding the Constitution, the ECOA "says what it says and doesn't say what it doesn't say."[14]

Nevertheless, lower courts have not always focused on the statutory construction of ECOA, with certain cases upholding disparate impact liability.[15] Instead, they have relied principally on excerpts from committee reports developed in connection with the 1976 ECOA amendments, which reference an "effects test" for credit discrimination.[16] There are two problems with this analysis.

First, while the Senate Banking Committee may have made reference to the effects of credit discrimination in their deliberations, in no place in the statute did Congress actually implement this language when it had ample opportunity to do so. The 1976 amendments merely added a broader list of protected classes. It did not alter ECOA to explicitly cover disparate impact claims.

Second, the Supreme Court has consistently reaffirmed the primacy of statutory text in interpreting law.[17] In other words, it must interpret the meaning of words that are actually there when deciding what Congress intended. Therefore, the failure of Congress to enact disparate impact proscriptions must be interpreted to mean that Congress decided to limit the scope of the ECOA to disparate treatment.[18]

The Supreme Court has never decided whether the disparate impact theory is valid under ECOA. But the Court has ruled on many other anti-discrimination laws to set some precedent. The most recent was a dispute under the Fair Housing Act (FHA), *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.* In that decision, Justice Anthony Kennedy announced that "antidiscrimination laws should be construed to encompass disparate-impact claims when their text refers to the consequences of actions and not just to the mindset of the actors, and where that interpretation is consistent with the statutory purpose."[19]

The FHA includes this "effects" language. The Court thus concluded that "this results-oriented language counsels in favor of recognizing disparate-impact liability." Further, in other statutes, such as the Age Discrimination in Employment Act (ADEA), Congress purposefully included "effects" language that signifies a deliberate decision to permit disparate impact claims.

ECOA's implementing regulation, Regulation B, originally recognized this and prohibited only disparate treatment.[20] But in 1994, the Federal Reserve issued an interagency "Policy Statement on Discrimination in Lending," claiming that Regulation B could prohibit *both* disparate treatment and disparate impact, effectively skirting the rulemaking process to pursue an agenda Congress never intended.[21] When enforcement and rule-writing responsibilities of the statute and implementing regulation were transferred to the CFPB under the Dodd-Frank Act, the CFPB confirmed that it would persist with this interpretation of ECOA.[22] Unlike other credit discrimination claims, disparate impact claims do not require the CFPB to prove a firm's intent to discriminate. This has enabled the CFPB to aggressively enforce the ECOA against completely neutral practices that it disfavors, largely for policy-based reasons—not legal ones.

Language of Anti-Discrimination Statutes (emphases in original)

Statute	Disparate Treatment Language	Disparate Impact Language
ECOA	(a) It shall be unlawful for any creditor to *discriminate against* any applicant, with respect to any aspect of a credit transaction— *on the basis of* race, color, religion, national origin, sex or marital status, or age …	None
FHA	805(a): (a) In general It shall be 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.	804(a): It shall be unlawful...To refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, *or otherwise make unavailable* or deny, a dwelling to any person because of race, color, religion, sex, familial status, or national origin.
ADEA	It shall be unlawful for an employer— (1) to fail or refuse to hire or to discharge any individual or otherwise *discriminate against* any individual with respect to his compensation, terms, conditions, or privileges of employment, *because of* such individual's age;	(2) to limit, segregate, or classify his employees in any way which would deprive or tend to deprive any individual of employment opportunities *or otherwise adversely affect* his status as an employee, because of such individual's age;

Source: House Financial Services Committee, *Unsafe at Any Bureaucracy Part I*

Problems with the CFPB's Enforcement of ECOA

Overreaching Authority: The Case of Auto Finance Companies. The CFPB is one of the most powerful regulatory agencies in United States history. It alone has rulemaking, supervision, and enforcement authority over nearly every consumer financial product in the economy.[23] And yet, even such a powerful agency faces some limits. The Dodd-Frank Act, which created the CFPB, included a bipartisan amendment[24] that explicitly exempted auto dealers from the Bureau's broad authority.[25] However, it did not exempt auto dealers from regulatory oversight altogether, as Dodd-Frank granted authority to regulate auto dealers to the Federal Trade Commission, which historically has expertise in policing car sales.[26] Despite this, the Bureau has sought to charge auto finance companies that work with auto dealers with disparate impact discrimination under ECOA. This was done not through the public notice-and-comment process of a rulemaking, as required by the Administrative Procedure Act, but via regulatory "dark matter"—agency issuances such as guidance documents, memos, and interpretive bulletins that are not officially "rules" but nevertheless carry regulatory weight.[27]

On March 21, 2013, the CFPB issued a bulletin detailing the liability that auto finance companies may face under ECOA.[28] The Bureau alleged that these third-party auto finance companies' markup and compensation policies trigger disparate impact liability if the auto dealers' credit decisions result in discriminatory outcomes.[29] The bulletin provided no evidence of discrimination. Rather, it claimed that the way in which consumers bargain with auto dealers for loans creates a situation ripe with potential for discrimination.

The bulletin advised auto finance companies to impose controls on compensation and dealer discretion policies that allow auto dealers to mark up interest rates.[30] As attorney Kim Perez, then a J.D. candidate at the University of North Carolina law school, noted for the North Carolina Banking Institute, the bulletin "therefore seeks not to regulate auto dealers directly, but rather to effectively enlist indirect auto lenders under its jurisdiction; in order to police auto dealer transactions that otherwise would be outside its jurisdiction."[31]

Guidance documents are not legally binding and cannot be relied upon in an enforcement proceeding (although they may be binding in practice.) While interpretive rules are merely designed to clarify what the law says, the auto lending bulletin stretched the ECOA to cover an entirely new arena that was not prescribed in the statute. Not only did this completely change the common understanding of the law, it imposed a new compliance burden on lenders that was not subject to the Administrative Procedure Act's notice-and-comment rulemaking process. In many cases, this would require completely changing their business model.[32] As Perez has further written: "This uncertainty on the Bulletin's binding authority puts lenders between a rock and a hard place: weighing the risks of noncompliance with the benefits of continuing to allow dealer reserve compensations."[33]

Based on that guidance document, the CFPB, in conjunction with the Department of Justice, pursued enforcement actions against four entities—Ally Financial,[34] American Honda Finance Corporation,[35] Fifth Third Bank,[36] and Toyota Motor Credit.[37] The issue at

hand was a standard compensation practice whereby a dealer assists in financing a car through a third-party lender and is compensated by "marking up" the interest rate. Consumer groups, such as the Center for Responsible Lending, have lobbied against this practice for years.[38] The CFPB relied on analysis by these consumer groups, not consumer complaints or internal research, to justify its enforcement action.[39]

However, in December 2017, the Government Accountability Office (GAO) determined that the auto lending bulletin was in fact a "rule" that was never submitted to Congress as required under the Congressional Review Act.[40] In May 2018, Congress voted to disapprove the auto lending bulletin, rescinding the rule and prohibiting the CFPB from issuing a similar one.[41] This action may provide needed regulatory relief for auto lenders, but the whole controversy highlights the danger of the CFPB's capability to use its enormous power arbitrarily.

How Dealer Markup Works. The compensation practice works like this. As part of an auto sale, a dealer may offer financing for the vehicle through a creditor. The creditor offers a wholesale interest rate to the dealer based on factors like the customer's creditworthiness. The dealer then negotiates with the customer an interest rate above the wholesale rate in order to cover the dealer's costs and provide a return. The difference between the rate accepted by the buyer and the rate quoted by a creditor is the dealer's "markup." Because the CFPB's action targeted auto finance companies' practice of allowing auto dealers to mark up interest rates, it is a de facto regulation of auto dealers, which are supposed to be exempt from the CFPB's authority under Dodd-Frank.

This dealer markup is a common retail practice, but consumer advocacy groups and the CFPB argue that the auto lender "discretion" in negotiating rates means that consumers, particularly members of ethnic minority groups, pay a higher rate than they would otherwise. If the Bureau could indicate that minorities paid higher interest rates on average, this would constitute disparate impact discrimination under the CFPB's interpretation of ECOA.

There are numerous problems with the CFPB's claims.

First, the CFPB had no data on race or national origin to validate its claims. The law prohibits auto lenders recording any form of racial characteristics, to ensure that such factors do not influence a lending decision.[42] Instead, the Bureau relied on a proxy methodology, known as Bayesian Improved Surname Geocoding (BISG), which involved taking a customer's surname and zip code and attempting to estimate his or her likely ethnic background.

This methodology proved to be highly erroneous. It significantly overestimated the number of individuals allegedly discriminated against.[43] In fact, internal Bureau emails reveal that the CFPB knew that its controversial statistical approach was less accurate than other available methods and was prone to significant error. For example, for every 100 African Americans, the Bureau's proxy methodology could only identify roughly 19 of them

correctly.[44] Accordingly, CFPB staff themselves did not believe their case would hold up in federal court.[45]

Even worse, the BISG methodology is entirely inappropriate for the kind of analysis the CFPB attempted to conduct. BISG is designed to try to predict the relative proportions of different groups in a population sample, but not whether any particular person is of a particular ethnicity.[46] Had the Bureau gone through the notice-and-comment process of a rulemaking, the methodology likely would not have survived public scrutiny. Indeed, even the most prominent BISG scholars, including its inventor, Marc Elliot of the RAND Corporation, have criticized the CFPB's use of the methodology.[47] The CFPB's gross overestimation of the supposed discrimination became clear when it distributed the refund checks to many white Americans as compensation for supposed discrimination against them as African Americans.[48]

Second, the Bureau's findings omit numerous factors that can explain the perceived disparate impact on protected classes. The Bureau's methodology never accounted for:

- Consumers' credit risk, such as different income levels or credit scores;
- Whether the car was new or used;
- Promotional financing rates for certain vehicles and differences in demand for those vehicles;
- The location of different showrooms and their customers' demographics;
- Whether the customer had shopped around for a better deal;
- Customers' negotiating ability;
- Customer commitment to the transaction; or
- The time frame of the transaction.[49]

Without accounting for these many variables, it is difficult to identify discrimination as the sole or main cause of higher interest rates. When these factors are taken into account, as they were by many industry studies criticizing the CFPB's findings, the racial disparity all but disappears.[50] The supposed disparate impact found by the CFPB does not hold up under empirical scrutiny.

Third, claims that consumers are harmed by such markup compensation policies are off the mark. The policies enable dealers to obtain financing that consumers otherwise could not obtain on their own. Such financing enables more vehicles to be sold to more people across more income levels in a cheaper and quicker way. Moreover, the interest rate is only one of many points negotiated in an automobile transaction, and a marked up interest rate is often used to offset other factors, such as the down payment.[51] If the law were to ban the negotiated interest rate, all other components of the transaction would likely become more expensive to compensate for the dealer's loss of revenue.

This was a common practice among the auto lenders that settled with the CFPB. For example, American Honda Finance Corporation lowered one portion of its markup as a result of the CFPB consent order. But it also raised the price of other less negotiable aspects of its rates, thereby increasing the overall cost of the loan to the consumer by 1.1 percent, or around $586 in extra interest payments over the life of a typical four-year $25,000 loan.[52]

As has often been the case with its rulemakings, the CFPB never conducted a rigorous cost-benefit analysis of any of the proposals it put forward, such as looking at the effects that a change in compensation policy would have on lenders and consumers.[53] Nevertheless, the CFPB pursued settlements with the four companies totaling $200 million in fines. No case was proven in a federal court. In many cases, the Bureau used its substantial leverage over these companies to force them into settling.[54] Some of the consent orders stipulated that the auto finance companies could no longer engage in the kind of markup or compensation practices that consumer groups have lobbied against for years. Internal emails reveal that the Bureau believed that by issuing hefty enforcement actions against prominent companies, it would be able to "tip" the market away from the markup and compensation policies it targeted in its enforcement action.[55]

The problems with a disparate impact theory of liability have been apparent since its inception—in particular, its lack of reliability as an identifier of actual violations of law.[56] The CFPB relied on questionable statistical correlations to assert discrimination in order to justify its efforts to shape private industries practices to its liking, as opposed to rooting out actual discrimination.

Stifling Innovation. The most noticeable impact of aggressive CFPB enforcement is the large fines issued against leading auto lenders. But the greatest "unseen" impact is the chilling effect it is likely to have on financial innovation.[57]

Large, established firms with armies of lawyers and compliance officers can more easily deal with increased regulatory burdens. In the case of Ally Financial, it can also better afford an expensive, even if unjustified, settlement out of court. By contrast, new startup ventures with little capital cannot run the risk of hefty enforcement actions from overzealous officials.

Financial technology, or "FinTech," firms have an enormous potential to revolutionize the consumer finance industry, by leveraging new data and machine learning to extend credit to more consumers through new, efficient business models that rely on algorithms instead of loan officers.[58]

As consumer credit is now largely guided by statistical models, the underwriting of a loan relies heavily on an applicant's credit scores. Yet approximately 35.4 million Americans, known as no-hit or thin-file consumers, are either "credit invisible" or lack sufficient data to generate a credit score.[59]

From the perception of a lender, a consumer's lack of credit history is a sign of that individual being a higher credit risk, even if in reality he or she has the ability to repay the loan and has a good track record of paying bills on time. The problem is that the information lenders obtain from credit reports does not present a complete picture of a consumer's credit risk.[60]

Minority groups are seriously overrepresented among the credit invisible and thin-file population, with only 51 percent of African-Americans and 58 percent of Hispanics having

a credit score, compared to 75 percent of all American adults.[61] By including alternative data such as utility bill payments, electronic transactions, educational attainment, and other information loosely tied to a person's financial behavior, the accuracy of existing credit scores and the amount of credit visible individuals could both improve. One early study from 2006 found that including just two alternative data points—utility and landline and mobile phones bill payments—allowed the creation of credit scores for nearly two thirds of consumers in the study's thin-file sample.[62] Minorities benefited most, with acceptance rates rising by 22 percent for Hispanic borrowers and 21 percent for African-American borrowers.

A shift toward greater automation in credit scoring and lending decisions may also reduce opportunities for prohibited bias. As University of California, Berkeley, researchers found in their study of conventional versus FinTech mortgage lending markets, FinTech lenders, on average, had virtually no disparate impact pricing on minority groups.[63] As the authors concluded:

> Our findings for more algorithmic FinTech mortgage lending suggest that, in addition to the efficiency gains of these innovations, they may also serve to make the mortgage lending markets more accessible to African-American and Hispanic borrowers and provide these borrowers with fairer pricing.[64]

However, overzealous regulators threaten all of these innovations when they pursue prosecution or litigation based on the disparate impact theory of liability. For example, credit scores derived from alternative data containing no records based on prohibited characteristics may be shown to have a similar statistically divergent outcome in certain instances, such as in auto loans, regardless of whether actual discrimination has occurred. A small startup firm cannot weather the kind of regulatory risk this entails. Where such risk is high, lenders will resort to more standardized services that play it safe—in other words, they fail to innovate and serve new markets.

Among banks, there is considerable uncertainty as to how to comply with the disparate impact standard. As a result, many banks have implemented costly compliance programs as a precaution to overzealous regulators. According to the American Bankers Association:

> Under these novel approaches to fair lending enforcement, banks have been struggling to know what is expected of them and how these theories affect their efforts to tailor lending products to reach the variety of credit-worthy borrowers in their communities.[65]

Aggressive regulators skirting the rule of law will only hinder the efforts of firms working to extend credit to currently underserved communities, including those of protected classes. Both lenders and customers will be made worse off, including those who would benefit from potential innovations that would extend affordable credit to consumers that have long been shut out from the financial system. As a recent Treasury Department report concluded: "The CFPB's approach to enforcement and rulemaking has hindered consumer choice and access to credit, limited innovation, and imposed undue compliance burdens, particularly

on small institutions."[66] Clear rules are required for financial innovation to flourish. A disparate impact theory of liability has the opposite effect.

The CFPB's Own Disparate Impact Problem. Ironically, the CFPB itself is a fitting example of the problems with the theory of disparate impact. In 2013, *American Banker* obtained data on the CFPB's job performance ratings that outlined stark racial disparities. According to the report, "whites were twice as likely to receive the agency's top grade than were African-American or Hispanic employees." That is exactly the kind of evidence the Bureau has relied on to pursue disparate impact charges against companies. One CFPB employee told *American Banker*: "If it was a lender and had similar statistics, it would be written up, immediately referred to the Justice Department, sued and publicly shamed."[67]

Broad statistical correlations do not prove discrimination. They may flag an underlying problem, but correlations alone are not proof of wrongdoing. Establishing evidence of discriminatory intent requires further investigation of instances of demonstrated discrimination, such as examining individual loan portfolios, beyond circumstantial evidence.

Opportunity for Reform. In November 2017, Consumer Financial Protection Bureau Director Richard Cordray resigned. President Trump then temporarily appointed Office of Management and Budget Director Mick Mulvaney as acting director. In January 2018, Mulvaney sent a memo to all CFPB staff outlining his vision for the agency. The "Mulvaney Memo," as it became known, established three priorities. Going forward, the CFPB would:

1) Faithfully enforce the consumer protection laws as written, but not attempt to regulate beyond that mandate.
2) Focus on quantifiable and unavoidable harm to the consumer and only pursue lawsuits where harm can be found to have occurred.
3) Pursue formal rulemaking and less regulatory "dark matter," such as guidance documents.[68]

The CFPB's enforcement of the ECOA against auto lenders violates all of these principles.

First, the CFPB, to paraphrase Mulvaney, "pushed the envelope," as Dodd-Frank explicitly prevents the Bureau from regulating auto dealers.[69]

Second, rather than focusing on quantifiable and unavoidable harm, the Bureau used flawed statistical methods and questionable legal theory to stamp out certain compensation policies it did not like on the basis of policy preferences, not law.

Third, instead of going through the appropriate procedures to write a new rule, the Bureau relied on a guidance document to rewrite existing law.

The new leadership and new priorities at the CFPB present a valuable opportunity to reform the Bureau's enforcement of the ECOA. Acting CFPB Director Mulvaney has already

shown a willingness to implement reform, with his decision to reorganize the Office of Fair Lending and Equal Opportunity (OFLEO), which oversaw the auto lending cases. In February 2018, Mulvaney shifted OFLEO from the CFPB's Supervision, Enforcement, and Fair Lending Division to the CFPB director's office, effectively stripping OFLEO of supervision and enforcement functions, while continuing to focus on advocacy, coordination, and education.[70]

Focus on Intent. Acting Director Mulvaney's priority for the CFPB to "faithfully enforce the consumer protection laws as written" means the CFPB should enforce the ECOA to prohibit disparate treatment of protected classes, not disparate impact. As noted, nowhere does the language of the ECOA give authority to regulators to prosecute firms for the disparate effect of a facially neutral policy. While the Supreme Court has not settled this question, a number of other Supreme Court precedents do not support the current interpretation of the law under Regulation B.

In the auto lending cases, the CFPB used the ECOA not to root out actual discrimination, but to try to eliminate a practice that consumer advocacy groups had long lobbied against. This does nothing to advance equality, and may actually work to inhibit financial innovations that would extend credit to underserved communities.

The CFPB should correct Regulation B's focus on disparate impact by rescinding any guidance documents that recognize the theory or through a new rulemaking to bring the rule in line with the underlying statute.

Expand "No-Action Letter" Program. Congress gave the CFPB the tools to foster financial innovation through providing regulatory certainty. Project Catalyst is a program of the CFPB that enables the Bureau to issue "no-action letters," which signify that the Bureau "has no present intent to recommend initiation of supervisory or enforcement action" against a firm based on a certain statute the CFPB administers.[71] Since its founding in 2010, the CFPB has only issued one no-action letter, to Upstart, an online platform for consumer loan services that evaluates applications using certain non-traditional factors such as education and employment history.[72]

As noted, alternative credit scoring systems have enormous potential to bring thousands of credit invisible consumers into the formal financial system. But disparate impact liability under ECOA will remain a major impediment as long as companies like Upstart continue to have to ask for permission to do business.

To fulfill the promise of FinTech, the CFPB should expand the no-action letter program under Project Catalyst to issue more letters to innovative firms that require regulatory certainty before they experiment with alternative methods to extend credit to underserved communities.

ECOA and Small Business Lending. When the Dodd-Frank Act established the CFPB in 2010, Section 1071 of the Act amended the ECOA to require the collection of women- and

minority-owned small business loan data. Such a requirement raises two major concerns, particularly regarding potential disparate impact enforcement.

First, unlike consumer credit products that typically involve a limited number of variables to be considered in the underwriting process, lending to small businesses is highly tailored and dependent on any number of relevant variables.[73] Statistical correlations that typically fail to capture nuanced explanatory variables will only become less reliable for small business lending than they are for proving consumer-lending discrimination, particularly if they require the use of proxy metrics.

Second, because the loan underwriting may be more individualized and complex, the temptation to use statistical shortcuts to allege discrimination may increase.[74] As with innovative financial technology firms, this gives financial institutions little incentive to expand their lending portfolios. If anything, the increased burden of data collection and compliance programs, combined with the risk of potential enforcement actions, will likely drive lenders out of the business.

Congress should repeal section 1071 of Dodd-Frank entirely. Short of repeal, the CFPB should tread carefully in its rulemaking process so as to not inadvertently discourage lending to the small businesses it seeks to protect.

Conclusion. Fair lending laws like the Equal Credit Opportunity Act are primarily focused on expanding credit opportunity, but problematic theories of fair lending liability undermine this goal. Disparate impact, as opposed to disparate treatment, does not require an agency to prove that a company discriminated against individual members of a group designated as a protected class under civil rights laws. Instead, it merely requires for a facially neutral policy to have a statistically disparate impact on a protected class.

Such a low standard of proof has allowed aggressive regulators like the Consumer Financial Protection Bureau to bring dubious enforcement actions against financial institutions, as demonstrated by a string of auto lending cases beginning in 2013. These cases had little to do with stamping out demonstrated discrimination and more to do with achieving policy objectives of the Bureau, such as eliminating compensation practices its leadership dislikes.

Worst of all, such aggressive enforcement of the ECOA may lead to fewer credit options for working and middle class consumers, as innovative financial services firms with the potential to extend credit to currently underserved markets are snuffed out. Such firms may not be willing to take a risk on alternative business models that could trigger disparate impact liability. As noted, FinTech firms and other innovative enterprises are working to extend credit to new, underserved communities. Aggressive disparate impact enforcement undermines these opportunities.

While fair lending remains a noble goal, the CFPB must take steps to ensure that it no longer relies upon unsound methods like the disparate impact standard. The ECOA was conceived as a means of ensuring equal *opportunity* to credit. As Acting Director Mulvaney

has promised, the CFPB should faithfully enforce ECOA as written, and not go beyond the mandate Congress intended.

Notes

[1] Perhaps the worst credit discrimination of all, particularly in the mortgage market, was at the hands of various federal, state, and local governments. For an extended discussion of how the government systematically segregated the United States through federal and state housing policy, see Richard Rothstein, *The Color of Law: A Forgotten History of How Our Government Segregated America* (New York: Liveright, 2017).
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[3] House Financial Services Committee, *Unsafe at Any Bureaucracy Part I: CFPB Junk Science and Indirect Auto Lending*, November 24, 2015, https://financialservices.house.gov/uploadedfiles/11-24-15_cfpb_indirect_auto_staff_report.pdf.
[4] National Commission on Consumer Finance, 1972, Chapter 8.
[5] Ibid.
[6] Equal Credit Opportunity Act, Pub. L. No. 93-495, §§ 501-503, 88 Stat. 1521, 1974.
[7] Regulators face challenges in defining exactly what characteristics to prohibit in a lenders underwriting decision. For example, most regulators prohibit the use of income as an underwriting factor as it tends to correlate with the race and gender of an applicant. However, there is evidence that points to minority applicants having higher incomes on average, which presumably would make it easier for them to obtain credit. For a discussion of these factors, see Gregory Elliehausen and Thomas Durkin, "Theory and Evidence of the Impact of Equal Credit Opportunity: An Agnostic Review of the Literature," *Journal of Financial Services Research*, Vol. 2, Issue 2 (1989), pp 89–114, https://link.springer.com/article/10.1007/BF00351648.
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[12] This was the case in the Supreme Court employment dispute, *Ricci v. DeStefano.*
[13] Peter Cubita and Michelle Hartmann, "The ECOA Discrimination Proscription and Disparate Impact—Interpreting the Meaning of the Words that Actually Are there," *The Business Lawyer,* Vol. 61, No. 2 (February 2006), pp. 829-842, https://www.jstor.org/stable/40688368?seq=1#page_scan_tab_contents.
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[15] Cubita and Hartmann.
[16] Ibid.
[17] Ibid.
[18] Ibid.
[19] *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, 135 S. Ct. 2507, 2519, 2015, https://supreme.justia.com/cases/federal/us/576/13-1371/.
[20] Ritter.
[21] Federal Reserve, Policy Statement on Discrimination in Lending, April 15, 1994, https://www.gpo.gov/fdsys/pkg/FR-1994-04-15/html/94-9214.htm.

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[25] Section 1029 (a) of the Dodd-Frank Act states, "the Bureau may not exercise any rulemaking, supervisory, enforcement or any other authority, including any authority to order assessments, over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both." Pub. L. 111–203, title X, § 1029, July 21, 2010, https://www.law.cornell.edu/uscode/text/12/5519.

[26] Section 1029 (d) of the Dodd-Frank Act states, "Notwithstanding section 18 of the Federal Trade Commission Act, the Federal Trade Commission is authorized to prescribe rules under sections 5 and 18(a)(1)(B) of the Federal Trade Commission Act in accordance with section 553 of title 5, United States Code, with respect to a person described in subsection (a)." Pub. L. 111–203, title X, § 1029, July 21, 2010, https://www.law.cornell.edu/uscode/text/12/5519.

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[45] Ibid.
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[47] AnnaMaria Andriotis and Rachel Louise Ensign, "U.S. Government Uses Race Test for $80 Million in Payments," *Wall Street Journal*, October 29, 2015, https://www.wsj.com/articles/u-s-uses-race-test-to-decide-who-to-pay-in-ally-auto-loan-pact-1446111002. Rachel Witkowski, "CFPB's Outside Expert on Disparate Impact Also Advises Banks," *American Banker*, September 28 2015, https://www.americanbanker.com/news/cfpbs-outside-expert-on-disparate-impact-also-advises-banks.
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[54] At the time of the consent order, Ally Financial was seeking approval from the Federal Reserve and Federal Deposit Insurance Corporation to gain a Financial Holding Company (FHC) charter. Internal emails obtained by the House Financial Services Committee show that the CFPB understood that any outstanding regulatory actions against Ally would result in the denial of a charter. The Fed had suggested to the Bureau that if Ally took prompt corrective action, it would be taken into consideration. Five days before its deadline for approval as a FHC, Ally signed a settlement with the CFPB and Justice Department. The application was approved three days later. See the case of Ally Financial in *Unsafe at Any Bureaucracy Part I.*
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APPENDIX III

Fair Lending:

Implications for the Indirect Auto Finance Market

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INTRODUCTION

Over the past few years, regulatory focus on fair lending examination of the indirect automotive finance market has increased significantly. Recent regulatory developments that impact the indirect auto finance market include the issuance on March 21, 2013 of the Consumer Financial Protection Bureau (CFPB) Bulletin 2013-02,[1] "Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act" (Bulletin) which details the manner in which certain policies related to dealer discretion have the potential to create significant fair lending risks for financial institutions that participate in this important consumer market.[2] At the same time, methodologies used by regulatory agencies for fair lending examinations have changed significantly. For example, the CFPB issued "Using Publicly Available Information to Proxy for Unidentified Race and Ethnicity" (White Paper) on September 17, 2014 which presents its methodology for using a proxy to assign race/ethnicity to consumers obtaining auto financing.

In this research, we illustrate the complexities of indirect automobile financing and evaluate current regulatory fair lending practices observed in the industry. The research uses data collected from a number of market participants and aggregated in order to inform the discussions concerning dealer compensation, prices observed in the market, and the costs and benefits to consumers of alternative dealer compensation methods.

Highlights of the study include demonstrating that:

- The markets for purchasing automobiles (the retail automotive market) and for financing automobiles (the automotive finance market) are complex, highly interconnected and highly competitive.
- Accurately analyzing dealer reserve is difficult for a number of reasons, and failure to consider these challenges increases the potential for drawing erroneous conclusions.
- The methods commonly used by regulators to proxy race and ethnicity, including the recently applied Bayesian Improved Surname Geocoding

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[1] CFPB Bulletin 2013-02, March 21, 2013.

[2] In this paper we use the term 'financial institution' to refer to any company that finances new or used vehicle sales. Financial institutions include banks, non-banks, credit unions, captive and non-captive companies, direct lenders and indirect finance companies, and buy-here pay-here dealers.

(BISG) method, are conceptually flawed in their *application* and subject to significant bias and estimation error.

- The use of biased race and ethnicity proxies creates significant measurement errors, which likely result in overstated disparities and overstatements of alleged consumer harm.
- The Department of Justice (DOJ) recognizes that dealer reserves depend on objective, observable business factors. Failure to consider legitimate business factors for observed disparities increases the potential for reaching erroneous conclusions.
- Aggregating contracts originated by individual dealers to the portfolio level may create the appearance of differential pricing on a prohibited basis when none exists.
- When appropriately considering the relevant market complexities and adjusting for proxy bias and error, the observed variations in dealer reserve are largely explained.
- Alternative dealer compensation structures, such as "flats," may lead to increased borrowing costs for many minority and non-minority consumers and, in turn, may limit access to credit for some consumers.

A first step in designing an appropriate fair lending strategy is developing the conceptual framework. The intricacies of this very complex market require more complex strategies than those used to date. Given the realities of the regulatory landscape and the limited tools available for analysis, the ability to perform meaningful, accurate and actionable analyses of dealer reserves at the portfolio level is very circumscribed. Based on our analysis, we offer the following key recommendations:

- In calculating any disparities at the portfolio level, make adjustments to the population to:
  - Exclude any volumes from dealers with zero dealer reserve.
  - Exclude any volumes from dealers with no variance in reserve.
  - Exclude any dealers with counts insufficient to monitor dealer activity – specifically, exclude dealers with fewer than 2 contracts from a protected class member and 2 contracts from non-Hispanic whites and a total of 5 contracts. (Similar restrictions should be applied when analyzing for age or gender).
- Implement economic controls to adjust for general economic conditions beyond the control of the financial institution or dealer. Specifically, adjust for:

  - Location – the analyses should include MSA level fixed effect controls. Market demand/supply conditions vary by MSA.
  - New/Used – these markets are completely different on many dimensions and the negotiation around trade in values may directly impact dealer reserves.
  - Broad credit tranche – this is not equivalent to controlling for credit score in the buy rate analysis but rather recognizes that prime and subprime markets vary broadly.
  - Month of origination.
- Adjust for the known bias in the use of the BISG proxy methodology:
  - If using a continuous approach, determine the "count" of affected minority consumers by applying a threshold after the application of the continuous method. At the very least, the consumers with BISG probabilities less than 50% should not be included in any calculation of consumer harm.
  - Require verification/certification that any consumer receiving settlement funds or other remediated responses actually is a member of a protected class.
  - If funds remain in the settlement fund, these should revert to the financial institution and not become part of any regulatory "settlement fund."
- When applying the BISG method, use a stricter threshold for any actions taken prior to 2012. The BISG approach had never been used historically, no one would have used it for monitoring, and applying a recent innovation to past behavior is unfair to financial institutions. For all originations prior to 2011, a 70% BISG threshold, or similar, should be applied.
- Going forward, while financial institutions may, given sufficient volumes, monitor activity quarterly, no remediation should take place until the end of the year. This will help adjust for seasonality during an annual cycle.
- The analysis should include a dealer level focus. There must be adjustments for the aggregation issue.
- The continuous BISG methodology should not be used in any analysis of indirect auto underwriting. The econometric interpretation of such a result is overly difficult.