COMMENTS
to the
U.S. Department of Housing and Urban Development
on
HUD's Implementation of the Fair Housing Act's Disparate Impact Standard

84 Fed. Reg. 42854 (August 19, 2019)

Docket No. FR-6111-P-02

By the

National Consumer Law Center
On behalf of its low-income clients,

Americans for Financial Reform Education Fund,
and
Consumer Federation of America

October 18, 2019

The National Consumer Law Center[1] (NCLC) on behalf of its low-income clients, Americans for Financial Reform Education Fund (AFR)[2] and Consumer Federation of America (CFA)[3] respectfully submit the following comment in response to the Proposed Rule on *HUD's Implementation of the Fair Housing Act's Disparate Impact Standard* issued by the U.S. Department of Housing and Urban Development (HUD). HUD's Proposed Rule would severely weaken disparate impact liability under the Fair Housing Act and undermine robust enforcement of this important civil rights statute. The Disparate Impact Rule serves to remedy severe,

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[1] The National Consumer Law Center, Inc. (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of practice treatises on credit discrimination, consumer credit laws and unfair and deceptive practices. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted trainings for tens of thousands of legal services and private attorneys, and provided extensive oral and written testimony to numerous Congressional committees on various topics. In addition NCLC attorneys regularly provide comprehensive comments to federal agencies, including HUD, on the regulations under consumer laws that affect low-income consumers. These comments were written by NCLC attorneys Jeremiah Battle, Odette Williamson, and AFR attorney Linda Jun. NCLC also supports comments submitted by the National Fair Housing Alliance on behalf of civil rights, consumer advocacy, housing, and community development organizations.
[2] Americans for Financial Reform Education Fund (AFR) is a coalition of over 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.
[3] Consumer Federation of America (CFA) is a nonprofit association of some 250 national, state, and local pro-consumer organizations created in 1968 to represent the consumer interest through research, advocacy, and education. Barry Zigas worked on these comments on behalf of CFA.

systemic discrimination that denies individuals access to credit, affordable housing, insurance and other services. In its current form, HUD's disparate impact rule has been used effectively and consistently to challenge housing discrimination. The Proposed Rule upends this progress without justification and HUD should withdraw this Proposed Rule.

The Proposed Rule undermines enforcement of the Fair Housing Act and should be withdrawn.

The Fair Housing Act prohibits discrimination in the sale, rental or financing of dwellings and other housing-related activities on the basis of race, color, religion, national origin, sex, disability or familial status.[4] HUD has long interpreted the Act to prohibit practices that have an unjustified discriminatory effect, regardless of intent, in keeping with the Act's broad remedial mandate to combat and prevent segregation and discrimination in housing, and promote integrated and inclusive communities.[5] HUD's 2013 final rule "Implementation of the Fair Housing Act's Discriminatory Effects Standard"[6] and 2016 supplement[7] (referred to collectively as the 2013 final rule), adopted the Act's disparate impact standard, long-recognized by the agency and federal circuit courts.

HUD's 2013 final rule is consistent with established case law and the Supreme Court's holding in *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, (*Inclusive Communities*) which held that disparate impact claims are cognizable under the Fair Housing Act.[8] The court in *Inclusive Communities* repeatedly referenced the current rule and highlighted without disagreement the rule's burden shifting framework, especially in discussing limits on disparate impact liability.[9] Lower court decisions recognized that the Supreme Court implicitly adopted the current rule's framework.[10] Changes to the current rule are not justified by the holding in *Inclusive Communities.* In fact the Proposed Rule would effectively undermine the Supreme Court's strong prescription to unwind the vestiges of historic segregation still "intertwined with the country's economic and social life."[11]

The Proposed Rule creates an insurmountable barrier to any consumer challenging discriminatory lending or housing practices. Our comments highlight aspects of the Proposed Rule that would make it difficult for victims of discrimination to bring viable discrimination claims; undermine the well-established business necessity defense; and shield algorithmic models from challenge for discriminatory outcomes under the Act.

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[4] 42 U.S.C. §§ 3601 et seq.
[5] See 78 Fed. Reg. 11460, 11461 (Feb. 15, 2013).
[6] 78 Fed. Reg. 11460, (Feb. 15, 2013).
[7] 81 Fed. Reg. 69012 (Oct. 5, 2016).
[8] 135 S. Ct. 2507 (2015).
[9] 135 S. Ct. 2514-15; 2522.
[10] Prop. Cas. Insurers Assn. of Am. v. Carson, 13-CV-8564, 2017 WL 2653069, at *9 (N.D. Ill. June 20, 2017) (the Supreme Court in *Inclusive Communities* expressly approved of disparate-impact liability under the FHA and did not identify any aspect of HUD's burden-shifting approach that required correction); Mhany Mgt., Inc. v. County of Nassau, 819 F.3d 581, 618 (2d Cir. 2016).
[11] 135 S. Ct. 2507.

A. The pleading requirements in § 100.500 of the Proposed Rule would make disparate impact claims virtually impossible to litigate.

Under the 2013 final rule, the first step to bring a disparate impact claim is identification of a defendant's policy or practice that causes a discriminatory effect. Plaintiffs must be able to point to a specific policy or practice and prove that it is the cause of the disparate impact. Once the plaintiff has identified the policy causing the disparate impact, the burden then shifts to the defendant to prove that "the challenged practice is necessary to achieve one or more substantial, legitimate nondiscriminatory interests."[12] It is only after a defendant has successfully proven that the policy advances a legitimate business interest that the burden shifts back to the plaintiff. A plaintiff may still prevail if the plaintiff is able to demonstrate that those substantial, legitimate nondiscriminatory interests "could be served by another practice that has a less discriminatory effect."[13] As mentioned above this three-part test is not only in the current disparate impact rule but is the test that courts have used for disparate impact cases for the past four decades and the test referenced by the Supreme Court in *Inclusive Communities*.

The first step of proving that a policy is causing a discriminatory effect is often a formidable challenge for victims of discrimination because they are usually not privy to a company's internal policies and procedures. Defendants may argue that no such policy exists, or that the discriminatory effect can be linked to other factors. Without discovery, it is often not possible to know what is or is not a company policy or practice or how that policy is affecting particular groups when put in action. Likewise, in most instances, it is difficult for plaintiffs to know whether other people's experiences with a financial institution or housing provider are similar or different from their own.

Bringing a successful disparate impact claim often takes significant amounts of data gathering, research and analysis to identify the patterns that demonstrate that a certain policy is causing a disproportionately adverse effect on a certain group. Nevertheless, plaintiffs use the resources they have to conduct their investigations and build their case. State and federal regulators uncovered problematic practices in the course of investigating and supervising the institutions under their jurisdiction, as the Department of Justice did when it found that Wells Fargo's policies caused African-Americans to be charged higher origination and broker fees for mortgages.[14] In individual cases plaintiffs and their advocates analyze publicly available data such as that available under the Home Mortgage Disclosure Act (HMDA) to document the disparities connected to a certain policy or practice and speak with other people in similar situations to compare experiences. In another mortgage lending discrimination case, HMDA data and borrower experiences revealed that both Latinx and African-American borrowers were being charged disproportionately higher interest rates than their white counterparts with similar credit risk because of a lender's discretionary pricing policy.[15] In other cases, plaintiffs collected data and conducted their own research to identify harmful policies. For example, a comparison of the

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[12] 24 C.F.R. § 100.500(c)(2).
[13] Id. § 100.500(c)(3).
[14] *United States vs. Wells Fargo*, No. 1:12-cv-01150 (D.D.C 2012).
[15] *Ramirez v. Greentpoint Mortgage Funding,* 268 F.R.D. 627 (N.D. Cal. 2010).

upkeep for similarly situated bank-owned homes in white and minority neighborhoods demonstrated a disparate impact on those minority communities[16]

The three-part test is the foundation of disparate impact liability and should not be changed. The three-part test continues to provide an effective legal framework to challenge policies that may seem neutral but unfairly exclude certain groups of people or isolate particular communities in practice. By bringing disparate impact claims under the Fair Housing Act within this framework, plaintiffs have been able to confront harmful, inequitable, and unjustified policies that create unnecessary barriers to housing and unfair lending practices for over 40 years. The current disparate impact rule effectively prevents plaintiffs from bringing unsubstantiated claims and at the same time prevents defendants from escaping responsibility with hollow reasons for their policies. The three-part test is sufficiently robust and should not be changed.

HUD's Proposed Rule threatens to dismantle this critical legal tool by making it nearly impossible for plaintiffs to meet their *prima facie* burden, which will make it easier for landlords and lenders to discriminate without consequences. The Proposed Rule requires plaintiffs to allege with greater specificity a problematic policy and practice, such as identifying a single decision or a single element of a program at the beginning of a case when, as noted above, plaintiffs often have limited insight into the company's decision-making process or internal practices. The Proposed Rule would require plaintiffs to plead five additional elements to prove that a specifically identifiable practice caused a discriminatory effect. Requiring plaintiffs to plead these five elements goes far beyond the Supreme Court's decision in *Inclusive Communities* and sets up virtually insurmountable barriers to challenging indirect discrimination.

The first added element is cause for the greatest alarm. HUD's Proposed Rule would require a plaintiff to allege that "the challenged policy or practice is arbitrary, artificial and unnecessary to achieve a valid interest or legitimate objective."[17] This element significantly raises the burden from the current rule, which only requires the plaintiff to identify a specific policy or practice that has caused a discriminatory effect. At this early stage of the process of challenging a policy or practice, plaintiffs are unlikely to know what reasons or objectives the defendant will put forth to justify the policy or practice at issue to be able to address it. Under the Proposed Rule, the plaintiff would have to "allege facts sufficient to support a plausible allegation that that a policy is arbitrary, artificial, *and* unnecessary"[18] to move forward, without knowing what the defendant will say and what discovery will reveal about the reality of the defendant's policy as applied. The proposed rule would allow problematic policies that subject certain groups to indirect discrimination because they meet one of these criteria but not all three.

It is unfair to ask a plaintiff to have the kind of intimate knowledge or understanding of the defendant's business practices to credibly allege that the defendant's practice is arbitrary without the benefit of discovery. Plaintiffs cannot possibly predict all plausibly valid interests or legitimate objectives the defendant may be able to connect to the challenged policy and discredit them in order to move forward with a case. The first element of HUD's Proposed Rule assigns plaintiffs a virtually impossible task to bring a disparate impact claim.

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[16] *National Fair Housing Alliance v. Bank of America*, No. 1:18-cv-01919 (D. MD 2019).
[17] 84 Fed. Reg. 42858.
[18] *Id.*

In addition to raising the plaintiff's burden to an unattainable level, the first element in HUD's Proposed Rule completely shifts the defendant's current burden onto the plaintiff. Under the current disparate impact rule, it is not the plaintiff but the defendant who is required to prove that the challenged policy or practice advances a legitimate nondiscriminatory interest. HUD's Proposed Rule drastically shifts the established framework and forces plaintiffs to ponder which of the defendant's interests might be served by the policy in order to make an argument for why the policy is arbitrary, artificial or unnecessary. Further, only if the plaintiff is able to make the case that the defendant's policy is arbitrary, artificial or unnecessary does the burden shift to the defendant to identify the valid interests behind its policy. This burden-shifting to the plaintiff is not consistent with the Supreme Court's decision in *Inclusive Communities* and unnecessarily raises the burden for disparate impact claims.

The Proposed Rule's first pleading requirement also lowers the bar for what is permissible for defendants, which will allow them to easily evade responsibility for discriminatory effects. Under the second prong of the current disparate impact rule, a policy must advance a substantial, legitimate nondiscriminatory interest. The Proposed Rule does not require proof that the policy is advancing a substantial interest, but simply a "valid interest" or "legitimate objective" for the policy. Neither "valid interest" nor "legitimate objective" is defined or limited in the Proposed Rule. Defendants could tie almost every policy they have to a legitimate objective since they likely had a reason for putting such a policy in place, even if the reason does not support a substantial interest.

By lowering the bar and shifting the burden onto the plaintiff for disproving the legitimacy of a defendant's policy before a case can proceed, HUD's proposed rule creates insurmountable hurdles for plaintiffs to bring a disparate impact claim. It will allow defendants to easily escape liability by making it impossible for plaintiffs to challenge policies. For example, disparate impact has been used to challenge the use of zip codes in insurance, which led to a disparate impact on borrowers of color, but this case likely would be unable to proceed under the Proposed Rule if the insurance company was able to provide a plausible explanation about predictiveness of zip codes to argue that the policy was not arbitrary or artificial, even if zip codes were not a good proxy for assessing risk and thus not a necessary policy.

Even if a plaintiff is somehow able to overcome the barriers and successfully plead the first element, the Proposed Rule would require pleading four more elements before the plaintiff could move forward with the case. The second element is a robust causal link between the challenged policy and discriminatory effect. The third element is an adverse effect on members of a protected class, which is consistent with both Fair Housing Act jurisprudence and *Inclusive Communities*. The fourth element is pleading that the policy causes a significant disparity. There is no significance requirement under the current disparate impact rule, and adding such a requirement is another hurdle for the plaintiff to overcome. Lastly, the proposed rule requires plaintiffs to prove that the plaintiff's injury was directly caused by the challenged policy or practice.

Collectively, the Proposed Rule's five elements work together to make it impossible for victims of discrimination to bring a viable disparate impact claim and provide defendants with multiple

opportunities to shield themselves from accountability for providing more expensive mortgage loans for people of color, forcing families with children to pay more money for housing, and shutting people out of housing with exclusionary zoning ordinances. The Proposed Rule undermines the Supreme Court's decision in *Inclusive Communities* and allows defendants to easily escape liability for the discriminatory effects of their harmful policies.

B. HUD's proposed profit defense in § 100.500 is inconsistent with well-established disparate impact jurisprudence.

In §100.500(b)(1), HUD has proposed to require plaintiffs, as part of their prima facie case, to state facts plausibly alleging that a challenged policy or practice is arbitrary, artificial and unnecessary to achieve a valid interest or legitimate objective such as a practical business, profit, policy consideration, or requirement of law. In §100.500(d)(1)(ii), HUD has proposed to allow defendants to rebut a plaintiff's assertion by showing that the challenged policy or practice advances a valid interest and then requires the plaintiff to prove that a less discriminatory policy or practice would serve the defendant's identified interest in an equally effective manner without imposing materially greater costs on, or creating other material burdens for the defendant. In these comments, HUD's proposals in §100.500(b)(1) and (d)(1)(ii) are collectively referred to as the profit defense. HUD's proposals are inconsistent with well-established disparate impact jurisprudence regarding business necessity and the concept of fair lending.

The business necessity defense can be traced to the U.S. Supreme Court decision in *Griggs v. Duke Power Company*, 401 U.S. 424, 91 S.Ct. 849 (1971). As later decisions of the Court began placing a greater burden on the plaintiff concerning business necessity, Congress responded by enacting the Civil Rights Act of 1991. In the 1991 Act, Congress unequivocally states that the defendant retains the burden of proving that a challenged practice constitutes a business necessity.[19] Congress' purpose in passing the 1991 Act was to return to the principles of *Griggs v. Duke Power Co.*,[20] and *Albemarle Paper Co. v. Moody*,[21] which articulated more generous standards for the plaintiff.

The 2013 final rule implementing the FHA discriminatory effects standard comports with existing case law on the burden of proof for business justification. The 2013 final rule does not use the phrase "business necessity," because that language may not be easily understood in the context of government or nonprofit defendants.[22] Instead, the regulation refers to "a legally sufficient justification" that exists when a challenged practice "is necessary to achieve one or

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[19] 42 U.S.C. §2000e-2(k) (1) (A).
[20] Griggs v. Duke Power Co., 401 U.S. 424, 91 S. Ct. 849, 28 L. Ed. 2d 158 (1971) (establishing that discriminatory impact violates Title VII's prohibition of employment discrimination).
[21] Albemarle Paper Co. v. Moody, 422 U.S. 405, 95 S. Ct. 2362, 45 L. Ed. 2d 280 (1975) (setting out disparate impact analysis for prima facie case by plaintiff, defendant's burden of proving business necessity, and plaintiff's opportunity to show less discriminatory means).
[22] Final Rule, Dep't of Hous. & Urban Dev., Implementation of the Fair Housing Act's Discriminatory Effects Standard, 78 Fed. Reg. 11,460, 11,470, 11,471 (Feb. 15, 2013) ("HUD chooses not to use the phrase 'business necessity' in the rule because the phrase may not be easily understood to cover the full scope of practices covered by the Fair Housing Act, which applies to individuals, businesses, nonprofit organizations, and public entities).")

more substantial, legitimate, nondiscriminatory interests."[23] The "substantial, legitimate, nondiscriminatory interest" standard "is equivalent to the 'business necessity' standard" and "is not to be interpreted as a more lenient standard."[24] The 2013 final rule further specifies that defendants bear the burden of proving that the practice is necessary to achieving a substantial, legitimate, and nondiscriminatory interest.[25] HUD's 2013 final rule emphasized that a challenged practice or policy interest must be *nondiscriminatory* in order to meet the legally sufficient justification standard. The 2013 final rule does not need to be changed.

In a disparate impact case, the creditor carries the burden of proving not only that its business justification is the reason it acted but that its business justification is a legitimate and necessary basis to evaluate credit risks.[26] If the business justification is the real reason for the creditor's actions, but the justification is not relevant to creditworthiness, then the plaintiff's prima facie case of disparate impact will be sufficient for the plaintiff to prevail.[27] Business necessity should relate to creditworthiness. Creditworthiness is the core concept in fair lending. As articulated by Representative Annunzio in 1975:

> The essential concept of nondiscrimination in the extension of credit is that each individual has a right when he applies for credit, to be evaluated as an individual: to be evaluated on his individual creditworthiness, rather than based on some generalization or stereotype about people who are similar to him in race, color, national origin, religion, age, sex or marital status. Bias is not creditworthiness. Impression is not creditworthiness. An individual's ability and willingness to repay an extension of credit is creditworthiness.[28]

Courts have consistently limited the legitimate business justification defense to a lender's use of variables and practices to ascertain creditworthiness.[29] For example, in *Miller v. Countrywide Bank NA*,[30] the court rejected an argument that "market forces" justified *Countrywide's* discriminatory pricing policy, noting that subjective criteria, unrelated to creditworthiness,

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[23] Id. at 11,482, codified at 24 C.F.R. § 100.500(b).

[24] Id. at 11,470.

[25] Id. at 11,482, codified at 24 C.F.R. § 100.500(c)(2).

[26] Congress in 1991 codified this standard for employment discrimination cases. See 42 U.S.C. § 2000e-2(e) (1) (A).

[27] See Wards Cove Packing Co. v. Atonio, 490 U.S. 642, 109 S. Ct. 2115, 104 L. Ed. 2d 733 (1989) (employment discrimination case); Watson v. Fort Worth Bank & Tr., 487 U.S. 977, 108 S. Ct. 2777, 101 L. Ed. 2d 827 (1988) (employment discrimination case). See also Town of Huntington v. Huntington Branch NAACP, 488 U.S. 15, 16, 109 S. Ct. 276, 102 L. Ed. 2d 180 (1988) (sole justification offered to rebut the prima facie housing discrimination case was inadequate); Mountain Side Mobile Estates P'ship v. Sec'y of Hous. & Urban Dev., 56 F.3d 1254 (10th Cir. 1995) (mere insubstantial justification of manifest relationship is insufficient, because such a low standard would permit discrimination to be practiced through the use of spurious seemingly neutral practices); Diamond Ventures, L.L.C. v. Baruah, 699 F. Supp. 2d 57, 64 (D.D.C. 2010) (finding that defendant had not proffered "any empirical evidence" linking its specific application requirements with success of businesses receiving loans).

[28] 121 Cong. Rec. 16, 740 (1975) (statement of Rep. Annunzio). Furthermore, creditworthiness is quantifiable and easily susceptible to comparison. See Coleman v. Gen. Motors Acceptance Corp., 220 F.R.D. 64 (M.D. Tenn. 2004) (granting plaintiffs motion for national class certification); CEIBA, Inc. v. Ford Motor Credit Co., 2003 WL 22204560 (E.D. Pa. Sept. 22, 2003)

[29] Robert Bartlett, Adair Morse, Richard Stanton, Nancy Wallace, *Consumer Lending Discrimination in the Fintech Era*, Working Paper 25943, June 2019.

[30] 571 F.Supp.2d 251 (D. Mass. 2008).

should play no part in determining a potential borrower's eligibility for credit.[31] While the pursuit of a reasonable profit is consistent with business necessity, policies or practices *unrelated to creditworthiness,* which allow creditors to extract supra-competitive revenues from protected classes of consumers merely because the creditor has the power to do so, is inconsistent with business necessity.

Proposed §100.500(d)(1)(ii) would allow defendants to rebut a plaintiff's challenge to the discriminatory effects of its policies or practices by simply producing evidence showing that the policy or practice "advanced a valid interest." In essence, HUD's proposal signals to mortgage lenders nationwide that it is acceptable to pursue profits without considering the discriminatory effect it may cause to protected classes.

HUD's proposed "profit defense" immunize policies and practices that create an unjustified discriminatory disparate impact, *but produce a profit*, from scrutiny. To say that policies or practices which generate a profit justify the discriminatory impact of those policies or practices on protected classes is antithetical   to the concept of fair lending.

Additionally, HUD's proposal would encourage lenders to pursue discriminatory discretionary pricing policies. On their face, lenders' discretionary pricing policies may appear neutral and not discriminate against protected classes. However, cases brought by advocates and government enforcement actions have shown that these pricing policies have the effect of discriminating based upon a consumer's membership in a protected class.[32] For example, in Allen v. Decision One Mortgage Co.,[33] the plaintiffs alleged that private banks and lenders maintained a policy that had a discriminatory impact on African-American applicants because the policy allowed a discretionary surcharge of additional points and fees to an otherwise objective risk-based financing rate. In May 2010, the class members settled for $6.5 million, financial education, quarterly reporting, and loan restructuring for class members.[34] In *Puello v. Citifinancial Services, Inc.*,[35] plaintiffs alleged that Citifinancial Services and Citigroup's lending practices had a discriminatory impact on minority applicants in their home financing policies and practices. In August 2012, the parties settled with Defendants paying compensation to class members who obtained their loans through mortgage brokers, housing counseling services for class members, a non-discretionary pricing policy, training, and class counsel's attorney fees.[36]

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[31] Id at 258.
[32] See § 8.6.5 National Consumer Law Center, Credit Discrimination (7th ed. 2018) updated at www.nclc.org/library.
[33] 07-cv-11669 (D. Mass.).
[34] Case Profile: Allen v. One Decision Mortgage Company, Civil Rights Litigation Clearinghouse, https://www.clearinghouse.net/detail.php?id=12531&search=source%7Cgeneral%3BsearchIssues%7C390%2C284%3BsearchCauses%7C49%2C29%3Borderby%7CfilingYear%3B
[35] 08-cv-10417 (D. Mass.).
[36] Final Approval Order and Judgment, Puello v. v. Citifinancial Servs., Inc., 08-cv-10417 (D. Mass.), Aug. 10, 2012, Dkt. No. 128; see also Case Profile: Puello v. Citifinancial Services, Inc., Civil Rights Litigation Clearinghouse, https://www.clearinghouse.net/detail.php?id=12449&search=source%7Cgeneral%3BsearchIssues%7C390%2C284%3BsearchCauses%7C49%2C29%3Borderby%7CfilingYear%3B.

There are many other examples of successful challenges to these types of discriminatory pricing policies in disparate impact cases brought against mortgage lenders by private attorneys,[37] the Department of Justice, and several federal agencies.[38]

HUD's proposed "profit defense" would embolden mortgage lenders to continue these discriminatory policies. HUD's proposed "profit defense" is in direct conflict with forty years of disparate impact jurisprudence and must be rejected.

C. HUD's Proposed Rule shields housing providers, lenders and other businesses using algorithmic models from liability and gives businesses a license to discriminate.

Discrimination flourishes in the dark. Landlords, creditors, appraisers and other housing-related businesses that use complex, opaque algorithmic models that have a discriminatory impact on protected classes would be shielded from liability under the Proposed Rule. These algorithmic models, which are proprietary and often closely guarded by the businesses that develop them, would escape public and regulatory scrutiny. HUD's Proposed Rule is particularly problematic because it comes at a critical time when new technology is being adopted at a rapid pace in a variety of housing-related business to automate decisions that are consequential to consumers' ability to obtain and retain housing on non-discriminatory terms.

HUD proposes three special defenses to aid defendants in avoiding liability for the discriminatory impact of their algorithmic models. First, the Proposed Rule protects defendants who provide the inputs used in the model and show that these inputs do not rely on factors that are substitutes or proxies for protected classes, and that the model is predictive of credit risk or other similar valid objective. Second, defendants avoid liability if the model was developed and distributed by a third party that determines industry standards. The third defense allows defendants to hire a qualified expert to analyze the model and show that it was empirically derived and statistically sound and accurately predicts risk or other valid objective.

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[37] See Ramirez v. GreenPoint Mortg. Funding, Inc., 268 F.R.D. 627 (N.D. Cal. 2010); Guerra v. GMAC, L.L.C., 2009 WL 449153 (E.D. Pa. Feb. 20, 2009); Taylor v. Accredited Home Lenders, Inc., 580 F. Supp. 2d 1062 (S.D. Cal. 2008); Miller v. Countrywide Bank, 571 F. Supp. 2d 251 (D. Mass. 2008); Ware v. Indymac Bank, 534 F. Supp. 2d 835 (N.D. Ill. 2008); Garcia v. Countrywide Fin. Corp., No. 07-1161 (C.D. Cal. Jan. 15, 2008), available at www.nclc.org/unreported; Newman v. Apex Fin. Grp., 2008 WL 130924 (N.D. Ill. Jan. 11, 2008); Martinez v. Freedom Mortg. Team, 527 F. Supp. 2d 827 (N.D. Ill. 2007); Jackson v. Novastar Mortg., Inc., 2007 WL 4568976 (W.D. Tenn. Dec. 20, 2007). Cf. Tribett v. BNC Mortg., 2008 WL 162755 (N.D. Ill. Jan. 17, 2008) (consumer can refile complaint with more specificity).

[38] Complaint, United States v. Countrywide Fin. Corp., Countrywide Home Loans, Inc. & Countrywide Bank, No. CV-11-10540 (C.D. Cal. Dec. 21, 2011) (charging over 200,000 Hispanic and African American borrowers higher interest rates, fees, and costs for mortgage loans than non-Hispanic white borrowers and steering them into subprime loans), available at www.justice.gov; Stipulated Final Judgment & Order, Fed. Trade Comm'n v. Golden Empire Mortg., Inc., No. CV09-03227 (C.D. Cal. Sept. 24, 2010) (charging Hispanic consumers higher prices for mortgages than similarly situated non-white consumers), available at www.ftc.gov; Order to Cease & Desist, Order for Restitution, and Order to Pay, In re First Mariner Bank Balt., Md., No. FDIC-07-285b & FDIC-08-358k (Fed. Deposit Ins. Corp. Mar. 22, 2009), available at www.fdic.gov; Complaint, United States v. AIG Fed. Sav. Bank, No. 1:99-mc-09999 (D. Del. Mar. 4, 2010) (wholesale mortgage brokers charged higher fees to African American borrowers), available at www.justice.gov.

This rule, if adopted, is a blueprint for algorithmic discrimination. It is unclear why HUD would propose this standard given its recent action against Facebook where its Charge of Discrimination cogently outlined how the company's expert mining of vast quantities of user data, much of it seemingly neutral, had a discriminatory impact that denied consumers a meaningful opportunity to find housing.[39] HUD in its proposal acknowledged that these models can produce discriminatory outputs, and that bringing disparate impact cases to challenge a model is very complex.[40] Yet the agency chooses not to weigh in on the side of victims of discrimination but to limit disparate impact liability to allow businesses to make profit-driven decisions.[41]

1. **Data used by landlords, creditors and others to assess risk, creditworthiness or "other valid objective" has a potentially disparate impact on protected classes.**

Landlords, lenders and other businesses are using new and increasingly sophisticated models to automate housing-related decisions. The models are incorporating a broad array of inputs from a mix of traditional and new sources. New forms of tenant screening, for example, may evaluate risk using an applicant's credit rating, criminal history or social media accounts. Lenders are exploring alternative data sources and new analytical techniques to assess credit risk, especially for consumers who have a "thin file" or no file on record with a traditional consumer reporting agency.[42] Leveraging new types of data and analytical techniques could potentially benefit consumers. However, serious concerns have arisen regarding the accuracy, relevance and predictability of the data sources used in these models and its potential to worsen existing disparities.

Alternative data – whether from conventional sources or Big Data – reflects historical biases that may be replicated in any automated credit decision or risk assessment. Much like the factors that drive the disparities in traditional credit scores, new sources of data reflect deeply ingrained structural inequalities in employment, education, housing and economic opportunity.[43] Seemingly neutral variables when used alone or in combination can correlate with race, ethnicity and other prohibited factors. Learning algorithms, processing large volumes of information, will

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[39] HUD v. Facebook, Charge of Discrimination, FHEO No. 01-18-0323-8, available at https://www.hud.gov/sites/dfiles/Main/documents/HUD_v_Facebook.pdf (noting that users disclose most of the data unwittingly through the actions they, and those associated with them, take on and off of the platforms).
[40] See 84 Fed. Reg. 42859.
[41] See id.
[42] National Bureau of Economic Research, The Role of Technology in Mortgage Lending, Working Paper 24500, April 2018 available at https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr836.pdf.
[43] See National Consumer Law Center, *Past Imperfect: How Credit Scores and Other Analytics "Bake In" Past Discrimination and Perpetuate It*, May 2016 (African American, Latinx, and Asian consumers have lower credit scores as a group than whites).

likely pick up subtle but statistically significant patterns that correlate with race and other protected characteristics and replicate existing bias.[44]

HUD noted in its Charge of Discrimination that much of the data used to target Facebook users was unwittingly provided through the actions of users, and those associated with them, on and off of the platform.[45] Such behavioral data enabled Facebook to classify users based on protected characteristics and invited advertisers to discriminatorily target or exclude housing-related ads to users based on these imputed protected traits. Commentators have noted that given enough data, and the right data, almost any input can be correlated to a protected characteristic.[46] In other words many inputs, when recycled through powerful and sophisticated algorithms, can become substitutes or proxies for protected classes.

While outcome depends on which data is used, how the data is used and whether it is accurate and predictive, there are known patterns in many types of data being considered or in use today to assess risk that can be mined to extract race, ethnicity or other protected characteristics. Three such examples include:

- Utility Payment Information. Full file utility credit reporting is often promoted as a form of alternative data that will assist those with a thin file or no file build credit histories to gain access to credit. Yet this type of data could adversely impact the credit scores of consumers who take advantage of state provided shut-off protections, falling behind on payments during winter or summer months, but catching up thereafter. These consumers are more likely to be disabled, elderly or low-income. There are also racial variations on who falls behind on payment and is disconnected from service. For example, 11.3% of African-American headed households were shut off from electricity in 2009, in contrast to 5.5 % of white households.[47]
- Subprime credit. Payday loans and other forms of subprime credit are not reported on traditional credit reports. In fact using this form of credit might lower a credit score. Research has found that payday lenders market heavily and set up businesses in communities of color underserved by mainstream lenders.[48] Payday lenders in California

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[44] See Moritz Hardt, *How Big Data is Unfair, Understanding Unintended Sources of Unfairness in Data Driven Decision Making*, Sept. 2014; Andrew Selbst, *A New HUD Rule Would Effectively Encourage Discrimination by Algorithm*, Slate, August 19, 2019.

[45] HUD v. Facebook, Charge of Discrimination, FHEO No. 01-18-0323-8 at paragraph 12.

[46] See Claire Miller, *When Algorithms Discriminate*, New York Times, July 9, 2015; Moritz Hardt, *How Big Data is Unfair, Understanding Unintended Sources of Unfairness in Data Driven Decision Making*, Sept. 2014; Andrew Selbst, *A New HUD Rule Would Effectively Encourage Discrimination by Algorithm*, Slate, August 19, 2019. See also National Consumer Law Center, *Big Data: A Big Disappointment for Scoring Consumer Credit Risk*, at 18, March 2014.

[47] U.S. Energy Information Administration, 2009 Residential Energy Consumption Survey, Tabulated by National Consumer Law Center.

[48] Delvin Davis et al, Race Matters: *The Concentration of Payday Lenders in African American Communities in North Carolina*, Center for Responsible Lending (March 2005); Assaf Oron, *Easy Prey: Evidence for Race and Military Related Targeting in the Distribution of Payday Loan Branches in Washington State*, Department of Statistics, University of Washington (March 2006).

were 2.4 times more likely to be concentrated in African-American and Latinx communities, even after controlling for income and other factors.[49]

- Education or occupation. There are well documented disparities in education and occupation by race, ethnicity and gender. For example 40% of non-Hispanic whites and 51% of Asians are employed in management or professional positions, but only 30% of African Americans and 22% of Latinx are similarly employed.[50] While 93% of whites graduate high school, only 67% of Latinx and 87% of African Americans do.[51]

Any data used for credit decisions must comply with the requirements of the Equal Credit Opportunity Act (ECOA) and the Fair Credit Reporting Act, which at a minimum mandate that the data used be accurate and predictive of creditworthiness.[52] Yet a report from NCLC on Big Data loan products revealed that the underlying information maintained on consumers and relied on by these companies was riddled with errors.[53] The information was inaccurate and incomplete and primarily gathered without the consumer's knowledge. There was no mechanism for consumers to dispute the accuracy of the information. In addition, unlike traditional credit scores, which also display racial disparities but under a business necessity analysis may be used to predict credit quality, with Big Data there is no definitive understanding of how data gathered from social media, online behavior, and by other means measures creditworthiness.

Mortgage lenders are leading the way on the use of algorithmic models to automate some or all of the loan process. New models have streamlined the application and underwriting process, including time-intensive tasks such as collecting documents, and analyzing and verifying information.[54] The use of algorithms to solicit customers and underwrite and process the loan raises concerns regarding pricing discrimination, redlining and steering. One study noted that Fintech lenders reduced but did not erase discriminatory lending patterns, particularly with respect to the pricing of loans.[55] Latinx and African-American borrowers paid 7.9 and 3.6 basis points more in interest for home purchase and refinance mortgages respectively because of discrimination. These magnitudes represent 11.5% of lenders' average profit per loan.[56] Other

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[49] Wei Li, Leslie Parrish, et al. *Predatory Profiling: The Role of Race and Ethnicity in the Location of Payday Lenders in California*, Center for Responsible Lending (March 2009).

[50] Bureau of Labor Statistics, BLS Reports, Report 1062: Labor Force Characteristics by Race and Ethnicity, September 2016.

[51] Camille Ryan and Kurt Bauman, U.S. Census: *Current Population Reports, Educational Attainment in the United States: 2015*, March 2016.

[52] ECOA, 15 U.S.C. § 1691 et seq.; FCRA, 15 USC § 1681 et seq.

[53] National Consumer Law Center, *Big Data: A Big Disappointment for Scoring Consumer Credit Risk*, at 18, March 2014.

[54] National Bureau of Economic Research, *The Role of Technology in Mortgage Lending*, Working Paper 24500, April 2018 available at https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr836.pdf. Fintech lenders, defined as those who get a pre-approval decision based on credit check, increased from two firms in 2010 to 18 lenders by 2017. See also Prabhakar Bhogaraju et al., *Without Data Standards, the Mortgage Industry Doesn't Go Digital*, Fannie Mae, October 2019 (significant increase in technology spending since 2017).

[55] Robert Bartlett, Adair Morse, et al., *Consumer Lending Discrimination in the Fintech Era, National Bureau of Economic Research*, Working Paper 25943 (June 2019).

[56] Id.

commentators expressed caution and noted that while "statistical models have the potential to increase consistency in decision making and to ensure that the results are empirically sound, depending on the data analyzed and the underlying assumptions, models may reflect and perpetuate existing social inequalities...[T]he fact that an algorithm is data driven does not ensure that it is fair or objective."[57]

In addition, a lending process that is partially automated leaves room for human input of data into the model that may be inaccurate, incomplete or purposefully omitted and this data may change the model's calculation of risk and credit decision.[58] Lenders may also overlay other terms or conditions. However, concerns about algorithmic discrimination extend beyond the underwriting process or credit decision itself to how the potential loan is marketed to consumers.[59] Instead of being shown a wide array of competitively priced loans, certain consumers may be steered toward higher cost loans. An FTC study highlighted how advertisers were able to target people living in low-income neighborhoods with high-interest loans.[60] HUD's case against Facebook highlighted another form of targeting.

As algorithmic models evolve, and new sources of data are mined, more scrutiny is needed to ensure that these models do no replicate existing biases. Yet HUD's Proposed Rule would insulate a wide variety of algorithmic models used to predict credit risk or for "other similar valid objective" from scrutiny when the model produces a discriminatory outcome.[61] This lack of transparency is utterly contrary to other civil rights laws that govern credit decisions, such as the ECOA, which requires creditors to disclose and explain credit decisions. Lack of transparency allows larger patterns of discrimination to go unrecognized and unchallenged.

2. **Industry creation or expert evaluation of undisclosed models will not deter housing discrimination.**

Housing-related businesses and lenders are rapidly adopting emerging technology. Fannie Mae recently implored legacy lenders to "abandon rigid and inefficient platforms and processes in favor of cutting-edge automation and digitalization."[62]   Given the rapid pace of innovation, and the dearth of research on the impact of these models, it is simply inappropriate for HUD to

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[57] Carol Evans, Board of Governors of the Federal Reserve System, *Keeping Fintech Fair: Thinking about Fair Lending and UDAP Risks*, Consumer Compliance Outlook (Second Issue 2017) at 4.

[58] Fannie Mae Selling Guide, B3-2-01, General Information on DU (8/7/2018); B3-2-10: Accuracy of DU Data, DU Tolerances, and Errors in the Credit Report (08/07/2019).

[59] See e.g., Amit Datta et al. *Automated Experiments on Ad Privacy Settings: A Tale of Opacity, Choice, and Discrimination*, Cornell Univ., 2015 available at https://arxiv.org/abs/1408.6491.

[60] Nathan Newman, *How Big Data Enables Economic Harm to Consumers, Especially to Low-Income and Other Vulnerable Sectors of the Population*, available at
https://www.ftc.gov/system/files/documents/public_comments/2014/08/00015-92370.pdf.

[61] *See Connecticut Fair Hous. Ctr. v. Corelogic Rental Prop. Sols., LLC*, 369 F. Supp. 3d 362 (D. Conn. 2019)(criminal tenant screening product made automated determinations of eligibility for tenancy without providing underlying documentation or details on model).

[62] Prabhakar Bhogaraju et al., *Without Data Standards, the Mortgage Industry Doesn't Go Digital*, Fannie Mae, October 2019 (noting a significant increase in technology spending since 2017).

propose a standard that would shield businesses from the discriminatory effects of industry developed models.

Giving industry a safe harbor for a problematic model is a green light for an entire industry to adopt a discriminatory model. The industry may well adopt a model that maximizes profit rather than diminishes the possibility of bias, even though that is the less discriminatory alternative. In addition lenders and others would be incentivized to adopt off-the-shelf models developed by the industry rather than innovate better models that may be less discriminatory. As a practical matter it is unclear what type of organization would qualify to as an industry gatekeeper such that the model it developed would be adopted as the HUD-recognized standard. Indeed, several organizations may make a claim to developing the industry model that is shielded from liability. Rapid adoption of discriminatory technology by an entire industry would have a swift and devastating impact on housing opportunities for protected classes.

Rather than give clear, specific guidance on how these models can comply with the Fair Housing Act, HUD outsources its responsibility to the industry and third parties. Empirical models evolve. While the industry or an expert may certify that a model is empirically derived and statistically sound, as required under the Proposed Rule, a model so certified could be subsequently altered, or used in a manner for which it was not validated.[63] Third party experts are unlikely to be retained beyond the initial evaluation. This Proposed Rule misses an important opportunity to encourage businesses to engage in ongoing evaluation of algorithmic outcomes and to pursue innovation and other strategies to debias problematic models.

Conclusion

The Disparate Impact Standard and HUD's current disparate impact rule have been used to effectively challenge discriminatory practices for decades. The Proposed Rule would undermine enforcement of the Fair Housing Act and roll back progress made to dismantle housing and economic segregation. The existing rule should be preserved and the Proposed Rule should be withdrawn.

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[63] See Carol Evans, Board of Governors of the Federal Reserve System, *Keeping Fintech Fair: Thinking about Fair Lending and UDAP Risks*, Consumer Compliance Outlook (Second Issue 2017) at 6.