DISPARATE IMPACT AND MORTGAGE LENDING: A BEGINNER'S GUIDE

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In the aftermath of the Great Recession, the federal government began to enforce fair lending laws with a vigor previously unseen. To hold lenders accountable for the racially discriminatory effects of their mortgage lending practices, federal prosecutors and financial regulators applied the theory of disparate impact to fair lending laws for the first time.

Unclear, however, is what legal standards exist to evaluate allegations of discriminatory effects in this industry. No court has ever decided a fair lending case under a theory of disparate impact on its merits. That will likely change soon as major municipalities are pushing the boundaries of this theory to its outer limits. Last June, the U.S. Supreme Court granted certiorari in Bank of America v. City of Miami *to address a pair of discrete issues in this area. This Comment attempts to answer some foundational questions about how the theory of disparate impact will be applied to mortgage lenders moving forward. It also makes a normative argument for judicial acceptance of this theory and continued governmental enforcement of fair lending laws.*

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INTRODUCTION

Since the passage of the Fair Housing Act (FHA) in 1968, enforcing the Act's policy to "provide, within constitutional limitations, for fair housing throughout the United States"[1] has been a herculean task. Although the Act has achieved a measure of success in curbing the most blatant forms of racial discrimination,[2] the FHA has failed in its broader goal to provide for truly fair housing.[3] This is particularly true in the

1. Fair Housing Act (FHA) of 1968, 42 U.S.C. §3601 (2012).

2. *See* MARGERY AUSTIN TURNER ET AL., U.S. DEP'T OF HOUS. & URBAN DEV., HOUSING DISCRIMINATION AGAINST RACIAL AND ETHNIC MINORITIES 2012 at 65–68 (2013) ("[T]hese findings suggest that the most blatant forms of 'door slamming' discrimination observed in the earliest [study] are much less frequent today . . . .").

3. *See* Janell Ross, *A Rundown of Just How Badly the Fair Housing Act Has Failed*, WASH. POST (July 10, 2015), https://www.washingtonpost.com/news/the-fix/wp/2015/07/10/a-look-at-just-how-badly-the-fair-housing-act-has-failed/ [https://perma.cc/9Q97-FBCW].

context of mortgage lending. Even controlling for income and other demographic factors, blacks and Hispanics tend to own homes at much lower rates than otherwise comparable whites.[4] While its sources are myriad, the relationship between the "homeownership gap" and wide racial wealth gap is glaring.[5] One report estimates that closing the homeownership gap would narrow the overall racial wealth gap in the United States by as much as one-third.[6]

Civil rights advocates have long argued that discriminatory practices in the mortgage lending industry itself—including discrimination in the underwriting of mortgages, the "redlining" of minority neighborhoods by lenders,[7] and predatory lending practices—have perpetuated and reinforced the homeownership gap.[8] And until recently, the various laws proscribing discrimination in mortgage lending—including the FHA, Equal Credit Opportunity Act (ECOA), and Community Reinvestment Act (CRA)—were inadequately enforced.[9]

4. Donald R. Haurin et al., *Homeownership Gaps Among Low-Income and Minority Households*, 9 CITYSCAPE, 2007, at 4, 24–34.

5. According to data gathered in 2011, the median white household had over $111,000 of total wealth holdings, whereas the median black and Latino households had less than $9,000. LAURA SULLIVAN ET AL., INST. FOR ASSETS & SOC. POLICY, DEMOS, THE RACIAL WEALTH GAP: WHY POLICY MATTERS 1, 7 (2015) (analyzing data from the Survey of Income and Program Participation conducted by the U.S. Census Bureau).

6. *Id.* at 2, 10–14.

7. Redlining occurs where a financial institution refuses to lend on properties in areas that are considered high financial risks based on the people who live in those areas. *Redlining,* BLACK'S LAW DICTIONARY (10th ed. 2014).

8. *See, e.g.*, Harold Black et al., *Discrimination in Mortgage Lending*, 68 AMER. ECON. R. 186, 189 (1978) (finding statistically significant evidence of underwriting discrimination); JOHN YINGER, *Discrimination and Redlining in Mortgage Lending*, *in* CLOSED DOORS, OPPORTUNITIES LOST: THE CONTINUING COSTS OF HOUSING DISCRIMINATION 63–86 (1995) (discussing important fair lending studies conducted in the early 1990s that strongly suggested persistent racial discrimination in mortgage lending).

9. Equal Credit Opportunity Act of 1974, 15 U.S.C. §§ 1691–1691(f) (2012); Community Reinvestment Act of 1977, 12 U.S.C. §§ 2801–10 (2012). Another key statute in fair lending law is the Home Mortgage Disclosure Act of 1975 (HMDA), also codified at 12 U.S.C. §§ 2801–11 (2012), which requires financial institutions to provide statistical information to the public concerning housing-related loans; however, the HMDA does not provide for a legal cause of action based on banks' disclosures. *See* Robert G. Schwemm & Jeffrey L. Taren, *Discretionary Pricing, Mortgage Discrimination, and the Fair Housing* Act, 45 HARV. CIV. RTS.-CIV. LIBERTIES L. REV. 375, 385–90 (2010) (noting that the DOJ did not file a single mortgage discrimination case until the mid-1990s and that private litigants were infrequent and largely unsuccessful); *see also* NAT'L COMM'N ON FAIR HOUS. &

The half-century era of under-enforcement came to an abrupt end in the aftermath of the Great Recession.[10] Practices that pervaded the mortgage lending industry before the Recession became the subject of high-profile public enforcement actions, and settlement agreements over the past five years between the federal government and mortgage lenders have run into the hundreds of millions of dollars.[11]

Like pre-Recession fair lending litigation, the post-Recession enforcement actions allege one or more of three discriminatory lending practices: unlawful discrimination in loan underwriting, the redlining of minority neighborhoods, or predatory lending—often described as "reverse redlining." But unlike the pre-Recession cases, which were relatively uncomplicated, brought primarily by private litigants, and relied almost exclusively on a theory of disparate treatment,[12] the prominent cases brought after the Recession are incredibly complex in comparison, primarily the product of enforcement efforts by federal agencies, and rely almost entirely on a theory of disparate *impact*.[13]

EQUAL OPPORTUNITY, THE FUTURE OF FAIR HOUSING 22–25 (2008) (discussing the lack of enforcement activity in the 2000s).

10. The Great Recession began in December 2007 and ended in June 2009. Press Release, Bus. Cycle Dating Comm. of the Nat'l Bureau of Econ. Research (Sept. 20, 2010), http://www.nber.org/cycles/sept2010.pdf [https://perma.cc/FA6S-SMJG].

11. *See generally* Christie Thompson, *Disparate Impact and Fair Housing: Seven Cases You Should Know*, PROPUBLICA (Feb. 12, 2013), http://www.propublica.org/article/disparate-impact-and-fair-housing-seven-cases-you-should-know [https://perma.cc/N6GM-JRBT] (discussing seven disparate impact cases pending around the country in the lead up to the Supreme Court's decision in *Texas Department of Housing and Community Affairs*); VANITA GUPTA, DEP'T OF JUSTICE, THE ATTORNEY GENERAL'S 2015 ANNUAL REPORT TO CONGRESS PURSUANT TO THE EQUAL CREDIT OPPORTUNITY ACT AMENDMENTS OF 1976 (2016), https://www.justice.gov/crt/file/882481/download [https://perma.cc/E639-QFRA] (summarizing the Civil Rights Division's "significant results in fair lending enforcement [in 2015], including filing and settling the federal government's largest redlining case in history").

12. Disparate treatment is defined as a practice of *intentionally* dealing with persons differently because of their race. *Disparate Treatment*, BLACK'S LAW DICTIONARY (10th ed. 2014). Many pre-Recession plaintiffs alleged both disparate treatment and disparate impact, but their allegations and the courts' assessments of their claims focused almost entirely on the intentional discrimination claims. *See, e.g.*, Assocs. Home Equity Servs., Inc. v. Troup, 778 A.2d 529, 538 (N.J. Super. Ct. App. Div. 2001) (stating that a plaintiff may establish a reverse redlining claim on either theory, but focusing its analysis on the lender's disparate treatment of the plaintiff).

13. Disparate impact is defined as the adverse effect of a facially-neutral

This Comment is a "Beginner's Guide" because the era of disparate impact liability in fair lending is just starting. Current scholarship lacks a straightforward explanation of how this theory of liability applies to mortgage lending, and more importantly, no court has ruled on the merits of any fair lending case based exclusively on the disparate impact theory.[14]

The analysis that follows is timely given a trio of recent developments in fair lending law. First, in June 2015, the U.S. Supreme Court in *Texas Department of Housing and Community Affairs v. The Inclusive Communities Project* expressly recognized the disparate impact theory under the FHA for the first time.[15] Then in October 2015, the Consumer Financial Protection Bureau (CFPB) amended Regulation C to expand lenders' reporting requirements under the Home Mortgage Disclosure Act (HMDA) so as to "better pinpoint and address potential discrimination in the mortgage market."[16] Finally, in June 2016, the Supreme Court granted certiorari in *Bank of America Corp. v. City of Miami* to settle a pair of discrete issues involving disparate impact liability under the FHA.[17]

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practice that nonetheless discriminates against persons because of race. *Disparate Impact*, BLACK'S LAW DICTIONARY (10th ed. 2014). *See* discussion *infra* Parts II–V.

14. A handful of federal district courts have held that plaintiff-mortgagors adequately stated a prima facie claim of disparate impact under the FHA, ECOA, or both, but those cases are either still pending or settled out of court. *See, e.g.*, Cty. of Cook v. HSBC N. Am. Holdings, Inc., 136 F. Supp. 3d 952 (N.D. Ill. 2015) (pending); Saint-Jean v. Emigrant Mortg. Co., 50 F. Supp. 3d 300 (E.D.N.Y. 2014) (pending); Stipulation & Agreement of Settlement, Ramirez v. GreenPoint Mortg. Funding, Inc., 633 F. Supp. 2d 922 (N.D. Cal. 2008) (No. 08-cv-00369-TEH).

15. Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc., 135 S. Ct. 2507 (2015); *see also* Robert G. Schwemm, *Fair Housing Litigation After* Inclusive Communities: *What's New and What's Not*, 115 COLUMBIA L. REV. SIDEBAR 106 (2015) (providing thorough analysis of the decision). The cognizability of disparate impact under the ECOA remains a contentious issue. *Compare* 12 C.F.R. § 1002.6(a) (2017) (CFPB interpreting the ECOA to include disparate impact liability), *with* Peter N. Cubita & Michelle Hartmann, *The ECOA Discrimination Proscription and Disparate Impact—Interpreting the Meaning of Words That Actually Are There*, 61 BUS. LAW. 829 (2006) (arguing that the ECOA lacks language critical to disparate impact).

16. CFPB, FAIR LENDING REPORT OF THE CONSUMER FINANCIAL PROTECTION BUREAU 2 (2016); Home Mortgage Disclosure (Regulation C), 80 Fed. Reg. 66, 128 (Oct. 28, 2015) (codified at 12 C.F.R. pt. 1003).

17. Bank of Am. Corp. v. City of Miami, 800 F.3d 1262 (11th Cir. 2015), *cert. granted*, 136 S. Ct. 2544 (U.S. June 28, 2016) (No. 15-1111).

The subject matter of racial discrimination in mortgage lending is important for at least three major reasons. First, the mortgage lending industry is massive. As of the second quarter of 2016, there existed more than eleven trillion dollars of outstanding mortgage debt on residential property in the United States,[18] and nearly fifty million housing units are secured by mortgages.[19] Second, the ability to secure a mortgage loan to buy a home is a first (and indispensable) step toward closing the racial wealth gap in this country.[20] And finally, the current litigation saga is far from over. Although the Department of Justice (DOJ), U.S. Department of Housing and Urban Development (HUD), and CFPB settled many of their high-profile cases between 2012 and 2015, other important cases are still pending.[21] These cases have the potential to define the breadth of fair lending liability for a generation to come.

This Comment proceeds as follows: Part I discusses the history of racial discrimination in mortgage lending from before the enactment of the FHA in 1968 until the beginning of the

18. *Mortgage Debt Outstanding*, BD. OF GOVERNORS FED. RESERVE SYS., http://www.federalreserve.gov/econresdata/releases/mortoutstand/current.htm (last updated Dec. 8, 2016) [https://perma.cc/R3FH-UV2J].

19. Mona Chalabi, *How Many Homeowners Have Paid Off Their Mortgages?*, FIVETHIRTYEIGHT (Dec. 11, 2014, 6:06 AM), http://fivethirtyeight.com/datalab/how-many-homeowners-have-paid-off-their-mortgages/ [https://perma.cc/J6AY-9U4Y].

20. *See* SULLIVAN ET AL., *supra* note 5; *see also* Editorial Bd., *Homeownership and Wealth Creation*, N.Y. TIMES (Nov. 29, 2014) https://www.nytimes.com/2014/11/30/opinion/sunday/homeownership-and-wealth-creation.html [https://perma.cc/B96H-7E98] ("As a means to building wealth . . . there is no practical substitute for homeownership.").

21. During the production of this article, Donald J. Trump was elected to serve as the United States' forty-fifth president. Although President Trump's views on specific civil rights enforcement strategies were not made abundantly clear through the recent campaign or early months in office, the fact that his family company settled a multi-million dollar claim alleging violations of the FHA brought by the DOJ in the 1970s, and his nomination of a vociferous civil rights opponent as Attorney General, strongly suggest that the Obama administration's enforcement priorities will not be the priorities of the Trump administration. *See* Michael Kranish & Robert O'Harrow, Jr., *Inside the Government's Racial Bias Case Against Donald Trump's Company, and How He Fought It*, WASH. POST (Jan. 23, 2016), https://www.washingtonpost.com/politics/inside-the-governments-racial-bias-case-against-donald-trumps-company-and-how-he-fought-it/2016/01/23/fb90163e-bfbe-11e5-bcda-62a36b394160_story.html [https://perma.cc/75JP-YDL3]; Josh Gerstein, *Civil Rights Leaders Savage Sessions*, POLITICO (Nov. 18, 2016, 11:13 AM), http://www.politico.com/story/2016/11/jeff-sessions-attorney-general-civil-rights-leaders-react-231609 [https://perma.cc/X796-7HE2].

Great Recession in 2007. It outlines the three causes of action that developed over the first forty years of the fair lending era—underwriting discrimination, redlining, and reverse redlining—and provides clear examples of each. Part II analyzes the origins of the disparate impact theory, its basic elements and burden-shifting structure, and how courts came to apply it to FHA claims. Part III analyzes the claims that emerged out of the Recession. It pays close attention to the legal issues left unresolved by recent redlining claims against two regional banks, and the massive reverse-redlining settlements against Wells Fargo and Countrywide. Part IV discusses the unresolved reverse-redlining claims lodged by the City of Miami and Cook County, Illinois against Bank of America and HSBC. The federal district and appellate courts that have dealt with these cases have arrived at conflicting conclusions on key jurisdictional issues, which the Supreme Court should resolve with its opinion in the summer of 2017 in *Bank of America*. Part V discusses discriminatory effects of certain mortgage underwriting practices, which many experts believe will be the focus of future claims.

This Comment focuses on discrete legal issues that remain unsettled under the disparate impact theory as it relates to fair lending. In doing so, it takes certain normative propositions for granted: The wealth and homeownership gaps are a source of perpetual blight on the American experience. Not all people want to own homes, nor can all people afford to own homes in the area where they desire to live. But for those who aspire to this integral part of the American Dream, the financing necessary to make homeownership possible should be available to all on truly fair terms, and it is the responsibility of government at all levels to ensure that it is so.[22]

This Comment also argues that there is simply no substitute for governmental oversight and enforcement of fair lending laws. Disparate impact cases in the mortgage lending context often involve thousands (and in some recent cases like

22. This Comment does not normatively nor positively assess the enormous economic distortions in the housing market created by federal housing policies. *Compare* Lawrence H. White, *How Did We Get into This Financial Mess?* (Cato Inst., Briefing Paper No. 110, 2008) (criticizing federal housing policy for its distortionary effects on interest rates, asset prices, and the allocation of capital), *with* A RIGHT TO HOUSING (Rachel G. Bratt et al. eds., 2006) (arguing for more intervention by the federal government to ensure safe and affordable housing for all Americans).

Associated Bank, *Countrywide*, and *Wells Fargo* discussed in Part III, hundreds of thousands) of borrowers spread across the country. The evidence is complex and consists of millions of data points contained in reports submitted to and reviewed by federal financial regulators. Individual plaintiffs—and even state attorneys general and national nonprofits—quite simply lack the expertise and economic wherewithal to pursue these claims. If we are to "provide, within constitutional limitations, for fair housing throughout the United States,"[23] the federal government must continue to play a leading role.

I. DE JURE DISCRIMINATION, THE FAIR HOUSING ACT, AND FAIR LENDING ENFORCEMENT: 1968–2008

The post-Recession lending discrimination cases cannot be properly understood outside of the historical and legal context through which they emerged. Section A describes the culture of intentional discrimination in mortgage lending that was pervasive before the FHA. Section B looks at discrimination in mortgage lending since Congress enacted the FHA in 1968. It is divided into three subsections corresponding to each of three types of claims—underwriting discrimination, redlining, and reverse redlining—that have developed since 1968.

All of the cases discussed in Section B involve private plaintiffs, and rely on the theory of disparate treatment to prove discrimination. Taken together, they reveal tremendous progress from state-sanctioned lending discrimination in the pre-Civil Rights era, but they also demonstrate why disparate treatment was not a sufficient legal theory to rout out discriminatory practices in the mortgage lending industry.

A. *De Jure Discrimination Before 1968*

Over the last century, no policy has resulted in more intractable racial segregation and economic injustice than discriminatory housing policy.[24] In the decades since the Civil Rights Movement, non-whites have made significant progress

23. Fair Housing Act of 1968, 42 U.S.C. § 3601 (2012).

24. *See* MICHAEL B. DE LEEUW ET AL., U.S. HOUS. SCHOLARS & RESEARCH & ADVOCACY ORGS., RESIDENTIAL SEGREGATION AND HOUSING DISCRIMINATION IN THE UNITED STATES i (2008) ("Residential segregation is an insidious and persistent fact of American life.").

in political participation,[25] educational attainment,[26] and access to better paying and more prestigious occupations,[27] but non-white households remain at a significant economic disadvantage in terms of household wealth.[28] Many experts attribute the persistence of this injustice to discriminatory housing policies.[29]

To describe the multitude of private and government-sanctioned practices affecting residential settlement as a "policy" derogates a term that implies a degree of internal coherence. In the first two-thirds of the last century, some six million black Americans left the rural South in trickles and waves, destined for urban areas throughout the country.[30] Upon arrival, they confronted a host of obstacles, not the least of which was a complex web of discriminatory practices by landlords, real estate agents, banks, and all levels of government that had the cumulative effect of isolating them in substandard and overpriced urban tenements.[31]

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25. *See generally* KHALILAH BROWN DEAN ET AL., JOINT CTR. FOR POLITICAL & ECON. STUDIES, 50 YEARS OF THE VOTING RIGHTS ACT: THE STATE OF RACE IN POLITICS 3–4 (2015) (noting dramatic decreases in the voter turnout gap and large increases in the number of elected officials of color).

26. *See* Office for Civil Rights, *Impact of the Civil Rights Laws*, U.S. DEP'T OF EDUC. (Jan. 1999), http://www2.ed.gov/about/offices/list/ocr/docs/impact.html [https://perma.cc/8DZG-CXPW] (noting substantial declines in minority high school dropout rates and increases in high school graduation rates and college enrollment). I do not mean to imply here that we live in a post-racial society—far from it—only that significant progress has been made in some areas over the last three generations.

27. Cassandra Jones Havard, *"On the Take": The Black Box of Credit Scoring and Mortgage Discrimination*, 20 B.U. PUB. INT. L.J. 241, 243 (2011).

28. SULLIVAN ET AL., *supra* note 5, at 1 (finding that in 2011 the median white household had $111,146 in total wealth holdings, whereas the median black household had $7,113 and median Latino household had $8,348).

29. *See generally* THE GEOGRAPHY OF OPPORTUNITY: RACE AND HOUSING CHOICE IN METROPOLITAN AMERICA 3 (Xavier de Souza Brigs ed., 2005) ("A growing body of empirical evidence indicates that racial segregation [of housing] is not merely correlated with unequal social and economic outcomes but also specifically contributes to worsening inequality in metropolitan areas . . . . "); *see also* SULLIVAN ET AL., *supra* note 5, at 9–15 (predicting that an equalization of homeownership rates would eliminate almost one-third of the overall racial wealth gap).

30. *See generally* ISABEL WILKERSON, THE WARMTH OF OTHER SUNS: THE EPIC STORY OF AMERICA'S GREAT MIGRATION (2010).

31. *See* NAT'L COMM'N ON FAIR HOUS. & EQUAL OPPORTUNITY, *supra* note 9, at 6–10 (discussing the historical roots of housing segregation); *see also* NAT'L COMM'N ON CIVIL DISORDERS, REPORT OF THE NATIONAL COMMISSION ON CIVIL DISORDERS (1968), http://www.eisenhowerfoundation.org/docs/kerner.pdf [https://perma.cc/UZ8J-PA92] (identifying "inadequate housing" as a "deeply held

As early as 1917, the Supreme Court declared such de jure racial segregation unconstitutional,[32] but until Congress enacted the FHA, no federal law existed to enforce such an edict and discriminatory practices proliferated.[33] For the black migrants who gained a secure foothold in these new urban areas,[34] practices in the mortgage lending industry—designed and supported by the federal government—prevented them from moving out of tenancy and into homeownership.[35]

From the beginning of New Deal housing policy in 1933 until the FHA in 1968, a full 98 percent of mortgages receiving government support went to whites.[36] The Home Owners' Loan Corporation, established in 1933 to refinance millions of mortgages in default as a result of the Great Depression, prepared "neighborhood security maps" to assess underwriting risk.[37] Neighborhoods threatened with "infiltration of foreign-born, negro, or lower grade population" were infamously outlined in red, and were deemed ineligible for government-guaranteed refinancing.[38] The private sector followed suit. Both the American Institute of Real Estate Appraisers and the National Association of Real Estate Boards adopted written policies that assessed underwriting risk based on a community's racial composition and forbid "introducing to a neighborhood . . . members of any race . . . whose presence will

grievance[]" of the highest intensity).

32. Buchanan v. Warley, 245 U.S. 60 (1917).

33. NAT'L COMM'N ON FAIR HOUS. & EQUAL OPPORTUNITY, *supra* note 9, at 6–10.

34. Contrary to popular myth, this experience was the norm rather than the exception. *See* WILKERSON, *supra* note 30, at 415 (lamenting that "[f]ew experts trained their sights on the unseen masses of migrants [] who worked from the moment they arrived, didn't end up on welfare, and stayed married").

35. DOUGLAS S. MASSEY & NANCY A. DENTON, AMERICAN APARTHEID: SEGREGATION AND THE MAKING OF THE UNDERCLASS 17–60 (1993). "Americans made a series of deliberate decisions to deny blacks access to urban housing markets and to reinforce their spatial segregation." *Id.* at 19.

36. *Id.* The importance of this fact can hardly be understated. *See* Thomas Piketty, *Theories of Persistent Inequality and Intergenerational Mobility*, *in* HANDBOOK OF INCOME DISTRIBUTION 429–73 (A.B. Atkinson & F. Bourguignon eds., 2000).

37. *See Digital HOLC Maps*, URBANOASIS, http://www.urbanoasis.org/projects/holc-fha/digital-holc-maps/ (last visited Jan. 17, 2016) [https://perma.cc/F6TT-77FR] (containing "neighborhood security maps" for major U.S. cities).

38. *Factors*, REDLINING RICHMOND, http://dsl.richmond.edu/holc/factors (last visited Feb. 19, 2017) [https://perma.cc/J5MC-A2FD] (listing factors Home Owners' Loan Corporation officials used to assess underwriting risk).

be clearly detrimental to property values in a neighborhood."[39] At a time when homeownership rates doubled for white Americans, the homeownership rate for black Americans barely budged.[40]

Of the three landmarks pieces of legislation enacted by Congress during the Civil Rights Movement, the FHA was the last. Congress began with the Civil Rights Act of 1964, which prohibited racial discrimination in public accommodations, educational institutions, and employment.[41] Substantial protection of voting rights came second in 1965.[42] For two years thereafter, Congress regularly considered, but failed to pass, a fair housing bill until the assassination of Dr. Martin Luther King, Jr. in April 1968.[43] The FHA was passed a mere two days after Dr. King's assassination, amid rioting in nearly all major U.S. cities.[44]

The FHA made unlawful a broad range of discriminatory practices related to housing, and it furnished plaintiffs with a powerful tool to combat discrimination.[45] Enforcement of the FHA's prohibition against racial discrimination in mortgage lending received a substantial boost from three laws enacted in the mid-1970s. The ECOA, enacted in 1974, made discrimination unlawful with respect to any aspect of a credit transaction;[46] the HMDA, enacted in 1975, required lenders to

39. NAT'L COMM'N ON FAIR HOUS. & EQUAL OPPORTUNITY, *supra* note 9, at 8.

40. *See* Ta-Nehisi Coates, *The Case for Reparations,* ATLANTIC (June 2014), http://www.theatlantic.com/magazine/archive/2014/06/the-case-for-reparations/361631/ [https://perma.cc/JG8J-T7AR].

41. Codified as amended at 42 U.S.C. §§ 1981–2000h-6 (2012).

42. Voting Rights Act of 1965, codified as amended at 52 U.S.C. §§ 10101–10702 (2012).

43. *History of Fair Housing*, U.S. DEP'T OF HOUS. & URBAN DEV., http://portal.hud.gov/hudportal/HUD?src=/program_offices/fair_housing_equal_opp/aboutfheo/history (last visited Nov. 7, 2015) [https://perma.cc/6DNY-T2AE].

44. Jean Eberhart Dubofsky, *Fair Housing: A Legislative History Perspective*, 8 WASHBURN L.J. 149, 160 (1969).

45. 42 U.S.C. §§ 3604–3606 (2012). For the purpose of this Comment, § 3605, making it unlawful for "any person or . . . business . . . to discriminate against any person in making available such a transaction . . . because of race" is the most germane section of the FHA. *But see* Havard, *supra* note 27, at 244–45 (stating that the original fair lending laws are not well suited to combat more complex "second-generation discrimination" of the type we see today).

46. 15 U.S.C. § 1691(a)(1) (2012) (making it unlawful for any creditor to discriminate against any applicant with respect to any aspect of a credit transaction on the basis of race); *see also* ROBERT G. SCHWEMM, HOUSING DISCRIMINATION: LAW AND LITIGATION § 18:1 (2009) (discussing overlapping coverage of FHA and ECOA).

publicly disclose mortgage lending data;[47] and the CRA of 1977 specifically sought to curtail redlining practices through regular Fair Lending Examinations.[48]

B. The Disparate Treatment Era: 1968–2007

In the first four decades of the fair lending era, governmental enforcement of the FHA's prohibition against discrimination in lending bordered on nonexistent. The DOJ did not file a single mortgage discrimination case until 1991, and private cases were likewise rare and extremely difficult to win.[49] Evidentiary problems certainly played a role;[50] unlike claims alleging "steering" by real estate agents, federal anti-fraud laws prohibited the use of "testers" in mortgage applications.[51] Furthermore, legal uncertainty surrounding the cognizability of disparate impact liability under the FHA chilled governmental enforcement efforts.[52]

Nevertheless, the handful of mortgage lending discrimination claims from this era can be divided neatly into three groups. The first group involves underwriting discrimination, where a lender denied credit outright to a

47. 12 U.S.C. § 2801–10 (2012). The HMDA did not require lenders to include race and ethnicity until the 1989 amendments to that act, data from which was not made public until 1994. Dubravka Ritter, *Do We Still Need the Equal Credit Opportunity Act?*, DISCUSSION PAPER PAYMENT CARDS CTR., Sept. 2012, at 24.

48. 12 U.S.C. § 2801–10 (2012); *see also The Community Reinvestment Act: Thirty Years of Accomplishments, But Challenges Remain: Hearing Before the H. Comm. on Fin. Servs.*, 100th Cong. 7 (2008) (statement of Sandra L. Thompson, Director, Division of Supervision and Consumer Protection, Federal Deposit Insurance Corporation).

49. *See* Schwemm & Taren, *supra* note 9, at 386–87.

50. *Id.* (discussing limitations on paired testing protocol to uncover lending discrimination and the difficulty of obtaining evidence of apples-to-apples comparables in larger real estate financing deals).

51. *Id.* Steering is the practice of channeling prospective minority buyers and tenants to designated areas and not permitting them access to all available housing. SCHWEMM, *supra* note 46, at § 13:5. *See also* MARGERY AUSTIN TURNER ET AL., U.S. DEP'T OF HOUS. & URBAN DEV., HOUSING DISCRIMINATION AGAINST RACIAL AND ETHNIC MINORITIES 2012 5–9 (2013) (discussing the utility of paired testing protocols for housing rentals and sales). For the first time in June 2016, a joint CFPB-DOJ redlining complaint contained allegations of disparate treatment in mortgage lending based on the use of paired testers. *See* Complaint at ¶¶ 99–112, CFPB v. BancorpSouth Bank, No. 1:16cv118-GHD-DAS (N.D. Miss. June 29, 2016).

52. NAT'L COMM'N ON FAIR HOUS. & EQUAL OPPORTUNITY, *supra* note 9, at 24; *see infra* Part II, discussing the recent U.S. Supreme Court decision in *Inclusive Communities Project* and its potential impact on mortgage lending cases.

prospective minority borrower while extending it to a similarly creditworthy white borrower. The second involves allegations of redlining, where a lender refused to extend credit to minority-majority geographic areas while extending it to otherwise similar white areas. The third involves reverse redlining, where a lender charged higher interest rates or fees to a non-white borrower relative to a similarly creditworthy white one.[53] Lenders must be familiar with these three claims because the post-Recession claims, which rely on more complex evidence, more attenuated theories of causation, and an altogether different theory of liability, are ultimately variations of these three vintage categories.

1. Underwriting Discrimination

Mortgage underwriting is the process by which a lender determines the risk that a borrower will default on his or her loan obligation.[54] The risk factors that lenders consider when deciding whether to extend credit and on what terms fall under the "three Cs" of underwriting: credit, capacity, and collateral.[55] In the absence of direct evidence of discriminatory intent,[56] a prima facie case of underwriting discrimination sufficient to raise an inference of discriminatory intent consists of four elements:

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53. *See* VANITA GUPTA, DEP'T OF JUSTICE, THE ATTORNEY GENERAL'S 2014 ANNUAL REPORT TO CONGRESS PURSUANT TO THE EQUAL CREDIT OPPORTUNITY ACT AMENDMENTS OF 1976, at 2 (2015) (dividing "the range of abuses in the mortgage market" into the same trichotomy).

54. *See generally* Brandon Cornett, *How the Mortgage Underwriting Process Works*, HOME BUYING INST. (2010), http://www.homebuyinginstitute.com/homebuyingtips/2010/02/what-is-mortgage-underwriting-and-how.html [https://perma.cc/P6FE-JL3B].

55. Credit includes all aspects of a prospective borrower's credit history; capacity measures a prospective borrower's ability to pay, namely monthly debt payment-to-income ratio; and collateral encompasses a prospective borrower's total equity or down payment. *The 3 Cs of Underwriting Factors Used in Loan Prospector's Assessment*, FREDDIEMAC (2016), http://www.freddiemac.com/corporate/au-works/factors.html [https://perma.cc/7UTU-VHZV].

56. Direct evidence includes written documents or a defendant's oral statements to witnesses evidencing racial animus. If plaintiffs can produce direct evidence of illegal motivation, they do not need to rely on the prima facie concept to create an inference of discriminatory intent. SCHWEMM, *supra* note 46, § 10.2 (noting that "most modern Fair Housing Act cases have had to rely heavily, if not exclusively, on circumstantial evidence for proof of the defendant's discriminatory motive").

1. the prospective borrower is a member of a protected class;
2. the prospective borrower applied for and was qualified for a loan;
3. the lender rejected the application; and
4. the lender continued to approve loans for white applicants with otherwise similar qualifications.[57]

Once a plaintiff proves all four elements by a preponderance of the evidence, the burden shifts to the defendant-lender, who must then articulate a legitimate, nondiscriminatory reason for its decision to reject the plaintiff's loan application.[58]

A pair of early cases alleging discriminatory assessment of credit risk—the first "C"—demonstrates the difficulty that real estate developers working in minority areas face in establishing the fourth element of a prima facie case. Specifically, the contrast between *Simms v. First Gibraltar Bank* and *Watson v. Pathway Financial* highlights the evidentiary problems faced by disparate treatment plaintiffs outside of the single-family home mortgage context.

In *Simms*, the owner of a cooperative multifamily property in a predominantly minority area of Houston sued a regional Texas bank for refusing to issue a commitment letter to refinance Simms's project despite the project's creditworthiness.[59] The Fifth Circuit conceded that the lender's refusal to issue the loan "may have been unsound, unfair, or even unlawful, yet not been violative of the FHA" without sufficient evidence of discriminatory intent.[60] The Fifth Circuit vacated the final judgment and damage award of $3.2 million against First Gibraltar, holding,

> [t]he fundamental flaw in this evidence is that Simms offered it in a vacuum; he presented absolutely no evidence that other, 'non-protected' applicants or applications were treated any differently [nor] any evidence from which it might be inferred that First Gibraltar had a poor record of

57. SCHWEMM, *supra* note 46, §18:3 (noting that all federal circuits except the Seventh accept this framework).

58. *Id.* §10.2. The ultimate burden of persuasion on the discriminatory motive remains with the plaintiff throughout. *Id.*

59. 83 F.3d 1546, 1556–59 (5th Cir. 1996).

60. *Id.* at 1556.

> lending in minority areas . . . .[61]

Given the idiosyncrasies of large, multifamily real estate development deals, the Fifth Circuit's demand for an apples-to-apples comparison to make a prima facie showing on the fourth element practically precludes claims for underwriting discrimination outside of the single-family home mortgage context.

Watson v. Pathway Financial presented just such a claim.[62] The Watsons were a black couple in the Chicago area whose application for a mortgage had been rejected by Pathway because of delinquent credit card accounts.[63] The court rejected the lender's motion for summary judgment after the Watsons produced evidence that the lender had approved at least six applications from white borrowers showing similar delinquencies.[64] The holding in *Watson* demonstrates that claims for discriminatory underwriting based on credit risk are much easier to bring in the context of single-family home mortgages where an abundance of comparable data is available.

More fertile ground for discriminatory underwriting claims has been found in the third "C" of mortgage underwriting—collateral—and particularly in claims alleging the discriminatory appraisal of real estate.[65] Until 1977, professional associations of real estate appraisers promulgated written standards that expressly discounted property values based on the racial composition of a property's neighborhood.[66] In the years since, courts in fair lending cases have been unable to draw a clear line between permissible and unlawful appraisal considerations.[67]

61. *Id.* at 1554, 1558.

62. 702 F. Supp. 186 (N.D. Ill. 1988).

63. *Id.* at 187.

64. *Id.* at 188.

65. This group of cases can be distinguished from traditional redlining claims, *see infra* section I.B.2., because these cases allege that a lender or independent appraiser's valuation of a *specific residence* affected a borrower's credit worthiness; traditional redlining cases involve a lender's unwillingness to loan on homes in *defined geographic areas* containing minorities.

66. *See* United States v. Am. Inst. of Real Estate Appraisers, 442 F. Supp. 1072, 1079 (N.D. Ill. 1977) (finding that the promulgation of standards that cause appraisers and lenders to treat race as a negative factor in determining the value of a dwelling violates FHA).

67. The issue of measuring the amount of discount in home prices

In one case from 1987, James and Rosie Thomas, a black couple residing in Gary, Indiana, sued a regional bank after the bank denied the couple a second mortgage on their home.[68] The plaintiffs alleged that the appraisal conducted by the bank undervalued their home because of its location in a black neighborhood.[69] The court held that banks could base their lending decisions on such "legitimate business criteria [as] . . . salability of the security property, including the neighborhood in which it's located which has a bearing on the salability. . . ."[70] The holding in *Thomas v. First Federal Savings Bank of Indiana* acknowledges that supply and demand factors, even those influenced by race, may lawfully play a role in real estate appraisals.[71] In other words, the *Thomas* court recognized that the demographic composition of a neighborhood may lower home values, and lenders may appraise homes and extend mortgages that reflect these exogenous market forces, so long as they do not explicitly factor racial composition into their appraisal practices.[72]

2. Redlining

Unlike an appraisal case where a lender discounts the value of a particular home for underwriting purposes, traditional redlining cases involve a mortgage lender that refuses to make loans in entire geographic areas because of

attributable to racial discrimination—the concept of the "discrimination coefficient"—has been the subject of academic research and debate among sociologists, psychologists, and economists for more than half a century. Suffice it to say that the estimation of any discrimination coefficient is fraught with omitted variable bias, measurement error, and other shortcomings typical to social science causation analysis. *See* Ritter, *supra* note 47, at 13–23.

68. Thomas v. First Fed. Savs. Bank of Ind., 653 F. Supp. 1330 (N.D. Ind. 1987).

69. *Id.* at 1339.

70. *Id.* at 1340 (quoting Laufman v. Oakley Bldg. & Loan Co., 408 F. Supp. 489, 501 (S.D. Ohio 1976)).

71. Numerous studies have examined and debated the existence (and intensity) of "racial housing price differentials" and have arrived at different conclusions. *See, e.g.*, Caitlin Knowles Myers, *Discrimination and Neighborhood Effects: Understanding Racial Differentials in U.S. Housing Prices*, 56 J. URB. ECON. 279, 284–85, 293–98 (2004).

72. *See generally* GARY S. BECKER, THE ECONOMICS OF DISCRIMINATION 13–18 (2d ed. 1971) (explaining the economic forces determining discrimination in a free market).

their racial composition.[73] The five elements of a prima facie redlining case are:

1. the residence sought was in a minority neighborhood;
2. the prospective borrower applied for a loan;
3. an independent appraisal determined the residence was valued fairly;
4. the prospective borrowers were otherwise qualified; and
5. the lender denied the application.[74]

The case of *Harrison v. Otto G. Heinzeroth Mortgage Company* presents a straightforward example of a traditional redlining claim.[75] In 1974, John Harrison and his wife wanted to buy a house in the racially mixed neighborhood of Old West End in Toledo, Ohio.[76] Harrison called Heinzeroth Mortgage.[77] A company agent said, according to Harrison, that Heinzeroth required a 50 percent down payment for homes in "bad areas" like the racially integrated Old West End, but only 10 percent for property elsewhere in (the white areas of) Toledo.[78] Finding for Harrison, the court remarked: "[Harrison] had the shocking experience of finding himself the victim of bigotry and intolerance. . . . To his credit, plaintiff did not take it lying down. He fought back, in a proper manner, in the courts."[79]

Harrison, decided in 1977, serves a suitable benchmark for gauging the FHA's progress up to that point. Compared to the pre-FHA era, when the federal government itself redlined minority neighborhoods, *Harrison* indicates a significant step forward in the country's commitment to fair lending. But lenders quickly learned to avoid making discriminatory statements like those made by Heinzeroth's agent. They even rewrote lending policies to be facially neutral, yet black and Hispanic borrowers continued to be disproportionately denied

73. Redlining violates the FHA, 42 U.S.C. §§ 3604, 3605, and the ECOA, 15 U.S.C. § 1691(a).

74. SCHWEMM, *supra* note 46, § 18:4. Similar to cases alleging underwriting discrimination, direct evidence of racial animus circumvents the need for prima facie burden shifting. *See supra* text accompanying note 57.

75. 430 F. Supp. 893 (N.D. Ohio 1977).

76. *Id.* at 895.

77. *Id.* at 895–96.

78. *Id.* at 896.

79. *Id.* at 897.

credit and offered comparably inferior mortgage products.[80]

3. Reverse Redlining

The residential mortgage industry changed drastically in the 1990s. It transitioned away from the practice of "credit rationing," where interest rates and creditworthiness requirements were fixed and loanable funds rationed, to a system of "risk-based pricing," where lenders would offer differential loan products and interest rates to borrowers based on creditworthiness.[81] Beginning around 2000, claims against lenders for underwriting discrimination became less common, and claims alleging "reverse redlining"—also frequently referred to as "predatory lending" or "price discrimination"—emerged and have accelerated since.[82] In most reverse redlining cases, plaintiffs allege that lenders either discriminated in their procedures for determining creditworthiness—resulting in non-white borrowers paying more in discretionary fees and interest rates—or discriminated in the types of loans offered to white versus non-white borrowers, resulting in non-white borrowers receiving more sub-prime or other non-traditional mortgage loans.[83] The elements of a prima facie reverse redlining case are:

1. the borrower-plaintiff is a member of a protected class;
2. the borrower-plaintiff applied for and was qualified for a loan from the lender-defendant;
3. the lender-defendant offered the borrower-plaintiff a loan on grossly less favorable terms; and

4a. the lender-defendant intentionally targeted the borrower-plaintiff for such terms due to their protected class; or

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80. Jared Ruiz Bybee, *Fair Lending 2.0: A Borrower-Based Solution to Discrimination in Mortgage Lending*, 45 U. MICH. J. L. REFORM 113, 113 (2011).

81. *See* Schwemm & Taren, *supra* note 9, at 390–91; *see also* Joseph E. Stiglitz & Andrew Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 AM. ECON. REV. 393, 393–410 (1981) (discussing credit rationing).

82. Underwriting discrimination is discussed *supra* section I.B.1. For a concise discussion of the rise of reverse redlining, see Gregory D. Squires, *Predatory Lending: Redlining in Reverse*, NAT'L HOUSING INST. (2005) http://www.nhi.org/online/issues/139/redlining.html [https://perma.cc/V7EM-6QPK].

83. *See id.* (providing examples of predatory lending practices).

4b. the lender-defendant issued loans on more favorable terms to others not of the borrower-plaintiff's protected class.[84]

The first appearance of a reverse-redlining allegation was in a case brought against a Chicago-area real estate developer.[85] The developer, Easy Life Real Estate, offered homes that it represented as fully rehabilitated to first-time homebuyers in a 95 percent black community on Chicago's West Side.[86] The plaintiffs alleged a pattern by Easy Life's agents of refusing to negotiate price, fraudulently giving buyers down payment money and disguising these transactions as gifts from relatives, encouraging buyers' families to co-sign loans, and asking buyers to sign blank pieces of paper that were later filled in with explanations for credit delinquencies.[87] While much of the district court's opinion analyzed the case through a lens of an "exploitation theory" under the Civil Rights Act, the final paragraph of the opinion held that the FHA, which historically received a broad reading by courts, also prohibited reverse redlining.[88]

For eight years after *Easy Life*, reverse-redlining claims increased in frequency, but the modest acceleration in the early 2000s in no way heralded the proverbial flood of allegations that followed the Recession.[89] This was because the pre-

84. U.S. DEP'T OF HOUS. & URBAN DEV., MEMORANDUM ON ELEMENTS OF PROOF TO HUD FAIR HOUSING & EQUAL OPPORTUNITY HEADQUARTERS AND FIELD STAFF OFFICES, 9–10 (2014) (on file with author).

85. Honorable v. Easy Life Real Estate Sys., 100 F. Supp. 2d 885, 892 (N.D. Ill. 2000).

86. *Id.* at 886.

87. *Id.*

88. *Id.* at 892. The Seventh Circuit endorsed a three-element "exploitation theory" of liability under 42 U.S.C. § 1982 in *Clark v. Universal Builders, Inc.*, where the defendants were accused of taking advantage of the shortage of housing in black areas of Chicago to sell homes at higher markups and on more onerous terms than equivalent homes in white areas. 501 F.2d 324 (7th Cir. 1974). This cause of action has not been well received outside of the Seventh Circuit. *See* Brown v. Phillip Morris, Inc., 250 F.3d 789 (3d Cir. 2001) (finding that tobacco company targeting sale of menthol cigarettes at African Americans did not violate civil rights statutes); Rivera v. Inc. Vill. of Farmingdale, 924 F. Supp. 2d 440, 445 (E.D.N.Y. 2013) ("[E]ven assuming *arguendo* that an exploitation theory of liability applies to claims made pursuant to the FHA and that the Second Circuit does (or would) recognize this theory," the court held that plaintiffs did not adequately plead their exploitation claim).

89. *See* Schwemm & Taren, *supra* note 9, at 392 n.106 (listing five reverse-redlining claims brought between 2000 and 2007).

Recession cases were hamstrung in two ways: First, they were overwhelmingly the result of private action; the DOJ and HUD played only a marginal enforcement role.[90] Second, pre-Recession plaintiffs relied exclusively on evidence of disparate treatment.[91] While individual plaintiffs with relatively small claims brought private suits against some of the worst reverse-redlining offenders in the late 1990s and early 2000s, a much larger crisis was percolating in the mortgage industry, a crisis that had dire consequences for the entire U.S. economy.[92] But before turning to the post-Recession cases, it is necessary to briefly summarize disparate impact's origins and how courts came to apply it to FHA claims.

II. THE THEORY OF DISPARATE IMPACT

The theory of disparate impact, also referred to as the "discriminatory effects test," is a judicially created doctrine with origins in state employment law.[93] Between 1945, when New York became the first state to ban racial discrimination in employment, until 1964, when Congress banned such racial discrimination nationwide, civil rights proponents began to realize that the problem of racial bias in employment was not predominantly grounded in blatant exclusion, i.e., disparate

90. *See* NAT'L COMM'N ON FAIR HOUS. & EQUAL OPPORTUNITY, *supra* note 9, at 24 (discussing a decision by the DOJ not to litigate fair housing cases involving practices that relied on a disparate impact analysis); *but see* Schwemm & Taren, *supra* note 9, at 393–95 (discussing three enforcement actions by the DOJ in the 1990s based on lenders' practice of allowing loan officers to charge "overages" on a borrower-by-borrower basis).

91. *See Fair Lending Enforcement Program,* U.S. DEP'T OF JUSTICE, http://www.justice.gov/crt/fair-lending-enforcement-program [https://perma.cc/8YTU-YU4R] (last updated Aug. 6, 2015) ("One of our principal concerns is that lenders have targeted vulnerable populations . . . ."); Jackson v. Novastar Mortg., Inc., 645 F. Supp. 2d 636, 640, 647 (W.D. Tenn. 2007). In a recent case, a federal jury in New York found a bank liable for violating the FHA and ECOA by intentionally marketing toxic mortgages to minority homeowners. Verdict Form, Saint-Jean v. Emigrant Mortg. Co., No. 11-CV-2122, (E.D.N.Y. June 27, 2016) 2016 WL 4722772; Y. Peter Kang, *Emigrant Bank Violated Fair Housing, Human Rights Laws: Jury*, LAW360 (June 28, 2016, 7:39 PM), https://www.law360.com/articles/812021/emigrant-bank-violated-fair-housing-human-rights-laws-jury%20 [https://perma.cc/9CKH-KUYA].

92. *See* Alan Greenspan, *The Roots of the Mortgage Crisis*, WALL STREET J., (Dec. 12, 2007, 12:01 AM), http://www.wsj.com/articles/SB119741050259621811 [https://perma.cc/PG6V-2LQL].

93. Susan D. Carle, *A Social Movement History of Title VII Disparate Impact Analysis*, 63 FLA. L. REV. 251, 275–85 (2011).

treatment, but rather in seemingly neutral "business practices that reinforced the effects of past exclusion."[94] This powerful observation rings true in the housing context as well.[95] Lenders do not develop lending practices with the intent to discriminate, just as municipalities do not enact zoning laws with the purpose of excluding poor families, but these policies frequently have the effect of perpetuating exclusionary housing.

The Supreme Court first endorsed a theory of disparate impact in the 1971 employment law case *Griggs v. Duke Power*. The North Carolina-based electricity company Duke Power refused to cooperate with the incipient Equal Employment Opportunity Commission, which had identified specific employment practices at the company that, while facially nondiscriminatory, disproportionately disadvantaged applicants of color.[96] The plaintiffs produced statistical evidence showing that Duke's hiring and promotion policies disproportionately screened out black applicants and that the new requirements bore no substantial relationship to job performance.[97] The Fourth Circuit dismissed the complaint citing the absence of clear discriminatory intent.[98]

The Supreme Court, in a unanimous opinion by Chief Justice Burger, reversed, and in doing so, it endorsed the theory of disparate impact under federal civil rights law.[99] Even absent a showing of racial purpose or invidious intent,

94. PAUL D. MORENO, FROM DIRECT ACTION TO AFFIRMATIVE ACTION: FAIR EMPLOYMENT LAW AND POLICY IN AMERICA 1933–1972, at 199–200 (1997).

95. Many scholars refer to these facially neutral policies and practices that nevertheless produce discriminatory effects as "second-generation discrimination." *See generally* KENNETH J. MEIER ET AL., RACE, CLASS, AND EDUCATION: THE POLITICS OF SECOND-GENERATION DISCRIMINATION (1989).

96. Carle, *supra* note 93, at 288–92. Before the 1964 Civil Rights Act took effect, Duke company policy explicitly limited black employment to the company's "Labor Department" and the highest paid black employees in that department earned less than their lowest-paid white coworkers in other departments. Griggs v. Duke Power Co., 401 U.S. 424, 427 (1971). Just before Title VII's effective date, Duke introduced a "professionally prepared aptitude test[]" and high school diploma requirement for non-Labor Department applicants and for transfer out of the Labor Department into more desirable posts. *Id.* at 427–28.

97. Only six percent of black applicants passed the company's new employment screening test, while 58 percent of whites did so, and only 12 percent of blacks in North Carolina—as compared to 34 percent of whites—held high school diplomas. *Griggs*, 401 U.S. at 430 n.6.

98. Griggs v. Duke Power Co., 420 F.2d 1225, 1227 (4th Cir. 1970).

99. *See Griggs*, 401 U.S. 424.

the Court held that "practices, procedures, or tests *neutral on their face*, and even *neutral in terms of intent*, cannot be maintained if they operate to freeze the status quo of prior discriminatory . . . practices."[100] The test for employment practices moving forward would be one of "business necessity," that is, a practice with a disproportionately negative effect on a protected class must have a "demonstrable relationship to successful performance" to pass muster under Title VII.[101]

Shortly after *Griggs*, in *McDonnell Douglas v. Green*, the Court formalized a burden-shifting framework for disparate impact allegations, which is presented in Table 1.[102]

Table 1. *McDonnell Douglas* burden-shifting framework

STEP	BURDEN	ELEMENTS
prima facie case	plaintiff-employee	(i) member of protected class (ii) qualified for position (iii) application rejected (iv) employer continued to seek applicants
business justification	defendant-employer	"articulate some legitimate, nondiscriminatory reason for rejection"
pretextual rebuttal	plaintiff-employee	"evidence . . . of pretext"

Between 1974 and 2007, eleven federal appellate courts recognized the disparate impact theory under the FHA and applied variations of the *McDonnell Douglas* framework to evidentiary burdens in those cases.[103] Federal financial

100. *Id.* at 429–30 (emphasis added).

101. *Id.* at 431. The Court in *Wards Cove Packing Co. v. Atonio* reduced the employer's burden of production from one of "business necessity" to a lesser "business justification." 490 U.S. 642 (1989).

102. 411 U.S. 792 (1973).

103. Schwemm, *supra* note 15, at 106 n.6 (citing cases in which eleven circuit courts of appeals recognized disparate impact under the FHA); *see also* Cubita & Hartmann, *supra* note 15, at 836 n.23 (discussing cases from four federal district courts that recognized disparate impact liability under the ECOA).

regulators began enforcing the ECOA in 1994 under the assumption that federal courts would hold lenders liable for discriminatory effects,[104] and in 2013, HUD formalized a plaintiff-friendly disparate impact framework through the regulatory process.[105] In 2015, the U.S. Supreme Court addressed the issue of disparate-impact liability under the FHA in *Texas Department of Housing and Community Affairs v. Inclusive Communities Project*, and in a five-to-four opinion held, for the first time, that disparate impact claims are cognizable.[106]

Unfortunately none of these cases, or any of the disparate impact claims brought under the ECOA, involved discrimination in mortgage lending.[107] The first case containing a substantial discussion of disparate impact liability for lending activity came in a 1987 underwriting discrimination case. In *Old West End Association v. Buckeye Federal Savings and Loan*, Buckeye Federal rejected a mortgage application for a home in a minority-majority neighborhood after a bona fide independent appraisal.[108] Applying the *McDonnell Douglas* framework, the plaintiff established all five elements of a prima facie redlining case.[109] Then, the burden shifted to the lender to articulate a non-discriminatory reason for rejecting the borrower.[110] Buckeye Federal justified its action by claiming that the subject property did not qualify for financing under Fannie Mae's established guidelines and that the independent appraisal was unacceptably high for the area.[111] Neither justification indicated intentional discrimination, so the court found that Buckeye had successfully rebutted the

104. 12 C.F.R. § 202.6(a) (2017).

105. Implementation of the Fair Housing Act's Discriminatory Effects Standard, 78 Fed. Reg. 30, 11460 (Feb. 15, 2013) (codified at 24 C.F.R. § 100.500).

106. 135 S. Ct. 2507, 2513–15 (2015). *Inclusive Communities* involved the allocation of tax credits for affordable housing development. *See generally* Schwemm, *supra* note 15 (analyzing holding).

107. Disparate impact's applicability to mortgage lending came through executive action. In 1994, HUD, the DOJ, and six other agencies with fair lending oversight banded together to promulgate the Policy Statement on Discrimination in Lending, which explicitly recognized statistical evidence of disparate impact as a legitimate evidentiary method for proving lending discrimination. Policy Statement on Discrimination in Lending, FRRS 6-153.13 (Apr. 15, 1994), 2006 WL 3946271.

108. 675 F. Supp. 1100, 1103 (N.D. Ohio 1987).

109. *Id.* See elements of a prima facie case of redlining *infra* section I.B.2.

110. 675 F. Supp. at 1103.

111. *Id.* at 1104–05.

prima facie case.[112]

Under *McDonnell Douglas*, however, the inquiry does not end once a lender rebuts a presumption of discriminatory intent; a plaintiff may still prevail by proving that the lender's proffered justification was pretextual. "The factual inquiry proceeds to a new level of specificity," remarked the court in *Old West End*.[113] To that end, the plaintiffs called an expert statistician to present evidence indicating that Buckeye Federal's underwriting policies caused racially discriminatory effects.[114] The expert witness concluded that statistically significant differences existed between Buckeye's treatment of conventional loans originating from white neighborhoods, and similar applications from racially mixed or minority-majority neighborhoods in Toledo, Ohio.[115] Buckeye Federal argued that the sample size of conventional loans underwritten for non-white borrowers—ten—was too small to produce statistically significant conclusions and that the plaintiffs' analysis lacked relevance by failing to include federally guaranteed loans.[116] The court disagreed and denied summary judgment for Buckeye Federal.[117]

The issues surrounding statistical evidence in fair lending litigation were nascent in 1987, but subsequent fair lending claims have built on the foundation established in *Old West End*. Statistical evidence of "a very general nature"—such as evidence demonstrating that a lender rejected black applicants at more than twice the rate of white applicants in a large metropolitan area—failed summary judgment because a plaintiff could not identify a specific policy that caused the discriminatory effect.[118] Raw rejection numbers by census tract likewise have been deemed insufficient to support a claim against a lender without corresponding application numbers,[119]

112. *Id.* at 1104.

113. *Id.*

114. *Id.* at 1105–06.

115. *Id.* at 1106.

116. *Id.* From 1981 to 1987, 177 loans were tendered to Buckeye, of which only ten were submitted from areas that were twenty percent or more black. *Id.*

117. *Id.* The author has expended some effort, without success, to learn how this case was resolved.

118. Saldaña v. Citibank, F.S.B., 1996 WL 332451, at *5 (N.D. Ill. June 13, 1996) (discussing lender activity relative to general demographics of Chicago area).

119. Cartwright v. Am. Sav. & Loan Ass'n, 880 F.2d 912 (7th Cir. 1989) (affirming involuntary dismissal of district court in favor of lender).

and lenders have been quick to deploy their own statistical evidence to refute claims of discrimination.[120] Compared with recent cases involving millions of mortgages underwritten by large national banks like Countrywide and Wells Fargo, the use of statistical evidence in *Old West End* was rudimentary, but, in retrospect, these cases augured the future of evidence in fair lending litigation.[121]

The distinction between the widely accepted theory of disparate treatment and the controversial theory of disparate impact "marks the boundary between consensus and controversy over the concept of equality in civil rights law."[122] A consensus exists that lenders cannot intentionally reject a minority loan application only because the prospective borrower is not white, refuse to lend on homes in minority neighborhoods, or charge higher interest rates to minority borrowers. But basing legal liability on complicated statistical discrepancies between white and non-white borrowers remains controversial in federal courts and unsettling to the mortgage lending industry.[123] In the post-Recession cases, the theory of disparate impact held plaintiffs liable for what they argue are market-based outcomes. As the following Part will discuss, the Obama administration had no qualms with applying this controversial theory to mortgage lending practices.

III. FAIR LENDING ENFORCEMENT AFTER THE CRISIS & THE RISE OF DISPARATE IMPACT

According to the National Bureau of Economic Research, the Great Recession in the United States lasted from December

120. *See* Latimore v. Citibank, F.S.B., 979 F. Supp. 662, 667 (N.D. Ill. 1997) (citing "uncontradicted evidence show[ing] that [lender's] appraisals consistently supported mortgage loans for other African-Americans and in the same neighborhood").

121. *See, e.g.*, OFFICE OF THE COMPTROLLER OF THE CURRENCY, CCE-FL, COMPTROLLER'S HANDBOOK FOR FAIR LENDING COMPLIANCE (2010) (describing fair lending analysis and risk factors in the 178 page manual); Kinsey Sullivan, *The Cost of Compliance for Lenders*, TRUPOINT PARTNERS (Aug. 11, 2016), https://www.trupointpartners.com/blog/cost-of-compliance-lending-2016 [https://perma.cc/3PFF-Z8ZV] (discussing upward trend in cost and increasing complexity of fair lending compliance).

122. George Rutherglen, *Disparate Impact, Discrimination, and the Essentially Contested Concept of Equality*, 74 FORDHAM L. REV. 2313, 2313 (2006).

123. *See* Texas Dep't of Hous. & Comm. Affairs v. Inclusive Cmtys. Project, Inc., 135 S. Ct. 2507, 2532–51 (Alito, J., dissenting).

2007 until June 2009.[124] During those eighteen months, the U.S. economy lost some eight million jobs; U.S. households lost an estimated $13 trillion of net worth; and the homeownership rate in the United States fell nearly two percent, erasing all the gains from the early 2000s housing boom.[125] Although experts disagree as to the specific causes of the crisis and how much blame to assign to each, there exists general consensus that the collapse of the mortgage lending system "was the spark that ignited a string of events" that "led to a full-blown crisis."[126] Minority borrowers, their families, and by extension their communities, bore the weight of the housing collapse with added force.[127]

These background facts set the stage for fair lending enforcement in the post-Recession era. In the thirty-eight years between the FHA's effective date in 1969 and the beginning of the Recession in 2007, courts decided an average of two fair lending cases per year; since then, the rate has more than doubled.[128] The post-Recession cases have largely been the result of federal enforcement (rather than private suit), and have alleged unlawful discrimination on a national scale.[129]

124. *See* Bus. Cycle Dating Comm. of the Nat'l Bureau of Econ. Research, *supra* note 10.

125. *Federal Reserve Economic Data*, FED. RESERVE BANK OF ST. LOUIS, https://research.stlouisfed.org/fred2/ (Unemployment Level data last updated Jan. 8, 2016) (Household Net Worth data last updated Dec. 11, 2015) [https://perma.cc/B6BA-ZQQT]; JOINT CTR. FOR HOUS. STUDIES HARVARD UNIV., THE STATE OF THE NATION'S HOUSING: 2009, at 16 (2009).

126. FIN. CRISIS INQUIRY COMM'N, FINANCIAL CRISIS INQUIRY REPORT xvi (2011).

127. *See* AMAAD RIVERA ET AL., FORECLOSED: STATE OF THE DREAM 2008, at vii (2008), http://d3n8a8pro7vhmx.cloudfront.net/ufe/legacy_url/3530/StateOfDream_01_16_08_Web.pdf?1448067696 [https://perma.cc/3C7E-84JN] (estimating a total loss of wealth for minority households of between $164 billion and $213 billion for subprime borrowing from 2000 to 2008; "We believe this represents the greatest loss of wealth for people of color in modern US history."); *see also* MATTHEW DESMOND, EVICTED: POVERTY AND PROFIT IN THE AMERICAN CITY 125 (2016) ("Between 2007 and 2010, the average white family experienced an 11 percent reduction in wealth, but the average black family lost 31 percent of its wealth. The average Hispanic family lost 44 percent.").

128. Based on an analysis of cases under Westlaw Key Number 78-1079, civil rights cases involving loans and financing, excluding cases not based on racial discrimination (i.e. gender, familial status, or handicap).

129. While the rest of this Comment focuses on the public enforcement actions, private plaintiff-borrowers continue to pursue disparate treatment claims. *See, e.g.*, Swanson v. Citibank, N.A., 614 F.3d 400, 400–03 (7th Cir. 2010) (holding that a black loan applicant sufficiently stated a claim for underwriting discrimination under FHA where the bank under-appraised her home by 30 to 40 percent); M&T

This recent burst of pattern-or-practice enforcement activity by federal prosecutors and financial regulators was long overdue. As discussed earlier in Part I.B.3, changes in the credit market during the 1990s—specifically, the transition from credit rationing (where many borrowers were denied access to credit) to risk-based pricing (where previously denied borrowers were offered more expensive loans to compensate for risk)—created a false impression of racial neutrality. In theory, lenders were simply plugging objective indicators of creditworthiness into a formula. In practice, however, automated lending created large discriminatory effects.

In the years leading up to the Recession, traditional lenders continued to underserve poorer communities. While national and regional banks opened sleek new branch locations in commercial centers and wealthy suburbs, poorer (and predominantly minority) areas were still served by a patchwork of short-term lenders and independent mortgage brokers who charge higher interest rates and fees than their national counterparts. It took a once-in-a-lifetime economic catastrophe to bring the discriminatory effects of these practices into focus.

To remedy these effects, disparate impact has emerged as the predominant theory of liability in fair lending cases following the Recession. Recent cases fall within the broad rubrics of redlining, reverse redlining, and discriminatory underwriting established before the Recession, but they are analytically distinct in that they have been brought by the government, rely on complex statistical evidence, and seek (and in some cases have settled for) enormous monetary awards.[130] The discussion of these cases will proceed in two Sections: Section A examines two recent cases where the CFPB and HUD brought allegations of redlining against two regional banks. Both cases settled in 2015 for a combined $227 million in fines, restitution, and remedial measures.[131] Section B

Mortg. Corp. v. White, 736 F. Supp. 2d 538, 575–76 (E.D.N.Y. 2010) (refusing to grant summary judgment in a case where an issue of fact existed as to whether a mortgage company had intentionally targeted racial minorities for unfair loan terms).

130. The settlement funds have been used to compensate the victims of discrimination. *See, e.g.*, Consent Order at 5, United States v. Countrywide Fin. Corp., No. 2:11-cv-10540-PSG-AJW (C.D. Cal. Dec. 28, 2011).

131. Press Release, U.S. Dep't of Hous. & Urban Dev., HUD & Associated Bank Reach Historic $200 Million Settlement of 'Redlining' Claim (May 26, 2015),

examines two cases brought by the DOJ alleging reverse redlining against national banks. These cases settled in 2011 and 2012 for a combined $510 million.[132]

These four cases—in particular, their pleadings, theory of liability, and evidence proffered—would be old news if not for a wave of complaints brought by major U.S. municipalities and a reputable nonprofit organization that relied on nearly identical pleadings, legal theories, and evidence.[133] This discussion would also be different if any of the earlier cases had gone to trial. Instead, largely because these cases settled, lenders and fair lending advocates have little case law to assess the strength of their current claims.[134]

A. *The Resurgence of Redlining*

The basic contours of redlining liability developed over forty years of FHA, ECOA, and CRA jurisprudence. Today, the resurgence of redlining cases is epitomized by two cases brought by the federal government that settled in 2015. Early redlining cases such as *Harrison* made clear that refusing to offer loans to prospective borrowers in minority neighborhoods was unlawful, and later cases like *Old West End* introduced statistical evidence as a tool to demonstrate a pattern of

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https://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2015/HUDNo_15-064b [https://perma.cc/BG8U-QH7E]; Press Release, Consumer Fin. Prot. Bureau, CFPB and DOJ Order Hudson City Savings Bank to Pay $27 Million to Increase Mortgage Credit Access in Communities Illegally Redlined (Sept. 24, 2015), http://www.consumerfinance.gov/about-us/newsroom/cfpb-and-doj-order-hudson-city-savings-bank-to-pay-27-million-to-increase-mortgage-credit-access-in-communities-illegally-redlined/ [https://perma.cc/2DU9-WF9V].

132. Press Release, U.S. Dep't of Justice, Justice Department Reaches $335 Million Settlement to Resolve Allegations of Lending Discrimination by Countywide Financial Corporation (Dec. 21, 2011), https://www.justice.gov/opa/pr/justice-department-reaches-335-million-settlement-resolve-allegations-lending-discrimination [https://perma.cc/U3UC-H8T9]; Press Release, U.S. Dep't of Justice, Justice Department Reaches Settlement with Wells Fargo Resulting in More Than $175 Million in Relief for Homeowners to Resolve Fair Lending Claims (July 12, 2012), https://www.justice.gov/opa/pr/justice-department-reaches-settlement-wells-fargo-resulting-more-175-million-relief [https://perma.cc/5SHF-9D5A].

133. Schwemm & Taren, *supra* note 9, at 404–06 & nn.158–66, discuss "a series of lawsuits," eight in total, that alleged discriminatory pricing and that began in 2007. Two of those suits—*United States v. Countrywide* and *United States v. Wells Fargo*—will be the subject of section III.B *infra*.

134. *Id.* at 422 ("As far as we can tell, no discriminatory lending case based on the disparate impact theory has ever gone to trial.").

discriminatory lending.[135] Traditional redlining cases like *Harrison* and *Old West End* evaluated a bank's lending activity in a two-step analysis: first, a plaintiff compared the lending activity of the defendant in minority census tracts to its lending activity in otherwise similar white tracts; next, the plaintiff compared these disparities to the disparities displayed by peer-lenders in the same geographic market.[136] In essence, so long as the defendant was not more discriminatory than its peer lenders, the plaintiff was out of luck.

A pair of recent redlining settlements signal important changes in enforcement strategy. First, federal bank regulators focused on whether a lender lent equally, in absolute terms, to minority and non-minority geographic areas. No longer do lenders appear to benefit from discriminatory effects built into peer-comparison analysis.[137] Second, regulators in these cases focused exclusively on the volume of loan applications underwritten and ignored higher-than-average approval rates for minority applicants and substantial purchases of minority-held loans in the secondary market.[138] These new redlining

135. See discussion *supra* Part II.

136. *See* Melanie Brody et al., *The Resurgence of Redlining: The* Hudson City Savings Bank *Settlement and How to Manage Redlining Risk*, K&L GATES LLP 5 (Oct. 14, 2015), http://www.klgates.com/files/Publication/6f63f4e9-3726-4bf9-833b-bdfb23d7a323/Presentation/PublicationAttachment/bd52cc01-67fa-4f47-bb36-bff84fd7576e/The_Resurgence_of_Redlining_Slides.pdf [https://perma.cc/KJ8Q-3P92].

137. *See* Andrew L. Sandler et al., *Redlining Cases in 2015 and a New Discrimination Standard*, LAW360 (Jan. 3, 2016), https://www.law360.com/articles/741345/redlining-cases-in-2015-and-a-new-discrimination-standard [https://perma.cc/7VGX-EDR7] ("[T]hese agencies have taken the position that the failure of a lender to achieve statistical equivalence in their lending in geographies with different racial and ethnic population characteristics suggests the need for investigation to determine whether that lender is engaged in redlining discrimination"); *see also* Michael M. Mierzewski et al., Presentation for Arnold & Porter: Best Practices for Complying with Fair Lending Laws 14–15, 35 (Dec. 4, 2012) (discussing how to conduct matched-pair file review of protected and non-protected class applicants for proactive compliance).

138. Before the recent wave of redlining enforcement actions, compliance experts generally agreed that purchasing minority-held mortgages in the secondary market was a legitimate way to satisfy a lender's obligations under the CRA. *See* Richard M. Alexander et al., *First DOJ/CFPB Joint Redlining Settlement Signals Major Changes for Fair Lending Enforcement*, ARNOLD & PORTER (Oct. 6, 2015), http://www.arnoldporter.com/es/perspectives/publications/2015/10/first-dojcfpb-joint-redlining-settlement-signals__ [https://perma.cc/9JQ4-MT4N]. This shift of strategy is controversial. Sandler et al., *supra* note 137 ("The agencies are misapplying the disparate impact discrimination standard recently affirmed by the U.S. Supreme Court for limited use in connection with the Fair

enforcement actions also challenged each lender's designation of its CRA Assessment Area (CRAAA)[139] and involved complex statistical analysis of whether a lender adequately serves the credit needs of protected persons in its CRAAA.[140]

1. Hudson City

In the first case, the CFPB and DOJ jointly investigated New Jersey-based Hudson City Savings Bank for suspected redlining violations.[141] After failing to follow the Bureau's recommendation to proactively monitor its redlining risk, the CFPB filed a complaint alleging that "by structuring its business so as to avoid the credit needs of majority-Black-and-Hispanic neighborhoods in its residential mortgage lending," Hudson City violated the FHA and ECOA.[142] The complaint alleged that Hudson City selected six counties in the greater-New York City area to include in its CRAAA and chose to exclude four: Bronx, Queens, Kings (Brooklyn), and New York Counties (Manhattan).[143] This choice of CRAAA had the effect of excluding 63.4 percent of the minority-majority census tracts in the New York metropolitan area while only excluding 37.1 percent of white-majority tracts.[144] In addition to challenging the discriminatory effects of Hudson City's CRAAA designation, the CFPB based its complaint on a number of

Housing Act.").

139. 12 U.S.C. §§ 2901–2908 (2012); 12 C.F.R. §§ 25, 195, 228, 345 (2017); *see generally* Kenneth Benton & Donna Harris, *Understanding the Community Reinvestment Act's Assessment Area Requirements*, CONSUMER COMPLIANCE OUTLOOK (2014), https://consumercomplianceoutlook.org/2014/first-quarter/understanding-cras-assessment-area-requirements/.

140. *See* David Skanderson, *Redlining Risk — Walking a Fine Line*, MORTG. BANKING (July 2016), *reprinted in* CRA INSIGHTS: FINANCIAL ECONOMICS 4–6 (2016),https://www.crai.com/sites/default/files/publications/FE-Insights-Redlining-Risk-Walking-a-Fine-Line-072116.pdf [https://perma.cc/N83K-JXE7] (discussing statistical analysis process).

141. Press Release, U.S. Dep't of Justice, Justice Department and Consumer Financial Protection Bureau Reach Settlement with Hudson City Bank to Resolve Allegations of Mortgage Lending Discrimination (Sept. 24, 2015), https://www.justice.gov/opa/pr/justice-department-and-consumer-financial-protection-bureau-reach-settlement-hudson-city [https://perma.cc/FG6G-UTA2].

142. Complaint ¶ 1, CFPB v. Hudson City Sav. Bank, F.S.B., No. 2:15-cv-07056-CCC-JBC (D.N.J. Sept. 24, 2015).

143. *Id.* ¶¶ 37–39.

144. *Id.* ¶¶ 38–39 (stating that Hudson City's CRAAA "forms a semi-circle around the four counties with the highest proportion of majority-Black-and-Hispanic neighborhoods in the State").

other "geographic" factors, including bank branch and mortgage broker locations and marketing strategies.[145] Rather than try its luck in court, Hudson City settled the redlining claims for $32.25 million in September 2015.[146]

A few lessons about the application of disparate impact theory to redlining allegations can be discerned from the *Hudson City* settlement. One obvious lesson is that appearances matter. Former Assistant Attorney General Thomas Perez, discussing CRAAAs, remarked, "[I]f your [CRAAA] looks like something you can eat—a bagel or is crescent shaped—that should be a red flag to you."[147] Furthermore, *Hudson City* suggests that lenders need to review their existing, new, and closed branch locations and overall marketing strategy, comparing branch concentration and marketing expenditures in minority census tracts to those in white ones.[148]

Finally, and perhaps most significantly, the exclusive emphasis on loan origination statistics in the *Hudson City* complaint clearly implies that purchase-loan activity—the acquisition by one bank of loans originated by another—and higher-than-average approval rates do not offset a statistically significant shortfall in loan originations. Previously, banks could purchase home and commercial loans secured by properties in minority neighborhoods and count that activity toward its CRA rating.[149] Now, these lenders must open branches, advertise, and originate loans for properties in minority areas.[150] While *Hudson City* provides some insight as to how federal regulators will apply the theory of disparate

145. *Id.* ¶¶ 14–32, ¶¶ 48–69.

146. CFPB, *CFPB and DOJ Order Hudson City Savings Bank to Pay $27 Million to Increase Mortgage Credit Access in Communities Illegally Redlined*, CFPB (Sept. 24, 2015), http://www.consumerfinance.gov/newsroom/cfpb-and-doj-order-hudson-city-savings-bank-to-pay-27-million-to-increase-mortgage-credit-access-in-communities-illegally-redlined/ [https://perma.cc/UHP3-C8JT].

147. Thomas E. Perez, Assistant Att'y Gen., Dep't of Just., Speech at the Fifteenth Annual Community Reinvestment Act and Fair Lending Colloquium (Nov. 7, 2011), http://www.justice.gov/opa/speech/assistant-attorney-general-thomas-e-perez-speaks-15th-annual-community-reinvestment-act) [https://perma.cc/9TV5-YD2S].

148. *See* CFPB, *Analysis of Potential Discriminatory "Redlining," in* SUPERVISION AND EXAMINATION MANUAL, PART III: EXAMINATION PROCEDURES 33–40 (Oct. 2012).

149. *See* DARRYL E. GETTER, CONG. RESEARCH SERV., 7-5700, THE EFFECTIVENESS OF THE COMMUNITY REINVESTMENT ACT 5 (2015).

150. Alexander et al., *supra* note 138.

impact to CRAAA designations, a second (and much larger) case from 2015 reveals how the theory applies to lending activity.

2. Associated Bank

In December 2011, HUD filed a redlining complaint against Wisconsin-based Associated Bank for its "disproportionate denial of [minority] loan applications" and for "underserv[ing] neighborhoods with significant African American or Hispanic populations, despite demand for residential mortgage loans in these neighborhoods."[151] HUD based its original complaint exclusively on three years of HMDA data showing that between 2008 and 2010, Associated Bank had "denial disparities" of 20 to 31 percent for black applicants relative to similarly creditworthy white applicants and seven to 16 percent for Hispanic applicants in five metropolitan areas in the Midwest.[152] In other words, Associated Bank was approving loans for white applicants with given credit characteristics at rates between seven and 31 percent higher than for identically creditworthy minority applicants. Although Associated Bank denied the redlining allegations, it settled the complaint for a record-breaking $200 million in May 2015.[153]

HUD's complaint against Associated Bank leaves unresolved some serious legal questions about disparate impact liability for redlining. The pleadings against Associated Bank rely exclusively on HMDA data, and federal enforcement policy clearly states that HMDA data do not, standing alone, provide sufficient information for a pattern-or-practice discrimination claim.[154] Between the filing of the complaint in December 2012

151. Hous. Discrimination Complaint at 2, Case No. 00-12-0003-8 (Dec. 28, 2011) (on file with author); *see also* Skanderson, *supra* note 140, at 3 (discussing how "lenders tend to write off underserved markets with perceived 'business justifications'").

152. Hous. Discrimination Complaint, *supra* note 151, at 3 (noting summarily that "[t]he denial disparities are statistically significant.").

153. Conciliation Agreement, Assistant Secretary of Fair Housing and Equal Opportunity and Associated Bank, N.A., Case No. 00-12-0003-8 (May 22, 2015); Brian Sullivan, *HUD & Associated Bank Reach Historic $200 Million Settlement of 'Redlining' Claim*, U.S. DEP'T OF HOUSING & URB. DEV. (May 26, 2015), http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2015/HUDNo_15-064b [https://perma.cc/YTU5-XT89].

154. Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,226

and settlement in May 2015, HUD almost certainly conducted additional discovery that confirmed its suspicions about Associated Bank's discriminatory lending activity. But neither HUD, nor the CFPB, nor any other fair lending enforcement agency publishes clear guidelines as to what variables it examines to supplement the HMDA data (e.g. credit scores, loan-to-value ratios, or debt-to-income ratios). Nor do they explain their sampling methodology or offer any publicly available guidance that indicates where thresholds exist for statistical significance of disparities.[155] This massive gap in guidance raises the possibility of a void-for-vagueness defense for future plaintiffs.[156]

B. *Reverse Redlining 2.0: The* Countrywide *and* Wells Fargo *Settlements*

The recent settlement agreements between the CFPB, HUD, and regional banks expanded redlining liability under the disparate impact theory. At the same time, another set of cases against national banks redefined the pre-Recession notion of reverse redlining. Whereas earlier reverse-redlining cases like *Easy Life* focused on lenders intentionally targeting an identifiable group of geographically unified borrowers with predatory loans,[157] the 2012 settlements between the DOJ and Countrywide and Wells Fargo indicted the pre-Recession mortgage industry writ large.

The two complaints alleged that discrete business practices adopted by these two banks resulted in more than 10,000 Hispanic and black borrowers from across the country being placed in subprime loans, while similarly creditworthy white borrowers received less expensive prime loans—a practice described by the DOJ as illegal "product placement." The

(1994).

155. *See* FED. JUDICIAL CTR., REFERENCE MANUAL ON SCIENTIFIC EVIDENCE 240–72 (3d ed. 2011) (discussing elements of statistical reasoning and relevant legal doctrine). The "standard" level of statistical significance is p=0.05, which means that a false indication should only occur once in twenty random trials.

156. *See* Michael S. Barr, *Credit Where It Counts: The Community Reinvestment Act and Its Critics*, 80 N.Y.U. L. REV. 513, 527 ("[Critics] charge that the CRA is vague, blunt, and contradictory. The Act does not make explicit whether it is targeted at discrimination, and fails to explain whether low-income communities or individuals are to be helped.") (internal citations omitted).

157. See discussion *supra* Section I.B.3.

complaints further alleged that the two lenders' established systems for pricing their loans that had the effect of charging more than 100,000 minority borrowers higher fees than white borrowers with similar credit characteristics—illegal "discriminatory pricing."[158] But unlike previous reverse redlining claims, the DOJ's pleadings relied exclusively on a theory of disparate impact.[159]

The analysis that follows will break the allegations against Countrywide and Wells Fargo into two categories: allegations regarding illegal product placement will be the subject of Part 1; allegations of discriminatory pricing will be discussed in Part 2.[160] Although these cases settled in 2012, and perhaps because they settled, they remain incredibly germane today. Because no case law exists, current and future litigants lack precedent from which to determine the sufficiency of their pleadings or the requisite robustness of certain statistical evidence.

1. Unlawful Product Placement

The DOJ alleged that discrete business practices at Countrywide and Wells Fargo resulted in black and Hispanic borrowers being discriminatorily placed into more expensive subprime loans, while otherwise similarly situated white borrowers received less expensive prime loans.[161] A wealth of recent scholarship supports the proposition that minority borrowers nationwide received a disproportionately large share of subprime loans during the housing boom of the early and mid-2000s,[162] but in order to prevail on an impact-based

158. Complaint, United States v. Countrywide Fin. Corp., No. 2:11-cv-10540-PSJ-AJW (C.D. Cal., Dec. 21, 2011) [hereinafter Countrywide Complaint]; Complaint, United States v. Wells Fargo Bank, NA, No. 1:12-cv-01150 (D.D.C. July 12, 2012) [hereinafter Wells Fargo Complaint].

159. Schwemm & Taren, *supra* note 9, at 406 n.171 (discussing the hybrid impact/intent nature of these claims).

160. The two complaints will be analyzed together because they follow the same pleading pattern, rely on the same theory of liability, and contain the same modes of analysis for statistical evidence.

161. Wells Fargo Complaint, *supra* note 158, ¶¶ 23–50; Countrywide Complaint, *supra* note 158, ¶¶ 80–94.

162. *See* Emily Badger, *The Dramatic Racial Bias of Subprime Leading During the Housing Boom*, CITYLAB (Aug. 16, 2013), http://www.citylab.com/housing/2013/08/blacks-really-were-targeted-bogus-loans-during-housing-boom/6559/ [https://perma.cc/977N-D4VL] (citing research on HMDA data showing that

theory, the government needed to both identify a *specific* bank practice and demonstrate how it *caused* a discriminatory effect.[163]

In the two complaints, the government identified specific practices that incentivized mortgage underwriters to place applicants who qualified for prime loans into subprime loans and then allowed underwriters to overwrite control mechanisms that sought to ensure that prime-eligible borrowers received prime loans.[164] Wells Fargo, for example, paid its mortgage brokers commissions of 0.75 to 1.8 percent of the total loan amount for subprime mortgages, while only paying a 0.5 percent commission for the origination of traditional prime mortgages.[165] Similarly, Countrywide capped total broker compensation for prime loans at five percent while offering a higher six percent commission for subprime loans.[166] So, in 2006, if a Wells Fargo mortgage broker originated a $250,000 prime loan, she would receive a $1,250 commission; for the same subprime loan, she could receive as much as $4,500.

With such a strong pecuniary incentive to steer qualified prime applicants toward subprime loans, the DOJ further alleged that both banks failed to impose effective controls to prevent this from happening.[167] Wells Fargo gave its originators a handwritten checklist to ensure that all prime-eligible borrowers were referred to the prime division.[168] To

minority borrowers were 2.4 times more likely to receive a subprime loan than white applicants); *see also* Marsha J. Courchane, *The Pricing of Home Mortgage Loans to Minority Borrowers: How Much of the APR Differential Can We Explain?*, 29 J. REAL ESTATE RESEARCH 399 (2007).

163. *See* 24 C.F.R. § 100.500(c)(1) (2017) (defining the legal standards for proving discriminatory effect).

164. Wells Fargo Complaint, *supra* note 158, ¶¶ 27–38; Countrywide Complaint, *supra* note 160, ¶¶ 80–85.

165. Wells Fargo Complaint, *supra* note 158, ¶ 27.

166. Countrywide Complaint, *supra* note 158, ¶ 62.

167. Wells Fargo Complaint, *supra* note 158, ¶ 7 ("Wells Fargo's internal documents reveal that senior officials were aware of numerous tactics that subprime originators employed to keep loans in the subprime division, and that a significant percentage of borrowers were receiving subprime loans when they could have qualified for prime loans."); Countrywide Complaint, *supra* note 158, ¶ 7 ("Countrywide knew or had reason to know based on its own internal monitoring and reporting that its policies . . . was [sic] resulting in discrimination.").

168. Wells Fargo Complaint, *supra* note 158, ¶¶ 31–32. Although the Complaint states only that "loan originators had the ability to enter incorrect information," *id.* ¶ 32, a study by a mortgage risk-management consultant found

circumvent this control and place prime-eligible borrowers into sub-prime loans, originators filling out the checklist frequently reduced applicants' incomes, omitted assets, misstated lengths of employment, or claimed that the prospective borrower had been unable to provide proper documentation of creditworthiness when in fact they had provided it.[169] Likewise, Countrywide published underwriting guidelines containing objective criteria for prime and subprime loans, but granted mortgage brokers the discretion to request exceptions to the guidelines.[170] By early 2007, mere months before the start of the Recession, Countrywide was excepting nearly half of certain loan products as exceptions to its general underwriting policy.[171]

At first blush, the statistical analysis of discriminatory product placement is damning. The DOJ presented its data at the aggregate, national level and broke it down by major markets.[172] All told, the government alleged that Wells Fargo unlawfully placed approximately 4,000 black and Hispanic borrowers into subprime loans.[173] The government's estimate for Countrywide exceeded 10,000.[174] By an odds ratio formulation, black retail borrowers at Wells Fargo were 5.6 times more likely than similarly creditworthy whites to receive a subprime mortgage; for black borrowers whose loans were purchased on the secondary market by Wells Fargo, they were 8.3 times more likely to have received a subprime loan. Wells Fargo's Hispanic retail borrowers were 2.4 times more likely than otherwise comparable white borrowers to receive subprime loans. For loans purchased on the secondary market, Hispanic borrowers were 1.7 times more likely to have a subprime loan.[175] At Countrywide, the odds ratio disparities

that more than 70 percent of defaults were linked to significant misrepresentation on the original loan application. Paul Jackson, *Study: 70 Percent of EPDs Linked to Fraud*, HOUSINGWIRE (Feb. 12, 2007), http://www.housingwire.com/articles/study-70-percent-epds-linked-fraud [https://perma.cc/NB6G-TYU2].

169. *Id.* ¶¶ 32–33.

170. Countrywide Complaint, *supra* note 158, ¶¶ 82–83.

171. *Id.* ¶ 83.

172. Wells Fargo Complaint, *supra* note 158, ¶ 23, 39–46; Countrywide Complaint, *supra* note 160, ¶ 80, 86–91.

173. Wells Fargo Complaint, *supra* note 158, ¶ 2.

174. Countrywide Complaint, *supra* note 158, ¶ 80.

175. Wells Fargo Complaint, *supra* note 158, ¶¶ 39–40. *See generally* Magdalena Szumilas, *Explaining Odds Ratios*, 19 J. CAN. CHILD & ADOLESCENT PSYCHIATRY 227 (2010) (explaining odds ratios).

were 2.1 to 2.7 for black borrowers and 2.6 to 3.5 for Hispanics.[176] These disparities persisted for both banks in the majority of high loan-volume markets throughout the relevant four-year period.[177]

On second glance, however, the DOJ's statistical analysis leaves a pair of key questions unanswered. Specifically, is odds ratio analysis a sound analytical method for inferring legal causation generally,[178] and if it is, was the technique properly applied these instances? The precedent and the pleadings suggest an affirmative answer to both questions.

The only case outside of the medical context where a court admitted odds ratio analysis was *Grutter v. Bollinger*—the landmark affirmative action case involving the University of Michigan Law School's admissions process.[179] The plaintiffs retained a professor of applied statistics who made "admissions grids" with 120 cells for applicants based on undergraduate GPA and LSAT scores.[180] The expert statistician then made cell-by-cell comparisons based on admit-deny decisions by race, and ran a logistic regression analysis to determine the statistical significance of race in each cell.[181] Finally, he computed the odds ratio of admission by race for each cell, which revealed, "the relative odds of acceptance for [non-white] applicants were many times greater than for Caucasian applicants."[182] The thrust of the university's counterargument focused on the under-inclusiveness of the analysis, namely that it excluded important factors like the strength of recommendations, essays, and quality of an applicant's

176. Countrywide Complaint, *supra* note 158, ¶ 88, 86.

177. The complaints covered 2004–2007. Wells Fargo Complaint, *supra* note 158, ¶¶ 44–45; Countrywide Complaint, *supra* note 158, ¶¶ 87–89. After the bubble burst, loan activity plummeted, and based on pending cases between U.S. cities and national banks, it appears as though the banks have cleaned up their act. *See infra* Part IV.

178. *See* CFPB, *supra* note 16, at 55–56 (describing odds ratio analysis as a "traditional method" to evaluate potential disparities in denial rates).

179. 137 F. Supp. 2d 821 (E.D. Mich. 2001), *rev'd*, 288 F.3d 732 (6th Cir. 2002), *aff'd*, 539 U.S. 306 (2003) (statistical methodology not a contested issue on appeal).

180. *Id.* at 832–42.

181. *Id.* at 836; *see generally* Karen Grace-Martin, *Explaining Logistic Regression Results to Non-Statistical Audiences*, ANALYSIS FACTOR, http://www.theanalysisfactor.com/explaining-logistic-regression/ (last visited Mar. 4, 2016) [https://perma.cc/K2JF-DKZU].

182. *Grutter*, 137 F. Supp. 2d at 837.

undergraduate institution.[183] The court roundly rejected that line of reasoning, finding that the plaintiffs' analysis "provided *mathematically irrefutable proof* that race is indeed an enormously important factor" in Michigan Law's admission process.[184]

The complaints against Wells Fargo and Countrywide essentially employ the same statistical technique, but instead of controlling for GPA and LSAT, the DOJ controlled for objective credit qualifications including credit score, loan amount, debt-to-income ratio, and loan-to-value ratio.[185] The *Grutter* court held that the odds ratio technique itself is a valid statistical method from which to infer causation.[186] But *Wells Fargo* and *Countrywide* present an even stronger case than *Grutter* for use of odds-ratio analysis because of the massive sample sizes—4.4 millions loans for Countrywide[187] versus 5,000 applicants to Michigan Law[188]—and because loan applications present fewer subjective variables than law school applications.

Wells Fargo and Countrywide obviously decided against pursuing a business necessity defense in this round of cases,[189] but such an avenue may be pursued in future fair lending litigation. The contours of such a defense can be found in numerous industry studies and best practices reviews.[190] Lenders could point out that discretion is necessary to compete profitably.[191] Loans are frequently adjusted down to match a competitor's offer or up to allow a bank to pay some or all of a borrower's closing costs.[192] To support the legitimacy of the

183. *Id.* at 839.

184. *Id.* at 841 (emphasis added).

185. Wells Fargo Complaint, *supra* note 158, ¶ 41; Countrywide Complaint, *supra* note 160, ¶ 88.

186. *Grutter*, 137 F. Supp. 2d at 841.

187. Countrywide Complaint, *supra* note 158, ¶ 2.

188. *Grutter*, 137 F. Supp. 2d at 828.

189. *See supra* note 134.

190. *See, e.g.*, DAVID SKANDERSON ET AL., CHARLES RIVER ASSOCS., MANAGING THE FAIR LENDING RISK OF PRICING DISCRETION 1 (2014) ("[R]easons for discretionary pricing adjustments appear to be grounded in legitimate business needs . . . .").

191. The Supreme Court in *Inclusive Communities* remarked that "disparate-impact liability must be limited so employers and other regulated entities are able to make the practical business choices and profit-related decisions that sustain a vibrant and dynamic free-enterprise system." Tex. Dep't of Hous. & Cmty. Affairs v. Inclusive Communities Project, Inc., 135 S. Ct. 2507, 2518 (2015).

192. SKANDERSON ET AL., *supra* note 190, at 5.

discretion, lenders should conduct regular regression testing for significant effects along racial lines, routinely review placement policies, and carefully decide to whom discretion is given.[193]

2. Discretionary Pricing

The system of risk-based or "discretionary" pricing that banks developed in the 1990s, and which most lenders continue to use today, works as a two-step process.[194] First, banks provide their loan officers and independent mortgage brokers with wholesale "rate sheets" that indicate price minimums for mortgages ("par rates") based on objective factors like product type, loan term, down payment amount, loan-to-value ratio, and credit rating.[195] Next, the loan officer or mortgage broker can adjust the cost of the loan, either by changing the interest rate or adding other fees that increase profitability; the lender then passes part of the higher profit back to the officer or broker.[196] Understanding the legal limits and potential liability for discretionary pricing remains important because the overwhelming majority of mortgage lenders—85 percent in a recent industry survey—still use a discretionary pricing system.[197]

Discretionary pricing is an entirely legal and justified practice up to the point it causes discriminatory effect on a protected class.[198] The second set of allegations against Wells Fargo and Countrywide claimed that the banks' discretionary

193. *See* Ari Karen, *How Disparate Impact Ruling Affects Lenders' Daily Operations*, NAT'L MORTG. NEWS (July 6, 2015), http://www.nationalmortgagenews.com/news/compliance-regulation/how-disparate-impact-ruling-affects-lenders-daily-operations-1055261-1.html [https://perma.cc/VBM8-VNMC].

194. For a more thorough explanation of this system, *see* Schwemm & Taren, *supra* note 9, 395–402; Alan M. White, *Borrowing While Black: Applying Fair Lending Laws to Risk-Based Mortgage Pricing*, 60 S.C. L. REV. 677, 687–91 (2009).

195. *See, e.g.*, *Southern California Wholesale Ratesheets*, PROVIDENT BANK MORTG. (Jan. 13, 2017), https://www.pbmwholesale.com/rates/CA-Whlsle-Conv99(2).pdf [https://perma.cc/7TVZ-VR5L].

196. Schwemm & Taren, *supra* note 9, at 395–402.

197. SKANDERSON ET AL., *supra* note 190, at 4–5.

198. *See id.* at 1 (discussing why lenders find it necessary to continue to use discretionary pricing systems despite their fair lending risks); *see also* Mierzewski et al., *supra* note 137, at 4 (suggesting training programs to mitigate risks associated with loan officer discretion).

pricing policies resulted in exactly such an unlawful effect.[199] In *Wells Fargo*, the DOJ identified more than 25,000 black and Hispanic borrowers adversely affected by the company's discretionary pricing policy.[200] Against Countrywide, the government identified more than 200,000.[201] According to the DOJ's analysis, black and Hispanic borrowers paid, on average, hundreds of dollars more in subjective fees than similarly creditworthy white borrowers.[202]

Within their discretionary pricing systems, each company would communicate its par rates, which ostensibly accounted for all objective credit risk characteristics, to its agents on a daily basis.[203] After communicating these par rates, neither bank provided any guidance to its agents for setting final fees, but they did provide strong incentives to extract the highest fees possible.[204] One incentive was through a "yield spread premium," which was based on how much interest the agent charged above the par rate. The higher the yield spread, the greater the compensation for the agent.[205] The other pecuniary incentive came in the form of direct broker fees, which brokers could set arbitrarily and from which they were paid directly.[206]

The DOJ never alleged that either bank or any of their agents were motivated by racial animus, but the government

199. The enforcement actions against Wells Fargo and Countrywide were only two of nine such actions taken under the Obama administration to remedy the discriminatory effects of unguided discretion in loan pricing. *See Housing and Civil Enforcement Section Cases*, CIVIL RIGHTS DIV., DEP'T OF JUSTICE, https://www.justice.gov/crt/housing-and-civil-enforcement-section-cases-1#lending (last updated Nov. 23, 2016) [https://perma.cc/RKW7-YGVS]. Although these two cases involved the largest volume of loans and largest monetary settlements, the pleadings indicate that the government's theory was consistent across cases. *See generally id.*

200. Wells Fargo Complaint, *supra* note 158, ¶ 51.

201. Countrywide Complaint, *supra* note 158, ¶ 29 (discussing retail lending), 49 (discussing wholesale lending).

202. Wells Fargo Complaint, *supra* note 158, ¶ 51; Countrywide Complaint, *supra* note 158, ¶ 29 (retail lending), 49 (wholesale lending).

203. Wells Fargo Complaint, *supra* note 158, ¶ 59; Countrywide Complaint, *supra* note 158, ¶ 32, 54.

204. Wells Fargo Complaint, *supra* note 158, ¶ 2, 51–78; Countrywide Complaint, *supra* note 158, ¶ 6, 29–35.

205. Wells Fargo Complaint, *supra* note 158, ¶ 60; Countrywide Complaint, *supra* note 158, ¶ 58.

206. *Id.* Unlike Countrywide, Wells Fargo capped total broker fees at between 4.5 to 5.0 percent of total loan value, but permitted exceptions to the cap for reasons "wholly unrelated to creditworthiness." Wells Fargo Complaint, *supra* note 158, ¶ 61.

did demonstrate that the cumulative effects of this unguided discretion fell disproportionately on borrowers of color.[207] On a nationwide basis, the complaint alleged that Wells Fargo charged black borrowers up to 0.78 percent more and Hispanic borrowers up to 0.55 percent more in total broker fees.[208] While these percentages may seem trifling in the context of smaller purchases, a black Wells Fargo prime loan customer in 2007 borrowing $300,000 would have paid more than $2,000 in additional broker fees compared to a similarly creditworthy white borrower, and a Hispanic borrower more than $1,200 more.[209] Figures for Countrywide were similar, ranging from 0.13 to 0.67 percent in additional fees.[210]

The allegations based on brokerage fees do not present the same evidentiary quandary as the product placement allegations for the simple reason that the par rates published by the banks should have accounted for all objective credit factors. The logical inference, therefore, is that any statistically significant variations in entirely discretionary fees based on race across such a large sample size—4.4 million residential mortgages in the case of Countrywide[211]—must be because of race and without legitimate justification.

Unanswered by the *Countrywide* and *Wells Fargo* settlements are two important questions: What magnitude of variations is cognizable under the disparate impact theory, and how would a lender frame a business justification defense? In these cases, nationwide disparities for Wells Fargo's origination fees were as high as 0.78 percent during a period when average origination fees ranged from 0.40–0.70 percent,[212] which means black borrowers were paying, on average, 50 to 100 percent more in fees than white borrowers. These differences are patently exploitative and fall within the

207. Wells Fargo Complaint, *supra* note 158, ¶¶ 51–78; Countrywide Complaint, *supra* note 158, ¶¶ 38–48.

208. As measured by the annual total broker fee disparities compared to white borrowers. Wells Fargo Complaint, *supra* note 158, ¶¶ 67–68 (looking at prime wholesale loans).

209. *Id.* ¶ 73.

210. Countrywide Complaint, *supra* note 158, ¶¶ 39–40 (prime retail loans), ¶¶ 65–66 (prime whole loans).

211. *Id.* ¶ 2.

212. *See Monthly Average Commitment Rate and Points on 30-Year Fixed-Rate Mortgages Since 1971*, FREDDIEMAC, http://www.freddiemac.com/pmms/pmms30.htm (last visited Jan. 30, 2016) [https://perma.cc/EPG9-2QRJ]; Wells Fargo Complaint, *supra* note 158, ¶ 67.

ambit of FHA and ECOA disparate impact liability. But what if, in future cases, the sample sizes were smaller, as one would expect in the case of local and regional lenders, or the average disparities were smaller, say only 10 or 20 percent? Given the large number of cases that have been filed over the last decade alleging unlawful discriminatory pricing, sooner or later a court will need to establish some materiality thresholds or provide guidance on what magnitude of disparity is actionable.

Regarding a potential business justification defense, both complaints conclude that neither banks' "policies and practices . . . were . . . justified by business necessity. . . . There were less discriminatory alternatives available . . . that would have achieved the same business goals as these policies and practices."[213] Because no lender has chosen to be the first to defend this industry practice, we truly do not know what alternative policies or practices could achieve a less discriminatory outcome in a highly competitive industry.

The long-term effects of the 2012 lending discrimination settlements will not be understood in their entirety for some time. On the one hand, the decision to settle deprived lenders and fair lending advocates of desperately needed jurisprudence in this area of law. If even one of these cases had gone to trial, it may have established clear boundaries for disparate impact liability under the FHA and ECOA. As the case law stands today, the sufficiency of the evidence proffered by the government—the odds ratio analysis for product placement discrimination, and average disparities for discretionary fees—has not been clearly established.

On the bright side, it does appear that the threat of massive fines and increased government oversight have incentivized positive change among lenders. A recent survey of lending institutions reveals less unguided discretion than we saw in *Countrywide* and *Wells Fargo*.[214] As further evidence of improving lender practices, recent litigation by major cities against national banks for lost property tax revenue and increased municipal service costs associated with subprime lending have thus far failed to turn up clear evidence of lending

213. Wells Fargo Complaint, *supra* note 158, ¶ 77. The language is functionally identical in Countrywide Complaint, *supra* note 158, ¶ 93.

214. SKANDERSON ET AL., *supra* note 190, at 7 tbl.4 (discussing lower "median limits on adjustment," i.e. less discretion, for loan officers in 2014), 8 tbl.8 (discussing more frequent documentation of price adjustments).

discrimination in the years since the Recession.[215]

IV. *LOS ANGELES*, *MIAMI*, AND *COOK COUNTY*: NEW PLAINTIFFS, NEW THEORIES

Much to the dismay of lenders, municipal governments realized that the costs of mortgage discrimination extended far beyond distressed borrowers and began taking legal action to recoup their losses attributable to discriminatory lending. Local governments were particularly hard-hit by simultaneous declines in property tax revenues and increased demand for municipal services that accompanied the Recession.[216] During the most arduous years, from January 2007 through December 2009, lenders foreclosed on an estimated 2.5 million residential properties in the United States, the vast majority backed by mortgages originated between 2005 and 2008.[217] One frequently cited study estimated the total cost of a foreclosure at almost $80,000, with local government bearing approximately a quarter of that cost.[218] Armed with convincing evidence that foreclosures during this period disproportionately affected black and Hispanic families,[219] municipalities including Miami, Los Angeles, and Cook County began to file suits against national banks to recover for a sundry list of harms they suffered as a result of the banks' discriminatory lending practices.[220]

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215. *See* Order Granting Defs.' Mot. for Summ. J. at 13–17, City of L.A. v. Wells Fargo & Co., Case No. 2:13-cv-09007-ODW(RZx) (C.D. Cal. July 17, 2015).

216. G. THOMAS KINGSLEY ET AL., THE URBAN INST., THE IMPACTS OF FORECLOSURES ON FAMILIES AND COMMUNITIES 13–20 (2009), http://www.urban.org/sites/default/files/alfresco/publication-pdfs/411909-The-Impacts-of-Foreclosures-on-Families-and-Communities.PDF [https://perma.cc/8LCE-RE2L].

217. DEBBIE GRUENSTEIN BOCIAN ET AL., CTR. FOR RESPONSIBLE LENDING, FORECLOSURES BY RACE AND ETHNICITY: THE DEMOGRAPHICS OF A CRISIS 2 (2010), http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf [https://perma.cc/UP4X-FC7S].

218. KINGSLEY ET AL., *supra* note 216, at 21 fig.3.

219. BOCIAN ET AL., *supra* note 217, at 2 (estimating that 44 percent of foreclosures occurred on non-white homes).

220. *See, e.g.*, City of Cleveland v. Deutsche Bank Tr. Co., 571 F. Supp. 2d 807 (N.D. Ohio 2008); City of Birmingham v. Citigroup, Inc., No. CV-09-BE-467-S, 2009 WL 8652915 (N.D. Ala. 2009); Mayor of Balt. v. Wells Fargo Bank, N.A., 677 F. Supp. 2d 847 (D. Md. 2010); City of L.A. v. Wells Fargo & Co., 22 F. Supp. 3d 1047 (C.D. Cal. 2014); City of Miami v. Bank of Am. Corp., No. 13-24506-CIV, 2014 WL 3362348 (S.D. Fla. 2014); Cty. of Cook v. HSBC N. Am. Holdings, Inc., 136 F. Supp. 3d 952 (N.D. Ill. 2015).

This group of cases is shaping up to be incredibly important for the future of fair lending jurisprudence. Although the underlying discrimination is almost beyond factual dispute,[221] federal courts thus far have arrived at different conclusions on other key legal issues, including standing, the pleading requirements for causation, and equitable tolling of the FHA and ECOA statutes of limitations. On June 28, 2016, the Supreme Court granted certiorari in *Bank of America Corp. v. City of Miami* to address issues of standing and causation.[222]

Based on well-reasoned precedent and the legislative history of the FHA, the Supreme Court should affirm the Eleventh Circuit's holding on standing. Municipalities fall squarely within the "zone of interests" that Congress intended to protect when it enacted the FHA. The Supreme Court said as much in its 1979 ruling *Gladstone Realtors v. Village of Bellwood*,[223] and that decision should be reaffirmed. Civil rights enforcement waxes and wanes with political vicissitudes, so when the political winds in Washington change, municipalities should be empowered to bring pattern-or-practice fair lending cases. On the causation issue, Miami faces a tough row to hoe. Although the City claims that it can isolate damages caused by discriminatory lending from other contributing or superseding causes, it stretches the concept of traceability beyond its logical limits.

The two Sections that follow address the other issues (aside from standing) from these cases on which the federal courts have not agreed. Part A discusses the statute of

221. Although the settlements between the DOJ and Wells Fargo and Bank of America (which acquired Countywide in 2008) contain no admission of guilt, the cities have been able to build the factual foundations for their cases on statistical analyses provided by federal regulators. *See, e.g.*, *Cty. of Cook*, 136 F. Supp. 3d at 955 (discussing Federal Reserve and HUD analyses of HMDA data indicating discriminatory effects).

222. Bank of Am. Corp. v. City of Miami, 800 F.3d 1262 (11th Cir. 2015), *cert. granted*, 136 S. Ct. 2544 (U.S. June 28, 2016) (No. 15-1111) (Mem.).

223. 441 U.S. 91 (1979). Standing under the FHA is complicated by inconsistent language in two sections of the statute—42 U.S.C. § 3610 and § 3612—and the debate in *Bank of America* turns on some intricate questions of statutory interpretation and does not implicate the theory of disparate impact. *See* Amy Howe, *Argument Preview: Justices to Consider Scope of Fair Housing Act*, SCOTUSBLOG (Nov. 3, 2016, 10:03 AM), http://www.scotusblog.com/2016/11/argument-preview-justices-to-consider-scope-of-fair-housing-act/ [https://perma.cc/UH44-VJ2F].

limitations issue and the continuing violations doctrine that the cities have invoked to toll it. Part B discusses causation and the concept of traceability.

A. Statute of Limitations and the Continuing Violations Doctrine

The FHA requires that claims be filed within two years of "the occurrence or the termination of an alleged discriminatory housing practice."[224] Earlier courts concluded that in the context of mortgage lending, the statute of limitations begins to run from the loan's closing date.[225] This formulation is problematic to the municipalities because most of the discrimination they allege occurred before the start of the Recession, roughly between 2003 and 2008. To argue their cases on their merits, the municipalities have unanimously turned to the continuing violations doctrine to toll the FHA's statute of limitations.[226]

The various federal courts hearing these cases appear willing to accept the doctrine at the dismissal phase. The *Cook County* court held that a motion to dismiss on a statute of limitations defense is typically inappropriate unless "the complaint plainly reveals that an action is untimely under the governing statute."[227] The Eleventh Circuit went even further. Miami's original complaint failed to allege that *any* of the loans in question were closed within the limitations period, but on remand the appellate court instructed the trial court to allow the city to remedy its statute of limitations deficiency.[228]

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224. 42 U.S.C. § 3613(a)(1)(A).

225. *City of Miami*, 800 F.3d at 1283; *accord* Estate of Davis v. Wells Fargo Bank, 633 F.3d 529, 532 (7th Cir. 2011).

226. The theory was first recognized under the FHA in *Havens Realty Corp. v. Coleman*. 455 U.S. 363, 380–81 (1982). For the Supreme Court's most recent exposition of the continuing violations doctrine, see Nat'l R.R. Passenger Corp. v. Morgan, 536 U.S. 101, 103–14 (2002).

227. Cty. of Cook v. HSBC N. Am. Holdings, 136 F. Supp. 3d 952, 965 (N.D. Ill. 2015).

228. *Bank of Am. Corp.*, 800 F.3d at 1283–84. The Supreme Court did not grant certiorari on the statute of limitations issue in this case; the petitioner, Bank of America, mentions it only in passing in their brief. Brief for Petitioner at 23, Bank of Am. Corp. v. City of Miami, 800 F.3d 1262 (11th Cir. 2015), *cert. granted*, 136 S. Ct. 2544 (U.S. June 28, 2016) (No. 15-1111) (noting that "[T]he court of appeals here suggested Miami might circumvent that time bar through "continuing violation" allegations.")

The suit filed by Los Angeles is further along in the litigation pipeline, and as such it reveals a problem that will likely face Miami and Cook County in the coming months. At the dismissal phase, the trial court in *City of Los Angeles v. Wells Fargo* arrived at the same conclusion as the *Miami* and *Cook County* courts on the impropriety of dismissal based on the pleadings alone,[229] but pursuant to the parties' stipulation, the *City of Los Angeles* court bifurcated the trial to consider the statute of limitations issue before considering the merits of the case.[230] Los Angeles argued that Wells Fargo continued to issue two types of predatory loans during the two-year limitations period: what the city described as "high-cost loans" and, interestingly, all Federal Housing Administration-backed loans.[231]

The court's order granting summary judgment to Wells Fargo strongly rebuked Los Angeles for its reliance on weak statistical evidence and cited the recent Supreme Court decision in *Inclusive Committees Project* to support its holding.[232] During the two-year statutory period, Wells Fargo issued 4,260 loans to minority borrowers in Los Angeles, only twelve of which were so-called "high-cost loans" for owner-occupied homes.[233] The city's statistical expert testified that the odds that a white borrower would receive a high-cost loan was 0.0008 percent, whereas Hispanic and black borrowers had likelihoods of 0.0033 and 0.0067 percent, respectively.[234] The court's indignation at these discrepancies is manifest: "A statistical disparity relying on thousandths of a percentage is merely colorable and not significantly probative . . . [to] raise

229. City of L.A. v. Wells Fargo, 22 F. Supp. 3d 1047, 1058–59 (C.D. Cal. 2014).

230. Order Granting Defs.' Motion for Summ. J. at 1, City of L.A. v. Wells Fargo & Co., Case No. 2:13-cv-09007-ODW(RZx) (C.D. Cal. July 17, 2015).

231. *Id.* at 4, 5–6 (defining "high-cost loans" as first-lien loans at least 1.5 percent above a federally established benchmark and subordinate lien loans 3.5 percent above the same benchmark and discussing Federal Housing Administration loans).

232. *Id.* at 12–28. In *Texas Departmentt of Housing & Community Affairs v. The Inclusive Communities Project, Inc.*, the Supreme Court recognized disparate impact liability under the FHA with important qualifications, including a prohibition against imposing liability solely on a showing of statistical disparity and a general admonition to include "adequate safeguards" at the prime facie stage of disparate impact cases under the FHA. 135 S. Ct. 2507, 2512, 2523 (2015). See Schwemm, *supra* note 15, for a thorough explanation of the decision.

233. *Supra* note 232, at 13 (noting that the FHA does not apply to financing of investment properties).

234. *Id.* at 14.

such an inference of causation."[235] Even though the orders of magnitude were almost identical to the disparities from the product placement allegations in DOJ cases, the court's decision to grant summary judgment against Los Angeles conveys the message that sample size matters in estimations of causal effects.

B. Causation and Traceability

The FHA, ECOA, and regulations implementing them prohibit lending practices that have an actual or predictable discriminatory effect on persons because of race.[236] Courts have long interpreted this language to impose a requirement on the plaintiff in fair lending cases to demonstrate a causal connection between the injury and some specific practice undertaken by the lender.[237] At the pleading stage, this causal connection need only be plausible or "fairly traceable" to the lender.[238] With a robust HMDA dataset and capable statisticians, plausibility is a low bar. At trial, the plaintiff bears a higher burden of proving that a specific practice undertaken by the lender caused a "distinct and palpable injury."[239]

The courts evaluating the municipalities' causal analysis have been presented with remarkably similar evidence and their responses have been all over the map. Two of the earliest cases in this group were defeated at the dismissal phase for

235. *Id.* (internal citations omitted).

236. 24 C.F.R. § 100.500(a) (2017); 12 C.F.R. § 202.6(a) (2017).

237. *See, e.g.*, Gladstone Realtors v. Vill. of Bellwood, 441 U.S. 91, 109–14 (1979).

238. Lujan v. Defs. of Wildlife, 504 U.S. 555, 560 (1992); *see also* Jeffrey S. Gutman, *Standing: Injury Fairly Traceable to the Challenged Conduct*, *in* FEDERAL PRACTICE MANUAL FOR LEGAL AID ATTORNEYS § 3.1.B.5. (2016) http://federalpracticemanual.org/chapter3/section1 [https://perma.cc/8RTB-RH7M] ("The Supreme Court has found standing . . . notwithstanding an attenuated or uncertain chain of causation. At the same time, the Court has denied standing in cases in which the chain seemed both shorter and more certain. The Court's standing causation jurisprudence has been markedly inconsistent and offers few lessons for general application.").

239. Havens Realty Corp. v. Coleman, 455 US. 363, 372 (1982) (citing Warth v. Seldin, 422 U.S. 490, 501 (1974)). Statistical evidence cannot, standing alone, ever prove causation; even an ideally controlled and measured experiment can, at best, create an inference of causation. Courts have previously dealt with these issues in mass tort and employment law cases. *See generally* Joseph L. Gastwirth, *Statistical Reasoning in the Legal Setting*, 46 AM. STATISTICIAN 55 (1992).

failure to allege a sufficiently specific causal connection. In *Mayor and City Council of Baltimore v. Wells Fargo Bank*, the court held that too few foreclosures had occurred on Wells Fargo loans in black neighborhoods—163 in total—to meet even the low threshold of traceability.[240] Likewise, the City of Birmingham had its claims dismissed because its pleadings relied on what the court described as "a series of speculative inferences," while the court itself speculated that minority borrowers may have defaulted on their mortgages because of individualized economic problems, or what statisticians describe as the "confounding variables" problem inherent to small sample sizes.[241]

Plaintiffs facing nearly identical motions to dismiss in 2015 presented better evidence of causation and the courts were more lenient in their conceptions of traceability. In *City of Miami* and *Cook County*, both courts disagreed with the *Birmingham* court's use of "confounding variables" reasoning, stating that the *Birmingham* court had essentially ignored binding Supreme Court precedent on FHA pleading standards,[242] and just for good measure, the City of Miami attached the DOJ's odds ratio and regression analysis to buttress its complaint.[243] Both the *City of Miami* and *Cook County* courts held that the municipalities had sufficiently alleged causation to establish standing and proceed to trial.[244]

At trial, the legal threshold rises from a traceability of

240. 677 F. Supp. 2d 847, 850 (D. Md. 2010).

241. City of Birmingham v. Citigroup, Inc., No. CV-09-BE-467-S, 2009 WL 8652915 *4 (N.D. Ala. 2009) ("[I]t is quite speculative that the depreciation in value of the neighboring homes in the City was caused by the foreclosures of minority borrowers' properties rather than as a result of a myriad of other factors, which, . . . could include rising unemployment in the region, changes in the housing market, or other economic conditions.") (internal citations omitted); *see also* Stephen J. Newman & Matthew D. Moran, *Cities Use Novel Tactics in Actions Against Subprime Lenders*, PRATT'S J. BANKR. L. (2008), http://www.stroock.com/siteFiles/Pub602.pdf [https://perma.cc/T9TE-FPTL] (discussing *City of Baltimore* and *City of Cleveland* cases).

242. City of Miami v. Bank of Am. Corp., 800 F.3d 1262, 1273 (S.D. Fla. 2015); Cty. of Cook v. HSBC N. Am. Holdings Inc., 136 F. Supp. 3d 952, 961 (N.D. Ill. 2015).

243. Complaint for Violations of the Fair Housing Act, City of Miami v. Bank of Am. Corp., No. 1:13CV24506 ¶¶ 15–16 (S.D. Fla. Dec. 13, 2013). Both *City of Miami* and *Cty. of Cook* cite *Gladstone Realtors v. Vill. of Bellwood*, 441 U.S. 91 (1979), which held that allegations of racial discrimination and generalized reductions in property values were sufficient for FHA pleading purposes.

244. *HSBC N. Am. Holdings,* at *9; *Bank of Am. Corp.*, 800 F.3d at 1273.

causation to proof that a specific policy caused a discriminatory outcome. In the only case to have reached trial, *City of Los Angeles v. Wells Fargo*, the city utterly failed to make that legally sufficient connection.[245] The municipalities with active cases face two addition obstacles: The opinion from *Inclusive Communities Project* established that plaintiffs asserting disparate impact cases must first make a "robust" showing of causality, linking specific practices to statistical evidence of discriminatory outcomes, and second, plaintiffs must specifically identify some "artificial, arbitrary, and unnecessary barrier[]."[246]

Although no definition of robust was forthcoming from the opinion, nor did the Supreme Court articulate what such a "barrier" might be outside of the land use context, the trial court in *City of Los Angeles* found neither robustness nor a clearly identified barrier in the city's complaint.[247] In addition to relying on what the court found to be statistically insignificant evidence, the court characterized Los Angeles's argument that Wells Fargo failed to adequately monitor lending data as "a roundabout way of arguing for a racial quota."[248]

The Supreme Court heard oral arguments in *City of Miami* in November 2016,[249] and Cook County is preparing its trial against HSBC in federal district court.[250] Depending on how these cases end, they could establish important and desperately lacking jurisprudence for the disparate impact theory. To date, however, the evidence presented by the cities of Los Angeles and Miami suggests that the worst abuses at

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245. *See* Order Granting Defs.' Mot. for Summ. J., City of L.A. v. Wells Fargo & Co., Case No. 2:13-cv-09007-ODW(RZx), 2015 WL 4398858 at *15–17 (C.D. Cal. July 17, 2015). The city has appealed this decision to the Ninth Circuit, where litigation continues. No. 15-56157 (9th Cir. July 29, 2015).

246. 135 S. Ct. 2507, 2522–23 (2015).

247. *Wells Fargo & Co.,* Case No. 2:13-cv-09007-ODW(RZx), at 16.

248. *Id.*

249. *Bank of America Corp. v. City of Miami*, SCOTUSBLOG, http://www.scotusblog.com/case-files/cases/bank-of-america-corp-v-city-of-miami/ (last visited Jan. 17, 2017) [https://perma.cc/V6T6-G922].

250. *See* Evan Weinberger, *Banks Seek Review of Miami's Discriminatory Lending Win*, LAW360 (Sept. 23, 2015), http://www.law360.com/articles/706450 [https://perma.cc/SXE2-6JES]; *see also* Jonathan Stempel, *HSBC Must Face Chicago Predatory Lending Lawsuit – Judge*, REUTERS (Sept. 30, 2015), http://www.reuters.com/article/hsbc-chicago-lawsuit-idUSL1N1203KL20150930 [https://perma.cc/T4L4-WVPA].

large banks like Wells Fargo and Bank of America (which acquired Countrywide in 2008) have been reined in since the Recession,[251] and this fact will likely prove fatal to the municipalities' cases sooner or later under the FHA's statute of limitation.

To incentivize monitoring and future compliance with fair lending laws, the Supreme Court should reaffirm its opinion in *Gladstone Realtors*, where it held that municipalities fell squarely within the "zone of interests" that Congress intended to protect under the FHA. Although the Court's review in *Bank of America* does not implicate disparate impact directly, a clear statement re-affirming standing for municipalities would empower local governments to take a more active role in fair lending enforcement should the federal government cease to do so.

On the causation issue, the City of Miami's case is weaker. It alleges a series of actions that began with predatory loans, which led to loan defaults, then to foreclosure, blight, lower property values, and ending in strained municipal budgets. Their theory of causation does not contain a limiting principle and seems at odds with the "robust" causality demanded by the Supreme Court in its *Inclusive Communities* decision in 2015 to limit disparate impact liability.

V. THE NEXT FRONTIER OF FAIR LENDING: UNDERWRITING DISCRIMINATION IN THE ERA OF DISPARATE IMPACT

Although federal enforcement activity in redlining and reverse redlining has subsided over the last couple of years,[252] new cases, changes in enforcement priorities, and academic

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251. City of Miami v. Bank of Am. Corp., 171 F. Supp. 3d 1314, 1318–19 (S.D. Fla. 2016) (dismissing city's FHA claim for failure to "identi[fy] at least one timely and actionable claim of discrimination" within the last two years); City of L.A. v. Wells Fargo & Co., No. 2:13-cv-09-007-ODW (R2x),2015 WL 4398858 at *2 (C.D. Cal. July 15, 2015) ("[T]he parties do not dispute that Wells Fargo terminated most of the alleged 'predatory' lending practices well before December 2011.").

252. NAT'L FAIR HOUS. ALL., FAIR HOUSING TRENDS REPORT 2014, at 19 (2015) (reporting a 13 percent decline in mortgage lending discrimination complaints brought by private groups from 2011 to 2013); U.S. DEP'T OF HOUS. & URBAN DEV., FISCAL YEAR 2012/2013 ANNUAL REPORT ON FAIR HOUSING 4 (2014) (indicating a 17 percent decline of discriminatory lending complaints from 2010 to 2013); GUPTA, *supra* note 53, at 19 (indicating a 54 percent decline in race/national original referrals from bank regulatory agencies over the same period).

debates have caused fair lending advocates and federal agencies to re-examine potentially discriminatory effects embedded in traditional loan underwriting criteria. Of the three types of lending discrimination claims developed before the Recession—underwriting discrimination, redlining, and reverse redlining—disparate impact theory has been applied to all but one: underwriting.

Two seemingly unrelated factors make the underwriting issue ripe for reconsideration. Jurisprudentially, the Supreme Court's decision last summer in *Inclusive Communities Project*, although "cautionary" in tone, left the door open to these challenges.[253] Economically, the post-Recession mortgage lending sector has been characterized by more stringent underwriting criteria.[254] Lenders argue that tighter underwriting criteria have been a rational response to a crisis that occurred in large part because of lax underwriting standards.[255] Fair lending advocates point out that more stringent criteria impose a disproportionate burden on prospective borrowers of color—an allegation that lenders have not seriously refuted.[256] By the terms acknowledged, these underwriting practices fall squarely within the ambit of disparate impact.

Two aspects of the mortgage underwriting process have come under increased scrutiny over the last five years: the computation of traditional credit scores, and so-called "source of income" discrimination. Claims of disparate impact caused by underwriting discrimination will likely be the next frontier in fair lending law. Section A discusses credit scores and argues that lenders should re-calibrate their credit and capacity assessment practices to more accurately reflect the creditworthiness of low-income borrowers. Section B provides

253. *See* Schwemm, *supra* note 15, at 125 (mentioning "use by mortgage providers . . . of credit scores and other financial qualifying techniques that disproportionately exclude racial minorities" as a likely future challenge under the *Inclusive Communities* disparate impact standard).

254. *See generally* LAURIE GOODMAN ET AL., URBAN INST., THE IMPACT OF TIGHT CREDIT STANDARDS ON 2009–13 LENDING (2015), http://www.urban.org/research/publication/impact-tight-credit-standards-2009-13-lending/view/full_report [https://perma.cc/2YQY-Q7DB].

255. *Id.*

256. *See* NAT'L CMTY. REINV. COAL., WORKING-CLASS FAMILIES ARBITRARILY BLOCKED FROM ACCESSING CREDIT (Mortg. Lending Disparities Series Paper, 2010).

some preliminary discussion about source-of-income discrimination, a claim that the Fifth Circuit recently addressed and that the CFPB identified as an enforcement priority.

A. *Credit Scores So Racist? HUD Apparently Thinks Not*

The debate surrounding the discriminatory effects of credit scores is not new.[257] When Congress passed the Fair and Accurate Credit Transactions Act in 2003, it directed the Federal Reserve (Fed) to study the accuracy and fairness of credit scoring models with an eye to identifying racial bias.[258] The Fed concluded its study in 2007 and found that credit scores did in fact vary substantially between racial groups, but the study defended the statistical models underpinning the scores because the Fed argued that they accurately predicted future loan performance.[259] In other words, the Fed concluded that lenders' reliance on traditional credit scoring models served legitimate, nondiscriminatory business purposes. Mere months after the Fed delivered its report, the Recession began, and political capital shifted away from this issue and toward halting the economic freefall.

Three years later, with the macroeconomy on the mend, attention returned to credit scores, this time in the context of Federal Housing Administration loans. Many first-time homebuyers of modest means rely on the low down-payment requirements and the relatively relaxed credit standards of these loans to make homeownership possible.[260] In 2010, just like today, the Federal Housing Administration established a minimum credit score of 580 to qualify for its lenient 3.5 percent down payment requirement.[261]

257. *See* Note, *Credit Scoring and the ECOA: Applying the Effects Test*, 88 YALE L.J. 1450 (1979).

258. 15 U.S.C. § 1681 (2012) (Study of Effects of Credit Scores and Credit-Based Insurance Scores on Availability and Affordability of Financial Products).

259. BD. OF GOVERNORS OF THE FED. RESERVE SYS., REPORT TO THE CONGRESS ON CREDIT SCORING AND ITS EFFECTS ON THE AVAILABILITY AND AFFORDABILITY OF CREDIT S-2 (2007); *see also* Kenneth R. Harney, *Fed Examines Credit Scores, Finds No Bias*, WASH. POST (Sept. 1, 2007), http://www.washingtonpost.com/wp-dyn/content/article/2007/08/31/AR2007083100769.html [https://perma.cc/8Q3T-4DXW] (discussing the report's findings).

260. *See* NAT'L CMTY. REINV. COAL., *supra* note 256, at 3.

261. *See id.* (discussing 2010 FHA requirements); *see also* U.S. DEP'T OF HOUS. & URBAN DEV., HUD 4155.1, MORTGAGE CREDIT ANALYSIS FOR MORTGAGE

An investigation by the National Community Reinvestment Coalition (NCRC), an association of community non-profits, found that many of the largest mortgage underwriters of federally insured loans refused to lend to prospective borrowers with credit scores below 620.[262] According to the NCRC, these "credit overlay" practices were potentially excluding fifteen million Americans[263] who qualified at the 580 score but fell below the underwriters' 620 overlay requirement.[264] Utilizing publicly available data derived from the Fed and Census Bureau, the NCRC made a showing that this forty-point credit overlay had a disproportionate impact on prospective borrowers of color.[265]

Armed with these findings, in December 2010, the NCRC filed twenty-three complaints with HUD against loan underwriters alleging a disparate impact among prospective minority borrowers.[266] As discussed in the context of *Associated Bank*, HUD's administrative complaint process lacks transparency, but based on the Department's recent response to a FOIA request, HUD withdrew twenty-one of the complaints without resolution, one was resolved, and one ended with a conciliation agreement.[267]

INSURANCE (2014) (discussing 2014 FHA loan requirements).

262. *See* Katie Buitrago, *National Community Reinvestment Coalition Alleges That Lenders Are Disproportionally Limiting People of Color's Access to Credit*, WOODSTOCK INST. (Dec. 22, 2010, 11:25 AM), http://www.woodstockinst.org/blog/2010/national-community-reinvestment-coalition-alleges-lenders-are-disproportionately-limiting [https://perma.cc/5UZ8-7KJT].

263. This figure was calculated based on the U.S. adult population in 2010, approximately 237 million, minus the 45 million without credit scores, with approximately eight percent of FICO scores ranging from 580 to 620.

264. NAT'L CMTY. REINV. COAL., *supra* note 256, at 10.

265. *Id.* at 10–21.

266. Press Release, U.S. Dep't of Hous. & Urban Dev., HUD to Investigate Allegations that 22 Banks and Mortgage Lenders Discriminate Against African American and Latino Loan Seekers (Dec. 8, 2010), http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2010/HUDNo.10-266 [https://perma.cc/VN3T-47EJ]; *see also* Corbett B. Daly, *U.S. to Probe Alleged Mortgage Discrimination*, REUTERS (Dec. 8, 2010, 11:24 PM), http://www.reuters.com/article/us-usa-housing-mortgages-idUSTRE6B74XP20101209 [https://perma.cc/7GRP-SRA7].

267. Letter from Deborah R. Snowden, Chief of FOIA Branch, U.S. Dep't of Hous. & Urb. Dev. to Alex Gano (Mar. 8, 2017) (on file with author). The only complaint to end in a conciliation agreement was *NCRC v. Bank of the West and Bancwest Corp.*, 00-11-0016-8 (U.S. Dep't of Hous. & Urb. Dev.). The contents of that agreement would be useful, but the agreement is not publicly available, and the Department took fourteen months to respond to the author's first FOIA request.

The decision by lenders in the aftermath of an economic catastrophe (caused in large part by poor underwriting) to tighten standards certainly seemed to be within the rubric of a "valid interest" endorsed by the Supreme Court as the standard for the business justification defense. "The government can't have it both ways," said one fair lending consultant, referring to a three-year period marked by "overzealous" government enforcement followed immediately by demands to expand credit and take on the risk of new originations.[268] HUD itself opined that its disparate-impact rule should not "encourage lawsuits challenging credit scores[] or other credit assessment standards."[269]

The NCRC saw matters differently. With FHA loans, which account for a little more than ten percent of all mortgage loans,[270] the federal government guarantees 100 percent of the loan amount; lenders only bear the risks of underwriting errors, which they bear regardless of a particular applicant's credit score.[271] To overcome this argument, underwriters needed to prove that loans for applicants within this overlay range posed greater *underwriting* risks than loans for applicants just above the overlay's 620 threshold. The fact that loans from applicants in this range simply default more often than loans to higher scoring borrowers, i.e., pose a greater *credit* risk, would not suffice because the lenders did not bear those risks, the federal government did.

The decision to withdraw these complaints implies that the NCRC was unable to prove that the lenders' business interest could be served by a different practice with a less discriminatory effect.[272] Despite the lack of success with this group of complaints, the third step of the disparate-impact framework could provide future plaintiffs and complainants with a platform from which to challenge the formulation of

268. Brian Collins, *Rising Credit is the Norm Even at FHA* , NAT'L MORTGAGE NEWS (Dec. 29, 2011) https://www.nationalmortgagenews.com/news/rising-credit-is-the-norm-even-at-fha [https://perma.cc/3DKR-M9LQ].

269. Implementation of the Fair Housing Act's Discriminatory Effects Standard, 24 C.F.R. pt. 100 (2013).

270. Figure as of 2014. Ken Harney, *FHA: The Incredible, Shrinking Mortgage Resource*, INMAN (Jan. 16, 2014), http://www.inman.com/2014/01/16/fha-the-incredible-shrinking-mortgage-resource/ [https://perma.cc/S6AL-R2E7].

271. *See* NAT'L CMTY. REINV. COAL., *supra* note 256, at 7–8.

272. *See* 24 C.F.R. § 100.500(c)(3) (2017).

traditional credit scores more broadly.[273] No fewer than ten studies over the last two decades have shown that blacks and Hispanics have measurably lower credit scores than whites.[274] Part of this credit score gap can be explained by the complex and confounding history of racial discrimination in this country, but flaws and omissions in the formulas themselves may explain another source for the disparity.

The FICO score, the most commonly used credit score, is under-inclusive. The largest single component of a FICO score is "payment history," which has traditionally included mortgage loan payments but not rent payments.[275] Recent housing statistics show that 57.5 percent of blacks rent their homes, payments for which are not reflected on their credit scores, while 74.7 percent of whites own their homes (the majority owning their homes subject to a mortgage), payments for which are reflected in their credit scores.[276] Future fair lending plaintiffs should point out that a credit rating formula that considers both mortgage and rent payments would likely have a less discriminatory effect. Although recalibrating the FICO formula to include rental history would not benefit all prospective borrowers, it would improve creditworthiness for deserving borrowers.

Likewise, both the "payment history" and "types of credit in use" components of a FICO score reflect on-time and late payments on credit cards and other formal installment loans while not accounting for utility payments or other types of secured debt like car title loans.[277] This under-inclusive

273. *See supra* Table 1.

274. *See* Chi Chi Wu & Deidre Swesnik, Webinar: Credit Scores and Credit Reports: Problematic Uses and How They Worsen the Racial Economic Gap, NAT'L CONSUMER L. CTR. (May 20, 2014), https://www.nclc.org/images/pdf/conferences_and_webinars/racial_justice/credit_scores_and_credit_reports_webinar.pdf [https://perma.cc/YR6B-WB5N] (listing the various studies).

275. *Understanding Your FICO Score*, FICO 7 (2011), http://www.myfico.com/Downloads/Files/myFICO_UYFS_Booklet.pdf [https://perma.cc/FPG4-DU79]. Experian and TransUnion, two of the "big three" credit reporting agencies, have begun collecting data about consumer rental payments. Kenneth R. Harney, *Experian, TransUnion Start Adding Rent Payment Data to Credit Profiles*, L.A. TIMES (Aug. 10, 2014), http://www.latimes.com/business/realestate/la-fi-harney-20140810-story.html.

276. U.S. CENSUS BUREAU, AMERICAN HOUSING SURVEY 2013, https://www.census.gov/programs-surveys/ahs.html; *see also* Chalabi, *supra* note 19 (estimating that 68 percent of homeowners pay a monthly mortgage).

277. *Understanding Your FICO Score*, *supra* note 275, at 7–8, 12; Jenna Lee, *The Truth About Payday, Pawnshop and Car Title Loans*, U.S. NEWS & WORLD

component of the FICO formulation also disadvantages prospective borrowers of color, who hold credit cards at lower rates than whites but who more frequently utilize less formal sources of credit.[278] Again, future plaintiffs or federal financial regulators should offer an alternative formulation that includes a broader range of financial activity that would more accurately reflect the creditworthiness of minority borrowers.

B. Source-of-Income Discrimination

A second recent development in fair lending law involves source-of-income discrimination in mortgage underwriting. The ECOA forbids creditors from discriminating against any applicant "because all or part of the applicant's income derives from any public assistance program."[279] Under Regulation B, the CFPB has extended this prohibition to protect income derived from annuities, pensions, alimony, child support, and Section 8 Housing Choice vouchers.[280] In recent examinations, the CFPB found bank policies that automatically denied credit to loan applicants who relied on Social Security or Section 8 vouchers and marketing materials that discouraged applications from individuals who received public assistance.[281] In February 2017, the Fifth Circuit reversed a district court's dismissal of an ECOA claim against a Texas-based mortgage originator that refused to include Section 8 voucher funds in calculating applicants' debt-to-income ratio.[282] Most mortgage lenders promulgate guidelines on whether and how to count alimony, child support, and public assistance in income.[283]

REP. (May 22, 2014), http://money.usnews.com/money/blogs/my-money/2014/05/22/the-truth-about-payday-pawnshop-and-car-title-loans.

278. *See* Scott Schuh & Joanna Stavins, *How Consumers Pay: Adoption and Use of Payments* 25 tbl.1 (Fed. Reserve Bank of Boston, Working Paper No. 12-2, 2011) (citing a 2008 study in which only 50 percent of black U.S. consumers had at least one credit card whereas 83 percent of white consumers responded that they did); PEW CHARITABLE TRS., PAYDAY LENDING IN AMERICA: WHO BORROWS, WHERE THEY BORROW, AND WHY 11 (2012) (noting that black survey respondents were three times more likely that white respondents and twice as likely as Hispanic respondents to have used a payday loan).

279. 15 U.S.C. § 1691(a)(2) (2012).

280. 12 C.F.R. § 1002.6(b)(5) (2017); 12 C.F.R. § 1002.2 2(z)–3 (Supp. I 2016).

281. CFPB, *supra* note 16, at 23–26.

282. Alexander v. AmeriPro Funding, Inc., 848 F.3d 698, 708–09 (5th Cir. 2017). This case involves three groups of applicants; two groups had their claims dismissed because they were not "applicants" within the ECOA. *Id.* at 706–08.

283. *See Alimony, Child Support and Separate Maintenance—Does it Count as*

Guidelines that place a unique burden on public-assistance or private-support recipients should be examined carefully for discriminatory effects.

Another potential claim for source-of-income discrimination could be underwriting preferences for salaried over hourly employees. Relative to salaried borrowers, those paid hourly, especially those with fluctuating work schedules, pose additional risks that are counted against a loan applicant's creditworthiness.[284] When considered in conjunction with the fact that a larger proportion of black and Hispanic workers are paid hourly, lenders should be prepared to defend any risk penalty assessed on hourly employees.[285]

The current mortgage underwriting process does not accurately reflect the creditworthiness of many low-income borrowers. Traditional FICO credit scores do not include many financial transactions, such as rent and utility payments and small secured loans, that are relatively more prominent in the financial lives of lower-income (and disproportionately minority) borrowers. In fairness to those borrowers, that should change. Not every low-income borrower's credit score would improve by a more inclusive measure, but more creditworthy borrowers could be rewarded with more affordable long-term credit. Similarly, enforcing ECOA's prohibition against source-of-income discrimination would improve creditworthiness for many deserving single-parent and elderly households.

Income?, FED. HOUS. ADMIN., https://www.fha.com/fha_article?id=141 (last visited Feb. 19, 2017) [https://perma.cc/HD7B-G46E].

284. *See* Scott Sheldon, *Why Your Job Matters When Buying a Home*, CREDIT.COM (July 16, 2014), http://blog.credit.com/2014/07/why-your-job-matters-when-buying-a-home-88105/ [https://perma.cc/ERF6-WYSY] (discussing why "[h]ourly employees are under the tightest microscope when it comes to getting a mortgage").

285. As a portion of the total non-institutional civilian population, 41 percent of Hispanics are paid hourly, as compared to 36 percent of blacks and 30 percent of whites. *See Table 44. Workers Paid Hourly Rates*, BUREAU OF LAB. STAT., http://www.bls.gov/cps/cpsaat44.htm (last updated Feb. 10, 2016) [https://perma.cc/H7ES-RXAY]; U.S. BUREAU OF LABOR STATISTICS, LABOR FORCE CHARACTERISTICS BY RACE AND ETHNICITY 9 tbl.1 (2015), http://www.bls.gov/opub/reports/cps/labor-force-characteristics-by-race-and-ethnicity-2014.pdf [https://perma.cc/KZ2E-FYKW].

CONCLUSION

As the FHA approaches its fiftieth anniversary, its precatory policy to provide for fair housing throughout the United States remains largely unfulfilled. Until recently, advocates of fair lending lacked the necessary legal tools to further their laudable goal of forcing lenders to fairly provide mortgage financing to all creditworthy borrowers.

In the aftermath of the greatest economic downturn in three-quarters of a century, the federal government began to use the theory of disparate impact to assess liability for a whole host of mortgage lending practices that had, in varying degrees, produced discriminatory effects on minority borrowers. The incorporation of disparate impact into fair lending law has forced lenders to reevaluate policies and business practices, including branch locations, CRA Assessment Area designation, and the amount of discretion they grant brokers to select loan products and set interest rates and fees. Financial regulators and private plaintiffs are beginning to identify potentially discriminatory effects in traditional underwriting practices. All told, the theory of disparate impact has dramatically increased potential liability for mortgage lenders.

Although the mortgage industry has been rightly critical of vague legal standards and somewhat arbitrary enforcement, the increasing cost of fair lending compliance is a price worth paying. Racially discriminatory lending policies created the modern racial wealth gap in this country, and that injustice cannot be remedied by aggrieved individuals bring private lawsuits. Discrimination no longer appears in red lines on neighborhood maps or in written appraisal guides. It is a title loan company instead of a neighborhood bank. It is a subprime loan instead of a prime one. It is a minority borrower who pays a hundred dollars more a month than an equally creditworthy white borrower. This discrimination may be more subtle, but its effects are less damaging.

Many lawyers and industry experts believe that the post-Recession fair lending enforcement spike has come and gone, but advances in the cases by Miami and Cook County, as well as renewed interest in underwriting discrimination, suggest that fair lending's disparate impact era is just beginning. The standards by which future courts evaluate disparate impact claims have not yet been clarified, but if the settlements and ongoing litigation are any indication of what is to come, we are beginning a new era of heightened scrutiny for the mortgage lending industry. That scrutiny is long overdue.