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Via Electronic Submission

October 18, 2019

Department of Housing and Urban Development
Office of General Counsel
Rules Docket Clerk
451 7th Street SW
Room 10276
Washington, DC 20410-0001

**Re: Notice of Proposed Rulemaking; Request for Public Comment -- HUD's
Implementation of the Fair Housing Act's Disparate Impact Standard –
Docket No. FR-6111-P-02**

Dear Sir or Madam:

The Independent Community Bankers of America (“ICBA”)¹ appreciates the opportunity to provide comments to the Department of Housing and Urban Development (“HUD”) on its notice of proposed rulemaking on reconsideration of its implementation of the Fair Housing Act’s (“FHA”) disparate impact standard.

Background

On February 18, 2013, HUD issued its rule which established liability under the FHA for conduct that is otherwise lawful, but which has a disparate adverse impact on certain protected classes. Additionally, a three-part burden-shifting test was established for determining when a practice with a discriminatory effect violates the FHA. Under this test, the charging party or plaintiff first bears the burden of proving its prima facie case that a practice results in, or would predictably result in, a discriminatory effect on the basis of a protected characteristic.

¹ The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. With more than 50,000 locations nationwide, community banks constitute 99 percent of all banks, employ nearly 750,000 Americans and are the only physical banking presence in one in five U.S. counties. Holding more than \$5 trillion in assets, nearly \$4 trillion in deposits, and more than \$3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers’ dreams in communities throughout America. For more information, visit ICBA’s website at www.icba.org.

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If the charging party proves a prima facie case, the burden of proof shifts to the defendant to prove that the challenged practice is necessary to achieve one or more of its substantial, legitimate, nondiscriminatory interests. If the defendant satisfies this burden, then the charging party may still establish liability by proving that the substantial, legitimate, nondiscriminatory interest could be served by a practice that has a less discriminatory effect.

In 2015, the Supreme Court of the United States (“Supreme Court” or “Court”) upheld the application of disparate impact under the FHA in its ruling in *Texas Department of Housing & Community Affairs v. The Inclusive Communities Project, Inc.* (“*Inclusive Communities*”); however, the Court significantly narrowed its scope. In its opinion, the Court imposed a robust causality requirement and held that a “disparate-impact claim relying on a statistical disparity must fail if the plaintiff cannot point to a defendant’s policy or policies causing that disparity.”² The Court also established a burden-shifting framework for courts and the government adjudicating disparate impact claims.

Specifically, the Supreme Court required that a charging party or plaintiff bringing a disparate impact claim must first demonstrate a causal connection between the challenged practice or policy and the statistical disparity affecting a protected class. This robust causality requirement was designed to prevent defendants from being held liable for racial disparities that their policies and practices did not create. Likewise, the Court reiterated that a plaintiff who fails to allege facts at the pleading stage or produce statistical evidence demonstrating a causal connection cannot make out a prima facie case of disparate impact.

The Court was clear that “[w]ithout adequate safeguards at the prima facie stage, disparate-impact liability might cause race to be used and considered in a pervasive way and ‘would almost inexorably lead’ governmental or private entities to use ‘numerical quotas,’ and serious constitutional questions then could arise.”³ The Court also cautioned that “limitations on disparate-impact liability ... are also necessary to protect potential defendants against abusive disparate-impact claims. If the specter of disparate-impact litigation causes private developers to no longer construct or renovate housing units for low-income individuals, then the FHA would have undermined its own purpose as well as the free-market system.”⁴

On August 16, 2019, HUD issued a proposed rule that would amend the agency’s interpretation of the FHA’s disparate impact standard in order to better reflect the Supreme Court’s holding in the *Inclusive Communities* case. We strongly support this proposed rule and fully agree with HUD Secretary Dr. Benjamin Carson’s statement that the proposed rule is “intended to increase legal clarity and promote the production and availability of housing in all areas while making sure every person is treated fairly under the law.”⁵

² *Id.* at 2524.

³ *Id.* at 2523 (internal citations omitted).

⁴ *Id.* at 2524.

⁵ Press Release, Department of Housing and Urban Development, *HUD Proposes Revised ‘Disparate Impact’ Rule* (Aug. 16, 2019), available at: https://www.hud.gov/press/press_releases_media_advisories/HUD_No_19_122.

ICBA Comments

Executive Summary

ICBA and community bankers across this nation abhor illegal discrimination and support all efforts to combat illegal discrimination. Community banks strive to ensure that all banking needs, including lending, are met for the customers they serve. Illegal discrimination has no place in this country, and ICBA strongly supports its prohibition under the FHA. However, as currently written, the application of HUD's disparate impact rule ("Disparate Impact Rule" or "rule") has particularly deleterious effects on community bank mortgage lending because of the inconsistent frameworks between the rule and the Supreme Court ruling in *Inclusive Communities*. This creates uncertainty for community banks and exposes lenders to unduly punitive legal challenges without appropriate safeguards in place.

ICBA strongly supports HUD's proposal to modernize the Disparate Impact Rule and to bring it into compliance with the Supreme Court ruling outlined in *Inclusive Communities*. HUD's existing Disparate Impact Rule, which has not been revised since 2013, is inconsistent with the Supreme Court's decision and has created ambiguity for community banks and has exposed lenders to uncertainty when managing their policies and meeting their fair lending responsibilities. Additionally, the rule has stifled innovation by failing to keep pace with changing technology and has frustrated the purpose of the FHA.

As we commented previously, under the existing HUD rule private or governmental plaintiffs can challenge lending practices that result in, or would predictably result in, a discriminatory effect on the basis of a protected characteristic. However, the *Inclusive Communities* decision includes a "robust causality requirement,"⁶ where the charging party or plaintiff must demonstrate a causal connection between the practice and the alleged discriminatory impact in order to prove their prima facie case. Furthermore, the use of statistical evidence showing disparity could give rise to a disparate impact challenge under HUD's disparate impact rule but would not establish a prima facie case under the Court's ruling.

ICBA also supports HUD's proposed defense for defendants where their discretion is limited by a third party, such as complying with federal, state, or local law. This ensures that the alleged disparate impact is attributable to the actions of the third party – not the community bank.

HUD's proposed rule also provides protection for new technologies – such as data-driven models and risk assessment algorithms. If a disparate impact claim is made as a result of algorithmic models used for assessing risk or underwriting, HUD is proposing defenses for the use of models where defendants can show their models achieve legitimate objectives. The use of these models is critical to maintaining efficiency, and community banks' access to these models allows them to compete on a fair playing field. As such, ICBA supports the proposed defenses.

⁶ *Id.* at 2523.

Furthermore, ICBA urges HUD to include language in a revised rule that clarifies that a lending decision is a discrete act and as such, begins the clock for challenging its legality.

Punitive damages are designed to punish defendants for outrageous conduct and to deter future bad acts. While the FHA does permit punitive damages as a remedy, ICBA urges HUD to adopt a rule that limits their application to the most egregious cases.

Prima Facie Case

HUD's proposal would revise its disparate impact rule to create a five-element prima facie case which better reflects the standard outlined in *Inclusive Communities* than the existing rule. Consistency with the Supreme Court's decision is not only legally necessary, it also provides a more predictable and uniform national standard for litigating disparate impact claims. This will resolve a source of significant legal uncertainty for community banks. The five elements of the prima facie case in the proposed rule are:

- (1) That the challenged policy or practice is arbitrary, artificial, and unnecessary to achieve a valid interest or legitimate objective such as a practical business, profit, policy consideration, or requirement of law;
- (2) That there is a robust causal link between the challenged policy or practice and a disparate impact on members of a protected class that shows the specific practice is the direct cause of the discriminatory effect;
- (3) That the alleged disparity caused by the policy or practice has an adverse effect on members of a protected class;
- (4) That the alleged disparity caused by the policy or practice is significant; and
- (5) That there is a direct link between the disparate impact and the complaining party's alleged injury.⁷

The first element of the proposed rule, which requires plaintiffs to prove that a practice is "arbitrary, artificial, and unnecessary to achieve a valid interest or legitimate objective," more accurately reflects the "artificial, unnecessary, and artificial"⁸ language in *Inclusive Communities*. Under the current rule, plaintiffs are merely required to prove that a disparate impact exists, then the burden shifts to the defendant to prove that the challenged practice was necessary to achieve a legitimate interest.

The current regime forces community bank defendants to justify the necessity of their legitimate business practices if plaintiffs can point a statistical disparity that the banks and their policies had no role in creating. However, the proposed rule, which shifts the burden to require plaintiffs to show that a challenged policy is "arbitrary, artificial, and unnecessary," will shift community banks' limited resources from defending themselves from meritless lawsuits to focus on what they do best – lending to homebuyers in their communities.

⁷ Proposed 24 CFR 100.500(b)(1)-(5) (Aug. 16, 2019).

⁸ 135 S. Ct. 2524.

The second element of the proposed rule requires plaintiffs to prove a “robust causal link” between the challenged policy or practice and the alleged disparate impact. This rule is better aligned with the “robust causality” requirement in *Inclusive Communities* than the current rule which requires only that a plaintiff prove “that a challenged practice caused or predictably will cause a discriminatory effect.”⁹ This change is a significant improvement over the current rule and increases the regulatory certainty for lenders.

The proposed rule will ensure that community banks are not required to expend resources defending themselves from lawsuits based on hypothetical future disparate impacts or combating claims that are based solely on statistical evidence. The Supreme Court pointed out the unfairness of a rule that allows claims that are based on statistics alone, without evidence of causality. The Court also indicated that an insufficient causality requirement poses constitutional concerns. The proposed rule, which states that a challenged policy or practice must be the “direct cause” of the disparate impact complained of, is much more closely aligned with the *Inclusive Communities* decision.

Element three, which clarifies that a challenged practice must target a protected class as a group and not merely an individual member of that class, is a useful protection against frivolous litigation. The purpose of the FHA is to prevent discrimination against protected groups. It should not be a blunt instrument that can be used against financial institutions by anyone who is dissatisfied with an adverse credit decision. This element will reduce the specter of meritless lawsuits against banks and will increase lending in communities.

Element four of the prima facie standard in the proposed rule requires that the disparity caused by the challenged policy or practice be “significant.” A materiality requirement is appropriate in order to prevent frivolous litigation over de minimis disparate impacts that could be attributed to a statistical fluke. However, a requirement that the disparate impact be “statistically significant,” that is to say having a probability value of less than 5% ($p < 0.05$), would add further transparency to the rule and increase regulatory certainty about the magnitude of disparate impact considered material.

Finally, element five reaffirms the robust causality requirement of *Inclusive Communities* and requires plaintiffs to show a direct link between the disparate impact and their injury, rather than a remote or speculative one.

Burden Shifting Framework

Under the proposed rule, if a case is not dismissed at the pleading stage, the defendant may rebut the plaintiff’s assertion that a practice is “arbitrary, artificial, and unnecessary” by showing that it advances a valid interest or legitimate objective. If they do, the burden is then placed on the plaintiff to prove that an alternative practice exists that:

⁹ 24 CFR 100(c)(1).

- (1) serves the same interest,
- (2) is equally effective, and
- (3) does not impose additional material costs or burdens on the defendant.

If the plaintiffs meet this burden, defendants may prove one of their complete defenses and argue that the plaintiffs have not proved an element of their case by a preponderance of the evidence, or argue that the practice proposed by the plaintiffs is not equally effective or that it imposes materially greater costs.

This proposed rule better embodies the holding from *Inclusive Communities* that, “[i]t would be paradoxical to construe the FHA to impose onerous costs on actors who encourage revitalizing dilapidated housing in our Nation's cities merely because some other priority might seem preferable.”¹⁰

The current rule requires that defendants overcome the almost impossible challenge of proving a negative. That is, they must show that their policy or practice was less discriminatory than any hypothetical that plaintiffs can show after the fact, regardless of whether or not that hypothetical practice is materially more expensive and burdensome and without any requirement for the plaintiffs to show that the defendants considered their proposed practice and rejected it. This approach allows too much latitude for plaintiffs and courts to second guess business judgements and find fault in non-discriminatory policies.

Under the proposed rule, the plaintiffs are required to prove not only that a hypothetical less discriminatory practice exists, but also that it does not create additional costs or burdens on lenders. This will encourage lenders to lend in disadvantaged markets by decreasing the threat posed by frivolous legal challenges. The proposed rule puts its faith in the “free market system” referenced in *Inclusive Communities* and removes an impediment to increased lending in the communities that are most in need.

Defense for Limited Discretion

HUD is proposing to provide a defense to defendants, including community banks, where their discretion is materially limited by a third party; for example, when complying with a federal, state, or local law or a binding court or regulatory order. This defense provision ensures that the disparate impact is attributable to the actions of the third party – not the community bank. Community banks should not have to endure the costly process of defending disparate impact suits caused by their faithful compliance with the law, such as compliance with the Dodd-Frank Act’s Qualified Mortgage Rule.

¹⁰ *Id.* at 2523.

Defenses for Data-Driven Lending

HUD's proposed rule provides protection for new technologies – such as data-driven models and risk assessment algorithms applied in the credit underwriting or analysis process. The use of these models is critical to maintaining efficiency in the enormous lending market. Community banks' access to these models allows them to compete on a fair playing field. If every entity that used these models or algorithms is implicitly required to perform significant statistical testing to ensure the model does not raise disparate impact concerns, the cost of such testing, combined with the number of lenders, would be enormous. Furthermore, even though such testing would not make mortgage lending any fairer for any mortgage borrower, it would raise the costs of lending for almost every borrower. As a result, HUD's proposal will lead to significant savings for residential mortgage borrowers.

New technologies allow banks to accurately assess a loan applicant's creditworthiness more quickly and cost-effectively than previously possible. Though new technology will never completely replace face-to-face lending, it has the potential to expand the access to credit for underserved populations.

If a disparate impact claim is made as a result of algorithmic models used for assessing risk or underwriting, HUD is proposing the following methods of defending the use of models where defendants can show their models achieve legitimate objectives.

The first defense provides that a defendant can show that the use of the model is standard in the industry, it is being used for its intended purpose, and that the model is the responsibility of the third party. This protection is particularly important for small lenders such as community banks that may not have the resources to develop their own risk assessment model. Additionally, community banks should not be liable for disparities they did not create or intend. Protecting the use of models and algorithms from third parties that comply with industry standards will allow small institutions to innovate with new technologies and to see the benefits of data-driven lending. ICBA strongly supports this protection.

The remaining defenses allow a defendant to show that the model is not the actual cause of the disparate impact alleged by the plaintiff. The defendant can either provide a qualified expert to prove that the model was not the cause of a disparate impact or the defendant can break down the model piece-by-piece and demonstrate how each factor could not be the cause of the disparate impact and how each factor advances a valid objective. These defenses are fair to both defendants and plaintiffs because they allow for the use of racially neutral algorithms and ensure that the inputs considered by these algorithms do not consider factors that discriminate against a protected class.

Additionally, the standard created by the proposed rule preserves the ability of plaintiffs to challenge algorithms that consider inappropriate variables—those that implicate a protected class or do not serve a valid purpose—and to have them overturned in court. This protection, coupled with the built-in economic disincentive banks have to deny loans to creditworthy applicants, will serve as a two-pronged safeguard against discriminatory practices.

Additional Clarification Regarding the Limitation of Actions

ICBA urges HUD to clarify that a lending decision is a discrete act and as such, begins the clock for challenging its legality. Statutes of limitations exist because, as time passes, memories fade and become inaccurate, witnesses disappear, and evidence is lost, disposed of, or destroyed. This makes litigating cases that occurred years or decades earlier unpredictable and more likely to reach faulty factual conclusions.

In the context of banking, this unpredictability is particularly troubling because the potentially indefinite lifespan of liability for lending discrimination claims means that it is possible for a court to conclude that mortgage loans made decades prior were related to a discriminatory practice and are therefore able to be swept into a continuing violation suit. This risk affects the safety and soundness of financial institutions because it means there is no limitation on the number of a bank's loans that could become the subject of litigation. It may also decrease the value of loans in the secondary market and reduce access to credit.

To ameliorate this problem, ICBA urges HUD to include language in a revised rule that clarifies that a lending decision is a discrete act. According to the Supreme Court's decision in *National Railroad Passenger Corporation v. Morgan*, "[d]iscrete acts such as termination, failure to promote, denial of transfer, or refusal to hire are easy to identify."¹¹ The Court held that each discrete act begins its own clock for challenging its legality and that "discrete discriminatory acts are not actionable if time barred, even when they are related to acts alleged in timely filed charges."¹²

A lending decision, either resulting in the origination of a loan or rejecting an application, has the character of a discrete act like termination, failure to promote, or refusal to hire. It occurs at a particular point in time and, if it was made pursuant to a discriminatory policy, creates an actionable claim. This should cause the statute of limitations to begin to run.

Likewise, HUD should take this opportunity to clarify that, where plaintiffs bring a claim within the limitations period of 'the termination of an alleged discriminatory housing practice,' they must show that the challenged practice directly affected their individual lending decision and that the practice was continuously, uninterrupted, and uniformly enforced from the time of their lending decision until its termination.

Currently, the Fair Housing Act includes a two-year statute of limitations which begins to run with, "the occurrence or the termination of an alleged discriminatory housing practice, or the breach of a conciliation agreement entered into under this subchapter, whichever occurs last."¹³

¹¹ 536 U.S. 101, 114 (2002).

¹² *Id.* at 113.

¹³ 42 U.S.C. 3613(a)(1)(A).

This continuing violation doctrine was applied in *City of Los Angeles v. Citigroup* where the court concluded that all the challenged loans made over an eight-year period were actionable because “L.A. is alleging a pattern and practice of ‘discriminatory lending’ on the part of Defendants over at least an eight-year period. While the types of loans that Defendants allegedly issued to minority borrowers may have changed during the relevant time period, L.A. alleges that they remained high-risk and discriminatory. This is sufficient to apply the continuing-violation doctrine.”¹⁴

We believe this case wrongfully applied the continuing violation doctrine, the application of which should be the exception and not the rule. This overzealous application of the continuing violation doctrine makes discrimination claims more difficult to adjudicate fairly and increases systemic risk.

Punitive Damages in Disparate Impact Cases

Punitive damages are designed to punish defendants for outrageous conduct and to deter future bad acts. As such, they are reserved for cases where the defendant’s actions are truly reprehensible and demonstrate a disregard for the rights of others. In general, it is unlikely that many disparate impact cases will rise to this level because, as opposed to disparate treatment cases, they do not require discriminatory intent.

While the FHA does permit punitive damages as a remedy, ICBA urges HUD to adopt a rule that limits this remedy to the most egregious cases. For example, Title VII of the Civil Rights Act of 1964 limits the application of punitive damages to cases where “the complaining party demonstrates that the respondent engaged in a discriminatory practice or discriminatory practices with malice or with reckless indifference to the federally protected rights of an aggrieved individual.”¹⁵

A similar “malice or reckless indifference” standard for punitive damages in disparate impact cases would be appropriate. Such a standard would limit punitive damages to their proper role of deterring and punishing willful or egregious conduct. Punitive damages should not be applicable in cases of inadvertent and unintended discrimination.

Conclusion

Thank you for the opportunity to comment on the proposed rule. Given the significant amount of uncertainty created by the inconsistency of HUD’s current disparate impact rule and the Supreme Court decision, ICBA strongly supports HUD’s decision to amend and align its rule with the standards outlined in *Inclusive Communities*. Additionally, we believe HUD is in a unique

¹⁴ 24 F. Supp. 3d 940, 952 (C.D. Cal. 2014).

¹⁵ 42 U.S.C. 1981a(b)(1).

position to draft uniform standards for both the disparate impact and disparate treatment standards to apply consistently across our nation. Please contact me at Lilly.Thomas@icba.org or 202.659.8111 with any questions regarding our comments.

Sincerely,

/s/

Lilly Thomas
Senior Vice President & Senior Regulatory Counsel