




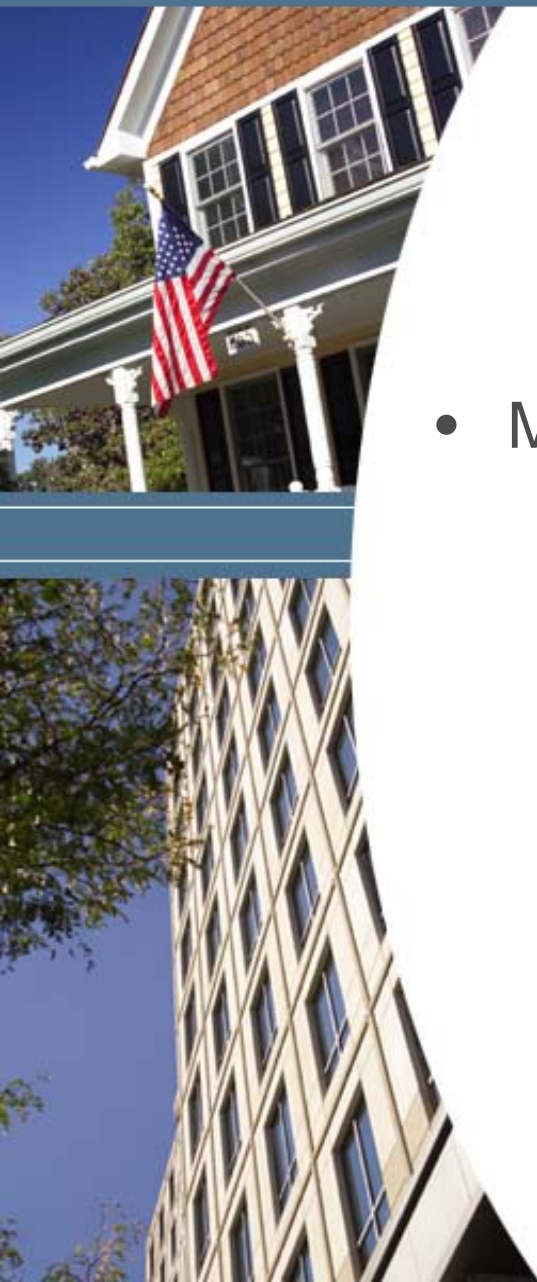
Regulatory Panel 4: Fair Lending

Legal Issues and Regulatory Compliance Conference 2010

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Paul F. Hancock
K&L Gates LLP
200 S. Biscayne Boulevard, 20th floor
Miami, Florida 33131
(305) 539-3378
paul.hancock@klgates.com

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- Major Issues
 - » Disparate Treatment v. Disparate Impact
 - » Potential Liability of Lenders for Broker Conduct under the Fair Housing Act and ECOA
 - Recent DOJ Settlement

Disparate Treatment vs. Disparate Impact

Disparate Treatment

- Focus is on the defendant's intent
- Typical disparate treatment claim involves defendant's refusal to make housing, or a home mortgage loan, available to plaintiff because of race or other prohibited characteristic
- Once plaintiff has made his prima facie case, the key issue is whether the defendant can come forward with evidence of a legitimate, nondiscriminatory reason for the conduct
- *See, e.g., McDonnell Douglas Corp. v. Green, 411 U.S. 792 (1973).*

Disparate Treatment vs. Disparate Impact

Disparate Impact

- “[P]ractices...neutral on their face, and even neutral in terms of intent” cannot be maintained if they result in discrimination. *Griggs v. Duke Power*, 401 U.S. 424 (1971).
- For years after *Griggs*, disparate impact cases involved **objective** criteria. *E.g.*, *Dothard v. Rawlinson*, 433 U.S. 321 (1977)(requirements that police officers be taller than 5’2” and weigh more than 120 lbs “would exclude 41.13% of the female population while excluding less than 1% of the male population”).

Disparate Treatment vs. Disparate Impact

Disparate Impact

Watson v. Fort Worth, 487 U.S. 977, 987 (1988).

- The Supreme Court noted for the first time that “disparate impact analysis is no less applicable to subjective...criteria than to objective” practices.
- However, the Court cautioned that it is not “appropriate to hold a defendant liable for unintentional discrimination on the basis of less evidence than is required to prove intentional discrimination. Rather, the necessary premise of the disparate impact approach is that some employment practices, adopted without a deliberately discriminatory motive, may in operation be functionally equivalent to intentional discrimination.” *Id.*

Disparate Treatment vs. Disparate Impact

Disparate Impact

The Court in *Watson v. Fort Worth* delineated the plaintiff's burden under a disparate impact theory:

A Plaintiff must prove that
The specific practice identified...
...caused...
the alleged observed statistical disparity.

The defendant must then rebut the plaintiff's statistical showing by justifying the challenged practice in terms of "business necessity."

Disparate Treatment vs. Disparate Impact

Disparate Impact

- One year later, the Court clarified its divided holding in *Watson*: “**Epecially** in cases where an employer combines **subjective criteria** with the use of more rigid standardized rules or tests, the plaintiff is in our view responsible for isolating and identifying the specific employment practices that are allegedly responsible for any observed statistical disparities.” *Wards Cove v. Atonio*, 490 U.S. 642 (1989).
- In other words, a plaintiff cannot show simply that “‘at the bottom line,’ there is racial imbalance in the work force” due to “the use of ‘subjective decision making.’” Instead, “a plaintiff must demonstrate that...a specific or particular employment practice...has created the disparate impact.” *Id.*

Disparate Treatment vs. Disparate Impact

Disparate Impact

Wards Cove v. Atonio, 490 U.S. 642 (1989)(continued)

- Further, the burden of persuasion remains with the plaintiff. The defendant need only produce evidence of a “business justification” or “business consideration” that serves the legitimate goals of the defendant.
- However, the Interagency Task Force on Fair Lending Policy Statement issued in 1994 uses the “business necessity” language. 59 Fed. Reg. 18266.

Disparate Treatment vs. Disparate Impact

Disparate Impact

Wards Cove v. Atonio, 490 U.S. 642 (1989)(continued)

- The Supreme Court also emphasized that for disparate impact, “it is...a comparison – between the racial composition of the **qualified** persons in the labor market and the persons holding at-issue jobs – that generally forms the proper basis for the initial inquiry in a disparate-impact case.” *Wards Cove*, 490 U.S. at 650-51 (same emphasis elsewhere in original).

Disparate Treatment vs. Disparate Impact

Disparate Impact

- Controversial Wards Cove holding led to 1991 Amendment to Title VII:
“An unlawful employment practice based on disparate impact is established...when...a complaining party demonstrates that **a group** of employment practices results in a disparate impact on the basis of race, color, religion, sex, or national origin.”
“...and the respondent fails to demonstrate that such group of employment practices is required by **business necessity**.”
And further: “If a complaining party demonstrates that **a group** of employment practices results in a disparate impact, such party shall not be required to demonstrate which specific practice or practices within the group results in such disparate impact.” See §105 of the Civil Rights Act of 1991, amending § 703(k) of the Civil Rights Act of 1964 (42 U.S.C. § 2000e-2).
- **There has been no comparable amendment to the FHA.**

Disparate Treatment vs. Disparate Impact

Disparate Impact

Supreme Court decision – *Smith v. City of Jackson*, 544 U.S. 228 (2005).

- Applying disparate impact analysis to § 4(a)2 of the ADEA.
- But recognizing that the language of § 4(a)(1) of the ADEA, like the virtually “identical” to § 703(a)(1) of Title VII, “does not encompass disparate impact liability.”

Disparate Treatment vs. Disparate Impact

Disparate Impact

Summary of Plaintiff's Burden

A plaintiff must:

1. Identify the specific policy or practice of the defendant;
2. Establish a disparate impact (through the use of statistical evidence); and
3. Prove causation

Does Disparate Impact Apply in Lending?

The Fair Housing Act

- While the majority of appellate courts have applied disparate impact under the FHA, these decisions have not involved § 805 of the FHA, which governs discrimination claims in mortgage transactions.
 - Some district courts have held that disparate impact does apply to § 805
- The Supreme Court has yet to determine whether disparate impact can be applied to any provision of the FHA.

Does Disparate Impact Apply in Lending?

Equal Credit Opportunity Act (ECOA)

- Several appellate courts have applied disparate impact under ECOA. The support for this is a Regulation B footnote, which states that “[t]he legislative history of the Act indicates that Congress intended an ‘effects test’ concept, as outlined in the employment field by the Supreme Court in the cases of *Griggs v. Duke Power* and *Albemarle Paper Co. v. Moody* to be applicable to a creditor’s determination of creditworthiness.” 12 C.F.R. § 202.6(a) n.2.
- However, the Supreme Court has yet to reach the issue.

Does Disparate Impact Apply in Lending?

Supreme Court Guidance

- It is possible that a disparate impact case brought against a lender may not survive Supreme Court scrutiny:
 - *Smith v. City of Jackson* (2005) offers some suggestion that disparate impact may not apply to the language of § 805 of the FHA, which is similar to the language of § 4(a)(1) of the ADEA.
 - Advocacy groups, and possibly the Administration, would strongly oppose such an interpretation.
 - *Ricci v. Destefano*, 557 U.S. ___ (2009), suggests that the Supreme Court may require a showing of discriminatory intent to establish a violation of lending discrimination laws.
 - The majority implies that disparate impact may not have been proper even in employment litigation until Congress codified the standard.

Are Lenders Liable for Discriminatory Conduct of Brokers?

The Fair Housing Act

- In *Meyer v. Holley*, 537 U.S. 280 (2003), the Supreme Court held:
 - The FHA does **not** impose a “non-delegable duty” on any party to ensure that third parties with whom it conducts business do not discriminate. Liability of a party for the actions of independent third parties must be evaluated in accordance with traditional principles of vicarious liability, *i.e.*, a traditional agency relationship must be established.
 - Right to control is insufficient in itself to establish principal agency relationship.

Are Lenders Liable for Discriminatory Conduct of Brokers?

ECOA

- Recognizes that separate creditors, with separate and distinct roles, can be involved in a loan transaction
- One creditor is not liable for unlawful conduct of another creditor, *unless the first creditor knew or had reasonable notice of the violation before becoming involved in the credit transaction*
- *Meyer v. Holley* may have impacted this standard

Are Lenders Liable for Discriminatory Conduct of Brokers?

Recent DOJ Settlement with AIG (March 4, 2010)

- Defendants: AIG Federal Savings Bank (AIG FSB) and Wilmington Finance, Inc. (WFI)
- Basis of Referral to DOJ: OTS determined that it had reason to believe that Defendants engaged in a pattern or practice of discrimination based on race by charging black borrowers higher **broker fees** than similarly situated white borrowers
- First case of mortgage loan price discrimination brought by the DOJ against a wholesale lender in more than a decade
- Brought under FHA and ECOA

Are Lenders Liable for Discriminatory Conduct of Brokers?

Recent DOJ Settlement with AIG (March 4, 2010)

- DOJ allegations:
 - Black borrowers nationwide were charged total broker fees 20 bps higher, on average, than whites.
 - In 19 MSAs, blacks paid total broker fees ranging from 25 to 75 bps higher, on average, than whites.
 - The higher total broker fees are a result of **the policy and practice of allowing unsupervised and subjective discretion by brokers in the setting of direct fees** and cannot be fully explained by factors unrelated to race or justified by business needs. → disparate impact?
 - The discriminatory policies and practices of the defendants were **intentional** and willful, and were implemented with reckless disregard for the rights of black borrowers. → disparate treatment?

Are Lenders Liable for Discriminatory Conduct of Brokers?

Recent DOJ Settlement with AIG (March 4, 2010)

- **Settlement is Controversial**
 - Confirms agency's belief that lenders should be held liable for broker conduct, absent any statutory or common law precedent
 - Seems to disregard *Meyer v. Holley* vicarious liability standard
 - Lender expected to pay restitution to borrowers for fees that were charged and retained by third parties

Are Lenders Liable for Discriminatory Conduct of Brokers?

Recent DOJ Settlement with AIG (March 4, 2010)

- **Settlement is Controversial (continued)**
 - Lenders that monitor wholesale price differences across borrower groups find it difficult or impossible to prevent disparities
 - Disparities can arise solely because of brokers' differing pricing policies
 - Holds one creditor liable for actions of another creditor despite ECOA provision
 - DOJ claimed that "information about each borrower's race and the amounts and types of broker fees paid was available to, and was known or reasonably should have been known by" the lender.
 - However, no allegation that the lender knew of the alleged discrimination

- Lenders may be held liable for their own discriminatory conduct under the FHA and ECOA
 - Agencies may apply a disparate impact theory despite the lack of Supreme Court precedent
- Lenders may be held liable for the discriminatory actions of independent third parties such as brokers
 - Recent DOJ settlement confirms this, despite the language of *Meyer v. Holley*