The Consumer Finance Podcast: The Latest on HUD's Disparate Impact Rule
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Host: Chris Willis
Guests: Lori Sommerfield and Leigh Poltrock

Chris Willis:

Welcome to the *Consumer Finance Podcast*. I'm Chris Willis, the co-leader of Troutman Pepper's Consumer Financial Services Regulatory Practice, and I'm glad you've joined us to talk today about HUD's ever-changing, but now at least temporarily finalized disparate impact rule. But before we jump into that topic, let me remind you to visit our blogs. We have consumerfinancialserviceslawmonitor.com and troutmanpepperfinancialservices.com, both covering the financial services industry from end to end. And don't forget about our other podcasts. We have lots of them. We have the *FCRA Focus*, all about credit reporting, *The Crypto Exchange*, which is about everything crypto, and *Unauthorized Access*, which is our privacy and data security podcast. All those are available on all the popular podcast platforms. And speaking of those platforms, if you like this podcast, let us know. Leave us a review on the podcast platform of your choice and let us know how we're doing.

Now, as I said, today we're going to be talking about the HUD disparate impact rule, which has been through a lot of changes in the past decade or so. But before we get into talking about those changes, let me introduce my two colleagues who I'm lucky to have joining me today. I have my partner, Lori Sommerfield, who you've heard on the podcast before, as well as our colleague, Leigh Poltrock, who is a member of our multifamily housing group and is our resident expert on the Fair Housing Act. So, Lori, Leigh, thank you for being on the podcast today.

Leigh Poltrock:

Thanks, Chris. It's great to be here.

Lori Sommerfield:

Thanks for having me, Chris.

Chris Willis:

Now, as I thought about recording this podcast episode, we were going to talk about the HUD disparate impact rule, the only thing I could think of was the song the Hokey Pokey, because HUD put the rule in and took the rule out and now put the rule back, and it's just been back and forth and back and forth. With all this history, now we finally have an allegedly final HUD disparate impact rule, which is just final until the next presidential election as far as I'm likely to be concerned. But let's talk about the rule and what it means for the financial services and housing communities, financial services, of course, as it relates to mortgage lending and housing as it relates to everything. We have the final rule that came out in March of 2023 that HUD published saying that it felt that the new rule, which is actually a reinstatement of the 2013 version of the rule, is more consistent with their view of the law. Let's start with you, Lori. So, was this something that we expected HUD to do?

Lori Sommerfield:

Yes, we did. And by the way, your song reference is hilarious and completely apropos. So shortly after President Biden took office in January of 2021, he ordered HUD to revisit the 2020 disparate impact rule by issuing a memorandum that required the agency to "take all steps necessary to examine the effects of the 2020 rule, including the effect that amending the 2013 rule has had on HUD's statutory duty to ensure compliance with the Fair Housing Act." So, six months later, HUD issued a proposed rule, in June of

2021, to carry out the president's order and announced a plan to reinstate the 2013 version of the disparate impact rule. And it then took HUD another nine months to consider all the public comments it received and then published the final rule, which as you said, we received in March of 2023.

Chris Willis:

Okay. Now as we've all made reference to, there have been several prior versions of this disparate impact rule under the Fair Housing Act. So, we had the original rule that was proposed in 2013, a 2020 version of the rule, and now the 2023 reinstatement of the 2013 rule. So, Leigh, would you mind just giving us some background on the original 10 years ago, what's old is now new version of the rule?

Leigh Poltrock:

Absolutely, Chris, and I think something that's important to know before we even go there is that the Fair Housing Act, which is part of the Civil Rights Act of 1968, made it unlawful for any seller, leaser, or financier of housing to discriminate based on a number of different categories. And those categories are race, color, religion, sex, which includes sexual orientation and gender identity, disability, familial status, or national origin. That's important to know as sort of a threshold matter for this. Really what that means is it's illegal to engage in facially discriminatory practices. So, what we think of as overt discrimination, to deny someone a loan or a home because they're disabled or because they have children, those types of things.

But it is also illegal to engage in what would otherwise be a facially neutral practice, but one which has discriminatory effects. For example, in the multifamily housing context, if a multifamily property institutes a local preference, meaning it gives leasing priority or even sale priority in certain circumstances to applicants who live or work in the area, it's a facially neutral policy, but it could be subject to challenge under the Fair Housing Act because it may have a disproportionately adverse impact on members of a protected class.

So, for example, it's facially neutral, but if we were to have that occur in a majority neighborhood where we are looking to keep people within that same neighborhood in the same neighborhood and we are excluding people from other neighborhoods, then that is something that would have an adverse impact potentially on a protected class under the Act. So, the success of such a challenge will depend on the facts and really how the preference is implemented. But in 2013, HUD issued a final rule that attempted to codify its standards for disparate impact claims brought under the Fair Housing Act. What that rule did was set up a framework for analyzing a potential claim. First, the plaintiff has to show a prima facie case that the challenge practice caused or predictably would cause a discriminatory effect. That's sort of the threshold step one. Then we get to step two where the burden shifts to the defendant to show that the challenged practice is necessary to achieve one or more substantial, legitimate, non-discriminatory interests.

A plaintiff says, "You're doing this wrong and it's resulting in discrimination." The defendant then has the opportunity to say, "Well, wait a second. I need to do it this way because of my business." And then lastly, this is where the burden shifts back again, if the defendant meets its burden, so the defendant puts forth a neutral reason why the practice exists, then the plaintiff has what I call the Monday morning quarterbacking opportunity to say that the challenged practice could be served by another practice that results in a less discriminatory effect. So essentially you could have a business practice that is well-thought-out, you've had your team involved in, it's been vetted completely, but the plaintiff gets that Monday morning quarterbacking opportunity to decide that you should have done it a different way and to try to convince the court of that as well. One thing I want to note, Chris, before I turn it back over to you, is that the second step in this 2013 rule is different than the traditional test used by the courts.

So, the test traditionally used by the courts is necessary to achieve a legitimate business purpose, whereas the standard used here by HUD is necessary to achieve one or more substantial, legitimate, non-discriminatory interests. So, looking at a lender, even if the lender can satisfy this burden under the 2013 rule, HUD courts can still find that the lender violated the Fair Housing Act if another practice could serve the same purpose with less discriminatory effect. And of course then the 2023 rule throws out the

2020 rule and reinstates what we've just talked about, this 2013 rule, which itself was really just the codification of longstanding law.

Chris Willis:

By way of background, Leigh, isn't it true that when that 2013 rule came out, there was some action going on in the Supreme Court with the Supreme Court being presented with a couple of opportunities to decide whether disparate impact was a real theory under the Fair Housing Act or not and those cases mysteriously kept getting settled before the Supreme Court could decide them? But my recollection is the 2013 rule came out at a very opportune moment right before the Supreme Court was going to hear one of those cases, maybe *Magner*. Was that right?

Leigh Poltrock:

Absolutely, Chris. There were a number of cases that were making their way up through the federal appellate chain. And interestingly, in the housing world, we kept hoping for a Supreme Court decision. However, all those cases were getting settled right before they had an opportunity to be argued and/or decided before we get to the *Inclusive Communities* case.

Chris Willis:

Got it. So, speaking of *Inclusive Communities*, that decision by the Supreme Court played a pretty significant role in shaping the 2020 version of the disparate impact rule. So, Lori, can you tell us a little bit about that?

Lori Sommerfield:

Sure, Chris. In 2015, the US Supreme Court handed down its decision in that case, which was called, the formal name, was *Texas Department of Housing and Community Affairs v. Inclusive Communities Project*. And in that case, the Supreme Court held that Congress intended the Fair Housing Act to permit disparate impact claims based on its interpretation of the Fair Housing Act's text, the history of Amendments to the Fair Housing Act, and also the purpose of the act. So, the court held that a defendant could be liable under the Fair Housing Act for a policy or a practice that has an adverse impact on members of a particular protected class group.

And by the way, the State of Texas had actually presented two questions to the court in *Inclusive Communities*. And the first was whether disparate impact claims are recognizable under the Fair Housing Act, which the court addressed. And the second one was what should the standard or the burden of proof be that would be applicable if that was the case? Interestingly, the court declined to answer that second question, so didn't specifically address HUD's disparate impact rule that was in place in 2013 in the *Inclusive Communities* case, but instead the court chose to focus on the three-step burden shifting test that is typically used by the courts to prove disparate impact claims. So, the court sought out to basically clarify its interpretation of that framework in the *Inclusive Communities* decision.

Chris Willis:

And as I recall, the court also had these warnings in the majority opinion about not allowing the law to drift into abusive, and that's a funny choice of word, isn't it, disparate impact claims. And that theme was running through the decision, as I recall, right?

Lori Sommerfield:

That's correct, Chris. And in fact, the Supreme Court kind of went out of its way to place scope limitations on the application of the law in that case, including placing prudential safeguards around the way that it could be interpreted by courts in the future. To a certain extent, it opened the door, shall we say, to defendants being able to use it to their advantage. But nonetheless, it created all this subsequent

uncertainty and legal challenges because it did not align with HUD's 2013 disparate impact rule at that time.

Chris Willis:

Okay. So then what did HUD do with *Inclusive Communities* in the 2020 version of the rule?

Lori Sommerfield:

Under the 2020 version of the rule, HUD decided that they needed to better align the 2013 version of the rule with *Inclusive Communities* and establish a uniform standard for determining when a housing policy or practice might have a discriminatory effect that could violate the Fair Housing Act. So, the 2020 rule basically expanded the three-step burden shifting test to one that had five prongs instead to assess claims of disparate impact. And then HUD also added some additional pleading elements that actually made it more difficult to initiate a case by plaintiff, created new defenses for defendants, and actually limited the available remedies under the Fair Housing Act. Although the rule was supposed to go into effect in October of 2020, a federal court actually enjoined its implementation in a case called *Massachusetts Fair Housing Center v. HUD*. So even though the revised 2020 rule was actually published by HUD in the Federal Register, it was essentially stayed and never implemented.

Chris Willis:

Right. I think it was the District of Massachusetts where that litigation was filed. And so, the 2020 rule is just sort of a glimmer in the 2020 HUD's eye that never really came to pass. And as I recall, there were some interesting elements in the 2020 rule. For example, there was a very generous and lenient phrasing of sort of the business justification defense. Leigh, you were talking about this a minute ago about the phrasing in the 2013 rule. Do you recall what the phrasing of it was in 2020? Because I remember it being more favorable to the defendant.

Leigh Poltrock:

I don't specifically remember the phrasing of that, Chris, in the 2020 rule, but Lori is correct that unquestionably it was easier to file suit under the 2013 rule and now the 2023 rule than it was under the 2020 rule. According to the current administration, the 2020 rule was inconsistent with the spirit of the Fair Housing Act, narrowed the types of suits that could be brought, and as Lori said, it added new pleading requirements, new proof requirements, new defenses, all of which made it harder to establish that a policy violated the Fair Housing Act. And it also made it harder for entities regulated by the Fair Housing Act to assess whether their policies were in fact lawful. According to HUD, again, the 2020 rule prevented plaintiffs from bringing claims based on certain specific theories of discrimination. For example, the perpetuation of segregation theory, which was present in *the Inclusive Communities* case, was essentially prohibited by the way the 2020 rule was drafted.

Chris Willis:

Let's stop reminiscing about the 2020 rule, which apparently I want to do on this podcast and talk about what do we do now? And so, Leigh, let me stay with you. You watch the law in this area so carefully. What should we expect from the standpoint of Fair Housing litigation and enforcement now that we have the 2023 redo of the 2013 rule, but we've still got *Inclusive Communities* out there with its various warnings about abusive disparate impact claims? What do we think is going to happen from an enforcement and litigation standpoint?

Leigh Poltrock:

Well, Chris, I think this is something that we don't have to guess about because the Biden administration, both the president himself and also Secretary of Housing and Urban Development, Marcia Fudge, have been very clear that enforcement is one of the things that they want to emphasize throughout their

administration. So, I think we are going to see an uptick in enforcement actions. Certainly, I think we will see an uptick in cases that are initiated by the government, where the government is investigating of their own initiative. So, we don't have to guess as to whether or not HUD is going to start responding more aggressively or pursuing more aggressive investigations. They have told us that is exactly what they are going to do, and I think both attorneys and then certainly the clients we serve in the financial services industry and the multifamily housing industry would really be well served to take that to heart.

Chris Willis:

Well, and of course, this sort of statement of intention to be aggressive in enforcement, I think, will sound very familiar to listeners of this podcast who hear statements like that from the financial services regulators every, I don't know, 20 or 30 seconds. At least that's how I feel like how often we get those warnings. But you gave the perfect segue, Leigh, to the last question that I wanted to ask, and I'll send this one to you, Lori. Now that we have the 2013 rule again, it's official as of March of this year, we have this very aggressive enforcement posture from HUD and presumably Department of Justice on Fair Housing Act related issues. What should industry participants be doing in light of these developments?

Lori Sommerfield:

Well, since the 2020 version of the rule never became effective for the reasons we previously discussed, if regulated entities were complying with the 2013 rule up until this point, then there's no need for them really to change any of their practices that they have in place. Because if they're complying with the 2013 rule, that's essentially the 2023 rule is now in effect. Really there should not be any sort of change. But nonetheless, because what Leigh said about the fact that we do anticipate increased government enforcement actions and potentially private litigation, asserting disparate impact discrimination under the Fair Housing Act, it’s still a good idea for our clients to revisit and reexamine any existing or new policies, procedures, or practices that have the potential for the risk of disparate impact and take steps then to reduce that fair lending risk. And in some cases that might involve actually modifying policies or procedures or discontinuing a practice. Now is the time to go back and look at HUD's disparate impact rule in its 2023 incarnation and make sure that everything is ticked and tied from a fair lending risk management perspective.

Chris Willis:

And you mentioned private litigation, Lori, and it makes me remember that a lot of the federal consumer financial protection laws don't have private rights of action or don't see frequent large scale private litigation, but that's not really true under the Fair Housing Act, is it, Leigh, because we have this whole cadre of Fair Housing Centers and Fair Housing advocacy groups who've made litigation under the Fair Housing Act sort of a staple of their activities for decades. So, it seems to me that the risk of private litigation is greater under the Fair Housing Act than we would typically anticipate under, say, equal Credit Opportunity Act or some of the other laws that deal with financial services specifically. Do you agree with that?

Leigh Poltrock:

I absolutely agree with that. And not only do we have these fair housing centers and advocates in cities and counties around the country, but HUD actually gives them money to pursue fair housing cases. That is what HUD funds them for. In order to fulfill their mandate and really to justify their continued existence in the receipt of HUD funds, they need to initiate these cases.

Chris Willis:

Got it. Leigh and Lori, thank you very much for being on today's podcast. It's really been invaluable to the audience to be able to hear your insights into the somewhat comical and interesting history and today's reality of HUD's disparate impact rule, and then what it means of course for the regulated community going forward. And of course, thanks to our audience for listening to today's episode as well. Don't forget

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