Using Disparate Impact Liability to Address Racial Disparities in Access to Financial Services

Robert Johnson

Since taking office, the Biden Administration has been vocal about its agenda to apply a "whole of government" approach to "advancing racial equity and support for underserved communities,"[1] especially through addressing the longstanding racial wealth gap.[2] The administration's efforts have included a particular focus on addressing longstanding disparities in access to capital and financial services for racial minorities.[3]

As highlighted by a 2021 report from The Brookings Institution, persistent disparities in access to capital, including home mortgage and small business loans, continue to limit opportunities for wealth-building through entrepreneurship and homeownership in communities of color, particularly among African American households.[4] Although there have been signs of bipartisan support in recent years for federal action aligned with these goals,[5] substantial disagreement remains as to the role that antidiscrimination law, particularly disparate impact liability, should play in efforts to reduce lending disparities and foster a more inclusive American economy.

Background on Disparate Impact Liability

When an institution observes a policy or employs a practice that has a disproportionately adverse impact on members of a protected class (i.e., race, gender, age, sexual orientation), the policy or practice is described as having a "disparate impact." Disparate impact as a theory of discrimination, differs from 'discriminatory treatment' because no showing of intent or motive to discriminate is required to establish a defendant's liability.

Disparate impact liability operates through a three-step burden shifting analysis:

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[1] See, Exec. Order 13985: Advancing Racial Equity and Support for Underserved Communities Through the Federal Government, January 20, 2021.

[2] In the United States, the average Black and Hispanic or Latino households earn about half as much as the average White household and own only about 15 to 20 percent as much net wealth. Aditya & Akila Forde, Wealth Inequality and the Racial Wealth Gap, FEDS Notes, Board of Governors of the Federal Reserve, October 22, 2021, https://www.federalreserve.gov/econres/notes/feds-notes/wealth-inequality-and-the-racial-wealth-gap-20211022.html.

[3] *Vice President Harris Announces New Public and Private-Sector Efforts to Advance Racial Equity at Freedman's Bank Forum*, White House Briefing Room, October 4, 2022, https://www.whitehouse.gov/briefing-room/statements-releases/2022/10/04/fact-sheet-vice-president-harris-announces-new-public-and-private-sector-efforts-to-advance-racial-equity-at-freedmans-bank-forum/.

[4] *See* Kristen Broady, et. al., An analysis of financial institutions in Black-majority communities: Black borrowers and depositors face considerable challenges in accessing banking services, Brookings, November 2, 2021, https://www.brookings.edu/research/an-analysis-of-financial-institutions-in-black-majority-communities-black-borrowers-and-depositors-face-considerable-challenges-in-accessing-banking-services/.

[5] For example, in 2020, the Ensuring Diversity in Community Banking Act (H.R. 5322) received a 52-0 vote for passage out of the House of Representatives Financial Services and Small Business Committees before final passage by the House. H. Rep. No. 163-4600 (2020). Leading up to the final vote for the bill, Republicans commended its chief sponsor, Rep. Gregory Meeks (D-NY), for introducing the bill and working "to reach a bipartisan solution on this important issue." Id.

1) First, a plaintiff must identify a specific 'neutral' policy or practice that has a disproportionately adverse effect on members of a protected class. Often statistical analyses are used to demonstrate that a disparity exists, but a plaintiff must also illustrate the causal relationship between the policy or practice and the highlighted disparity.

2) Once a disparate impact has been shown, the burden shifts to the defendant to explain why the challenged policy or practice is necessary to achieve some legitimate, nondiscriminatory purpose. In the corporate context, this is known as a "business justification."

3) Finally, even if a legitimate business justification is identified, the plaintiff may still establish that a policy is unlawful if they can identify a "less discriminatory alternative" to the current policy or practice that can achieve the stated purpose.

The Supreme Court first recognized "disparate impact" as a cognizable theory of liability under certain antidiscrimination laws in the 1971 case Griggs v. Duke Power Co.[6] There, the Court held that under Title VII of the 1964 Civil Rights Act, which prohibits the denial of employment opportunities "because of" protected class status, the Equal Employment Opportunity Commission was empowered to address not only deliberately discriminatory employment practices, but also those that produced disproportionately adverse outcomes for racial minorities.[7] The Court found that such an interpretation was required in light of the Act's "goal of achieving equality of employment opportunities" and removing barriers created by past discrimination.[8]

The Court most recently affirmed the validity of disparate impact liability by a 5-4 decision in the 2015 case Texas Dept. of Housing and Community Affairs v. Inclusive Communities Project, Inc.[9] That case applied the reasoning of *Griggs* and subsequent cases to find that the Fair Housing Act's antidiscrimination provisions should also be read as permitting liability for housing practices shown to produce disproportionately adverse effects.[10]

Justices Alito, Roberts, Scalia, and Thomas dissented from the Court's decision in *Inclusive Communities*.[11] Justice Alito, writing for the dissenters, argued that Fair Housing Act should not be read to include a focus on adverse effects because its language specifically prohibited the denial of housing and related services "*because of*" protected class status.[12] In the dissenters' view, when the phrase "because of" is used this way in an antidiscrimination law, that law's scope should be read as limited to discriminatory treatment claims, which require some showing of a discriminatory motive or intent in order to establish legal liability for the defendant. Going even further, Justice Thomas, in a

[6] 401 U.S. 424 (1971).
[7] *Id* at 431.
[8] *Id* at 429-430.
[9] 576 U.S. 519, 533 (2015).
[10] *Id.* at 539.
[11] *Id*. at 557-585 (Alito, J., joined by Roberts and Thomas, JJ., dissenting).
[12] *Id.* at 557-567 (Alito, J. joined by Roberts and Thomas, JJ., dissenting).

separately filed dissent,[13] effectively called for *Griggs* and other subsequent cases recognizing disparate impact liability under antidiscrimination statutes with similar language to be overruled.[14]

More fundamentally, the dissenters expressed skepticism against the very idea of regarding statistically significant differences in outcomes between racial groups as sufficient evidence of unlawful discrimination where no discriminatory intent exists.[15] Both dissenting opinions warned that "unfortunate consequences" could result from application of disparate impact theory, including incentivizing costly, vexatious litigation, while encouraging the use of misguided or "constitutionally dubious" race-conscious decision making by public and private actors seeking to avoid liability.[16]

In an effort to respond to these criticisms, Justice Kennedy, writing for the majority, defended disparate impact theory as playing a useful "role in uncovering discriminatory intent" by "permitting plaintiffs to counteract unconscious prejudices and disguised animus that escape easy classification as disparate treatment."[17] The majority further emphasized that a disparate-impact claim cannot rely on statistical disparity alone, but must also illustrate a causal relationship between the defendant's policy or policies and that disparity.[18] This "robust causality requirement," as described by the majority, is intended to prevent the debilitating prospect of liability for benign statistical differences, while also guarding against the kinds of perverse consequences discussed by Justices Thomas and Alito.[19] Furthermore, the court insisted that the availability of the 'business justification' affirmative defense would further limit imposition of liability, so long as the defendant can show the challenged policy or practice had a rational purpose and is not simply an "artificial, arbitrary, or unnecessary" barrier supplying pretext for discrimination.[20]

Today, *Inclusive Communities* remains the law on disparate impact liability. It commands that "antidiscrimination laws must be construed to encompass disparate-impact claims when their text refers to the consequences of actions and not just to the mindset of actors, and where that interpretation is consistent with statutory purpose." However, efforts to apply disparate impact liability to address racial disparities have remained controversial, including in the financial services sector.

Historical Efforts to Address Lending Discrimination through Disparate Impact Liability

Nearly thirty years ago, the Interagency Task Force on Fair Lending, a collection of ten federal agencies with regulatory authority over financial institutions released the Policy Statement on Discrimination in Lending ("Policy Statement")[21] that identified disparate impact as potential evidence of lending discrimination under the Equal Credit Opportunity Act (ECOA)[22] and Fair Housing Act

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[13] *Id.* 547-557. (Thomas, J., dissenting).
[14] *Id.* at 576-579 (Alito, J., dissenting); Id at 547 (Thomas, J., dissenting).
[15] *Id.* at 553-555. (Thomas, J., dissenting); Id at 564-565 (Alito, J., dissenting).
[16] *Id*. at 586-588. (Alito, J., dissenting).
[17] *Id.* at 540.
[18] *Inclusive Communities Project, Inc.,* 519 U.S. at 542.
[19] *Id.* at 542-544.
[20] *Id.* at 541.
[21] Interagency Task Force on Fair Lending, Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,266 (Apr. 15, 1994), https://www.govinfo.gov/content/pkg/FR-1994-04-15/html/94-9214.htm.
[22] 15 U.S.C. § 1691 et seq.

of 1968.[23] It did so on the recognition that even "policies and practices that are neutral on their face and that are applied equally may still, on a prohibited basis, disproportionately and adversely affect a person's access to credit."[24]

During the Obama administration, the Consumer Finance Protection Bureau incorporated the Policy Statement's position on disparate impact into its institutional approach to administering the ECOA.[25] In 2013 the agency issued guidelines advising auto lenders to adopt "robust" fair lending monitoring and compliance programs to minimize the risk of disparate effects, and thus potential enforcement actions.[26] Between 2013 and 2017, the CFPB brought several enforcement actions under the ECOA premised on disparate impact, including a series intended to address alleged racial disparities in the auto lending market.[27]

Under the Trump administration, however, the CFPB shifted its policy stance on disparate impact theory.[28] In 2018, President Trump signed a joint congressional resolution disapproving of and rescinding the 2013 bulletin[29] Subsequently, the CFPB expressed a view that the resolution "prohibited the Bureau from ever reissuing a substantially similar rule unless specifically authorized to do so by law."[30] The statement further cast doubt on the applicability of the disparate impact doctrine under the ECOA in light of the Supreme Court's opinion in *Inclusive Communities*, which it characterized as "distinguishing between antidiscrimination statutes that refer to the consequences of actions and those that refer only to the intent of the actor."[31] As a result of this policy shift, no disparate impact enforcement actions were brought by the CFPB under the Trump Administration.

Over the past year, the Biden administration has taken a number of steps to reinstitute the Obama-era policy of using disparate impact theory to address lending disparities through the CFPB, pursuant to its regulatory enforcement authority under the ECOA, as well as the Consumer Financial Protection Act (CFPA), which prohibits unfair, deceptive and abusive acts and practices (UDAAPs).[32] Senate Democrats also passed the Fair Access to Financial Services Act of 2022 (S. 4619), a bill that likely would have supplied firmer footing to the agency to carry-out its policy goals. If passed, the bill would have expressly prohibited "banks and other financial institutions from discrimination in

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[23] 42 U.S.C. 3601 et seq.
[24] *Supra*, note 21.
[25] Consumer Finance Protection Bureau, *Lending Discrimination*, CFPB Bulletin 2012-04, April 18, 2012, https://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf
[26] Consumer Finance Protection Bureau, *Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act*, CFPB Bulletin 2013-02 (March 21, 2013), https://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf.
[27] *See* Andrew Michaelson, et. al, *A Revived Disparate Impact Doctrine Under Biden's CFPB*, at 2, LAW 360 (February 17, 2021), https://www.kslaw.com/attachments/000/008/593/original/2-17-21_Law360.pdf?1613687065.
[28] Kate Berry, *CFPB Signals Pullback on Discrimination Cases*, AMERICAN BANKER, May 21, 2018, https://www.americanbanker.com/news/cfpb-signals-pull-back-on-discrimination-cases.
[29] S.J. Res. 57.
[30] *Statement of the Bureau of Consumer Financial Protection on enactment of S.J. Res. 57*, Consumer Finance Protection Bureau, (May 21, 2018), https://www.consumerfinance.gov/about-us/newsroom/statement-bureau-consumer-financial-protection-enactment-sj-res-57/.
[31] *Id.*
[32] *See CFPB Targets Unfair Discrimination in Consumer Finance*, Consumer Finance Protection Bureau, May 16, 2022, https://www.consumerfinance.gov/about-us/newsroom/cfpb-targets-unfair-discrimination-in-consumer-finance/.

providing goods or services."[33] Notably, the bill's text included more "effects-focused" language, proposing to guarantee to all persons "the full and equal enjoyment of the goods, services, facilities, privileges, and accommodations of any financial institution…without discrimination on the ground of race, color, religion, national origin, and sex (including sexual orientation and gender identity)."[34]

Both actions have instigated tremendous opposition from those opposed to disparate impact theory and/or further regulations for financial institutions.[35] For instance, during a December 2022 congressional hearing to discuss the proposed Fairness in Access to Financial Services Act, Republican Senator Pat Toomey (R-PA) criticized the bill, insisting that "disparate impact is not the same as discrimination" and that new nondiscrimination laws would only add to the regulatory costs faced by banks and other financial institutions that would ultimately be passed on to consumers.[36] He further echoed the dissenters in *Inclusive Communities* by characterizing the doctrine as "a gift to trial lawyers" and a "boon to regulators inclined to abuse their authority, like the CFPB."[37]

Why Disparate Impact Liability Should be Used to Address Racial Disparities in Access to Financial Services

Using disparate impact theory to define discrimination under the ECOA and CFPA could have a tremendous impact on the financial services industry due to underlying racial disparities associated with metrics traditionally relied upon by lenders when making operational decisions (i.e., borrower credit scores, homeownership, income, and personal wealth holdings).[38] Black and Hispanic Americans tend to have lower personal credit ratings, lower incomes, and less household wealth than other groups.[39] These disparities reflect historical inequities that continue to fuel a widening wealth gap, and have tended to restrain the economic opportunities available in many communities of color in the United States.[40]

Persistent reports of discriminatory treatment experienced by Black Americans while attempting to conduct routine banking transactions, described by the sardonic phrase "Banking While

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[33] *See Brown, Colleagues Reintroduce Legislation to Fight Discrimination from Financial Institutions*, U.S. Senate Committee on Banking, Housing, and Urban Affairs, July 26, 2022, https://www.banking.senate.gov/newsroom/majority/brown-colleagues-legislation-discrimination-financial-institutions.
[34] S. 4619, 117th Cong. (2022).
[35] John Mccrank, *Corporate Groups Sue U.S. Consumer Watchdog Alleging Legal Overreach*, REUTERS, September 28, 2022, https://www.reuters.com/legal/corporate-groups-sue-us-consumer-watchdog-alleging-legal-overreach-2022-09-28/.
[36] *Toomey to Biden Admin: Stop Abusing Authority to Advance Misguided, Liberal Legal Theory,* Minority Press Releases, U.S. Senate Committee on Banking, Housing, and Urban Affairs, December 1, 2022, https://www.banking.senate.gov/newsroom/minority/toomey-to-biden-admin-stop-abusing-authority-to-advance-misguided-liberal-legal-theory.
[37] *Id.*
[38] PETER BASSINE, ET. AL, BIG IDEAS FOR SMALL BUSINESS: A FIVE-STEP ROADMAP FOR REBUILDING THE U.S. SMALL-BUSINESS SECTOR, REVIVING ENTREPRENEURSHIP, AND CLOSING THE RACIAL WEALTH GAP 93, Yale Institution for Social and Policy Studies Working Paper, October 19, 2020, https://drexel.edu/~/media/Files/nowak-lab/201019BigIdeas_6P.ashx.
[39] *Id*. at 94.
[40] *Supra,* note 4.

Black" reveal that racial bias remains a barrier for many seeking to access financial services.[41] Research has also found that Black and Hispanic business owners are less likely to apply for credit out of fear of rejection, even when they have a high likelihood of approval based upon their credit and risk profiles [42]— suggestive evidence of the intergenerational psychological impact of racial discrimination.

But the problem of lending disparities is not simply a matter of perception. Minority business owners remain more likely to be denied credit compared with non-minority owners, "even after controlling for a number of owner and firm characteristics, including credit history, credit score, and wealth."[43] Furthermore, when Black-owned businesses are approved for financing, it is often at substantially lower levels than White businesses.[44] As a result, Black entrepreneurs on average tend to be more dependent on capital from friends, family, and their own resources than white entrepreneurs.[45] Statistical studies of the Paycheck Protection Program even suggest that racial bias likely played a role (as one of many factors) contributing to the disproportionately high loan application denial rates and lower approval amounts received by Black and Hispanic business owners.[46] Taken together, these disparities contribute to the "widening" of a racial wealth gap that economists have estimated will cost the American economy "between $1 trillion and $1.5 trillion by 2028 if permitted to continue growing at the current pace.[47]

Internalizing the Externalities of Racial Disparities through Disparate Impact Liability

An analogy between antidiscrimination law and the common law of torts has long been recognized, in that both share a primary purpose "to deter conduct which has been identified as contrary to public policy and harmful to society as a whole."[48] Thus, disparate impact liability can be

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[41] *See*, Emily Flitter, *'Banking While Black': How Cashing a Check Can be a Minefield'*, THE NEW YORK TIMES, June 18, 2020, https://www.nytimes.com/2020/06/18/business/banks-black-customers-racism.html; Julian Mark, A Black woman hit the jackpot. A Bank wouldn't cash the check, lawsuit says, THE WASHINGTON POST, September 9, 2022, https://www.washingtonpost.com/nation/2022/09/09/lizzie-pugh-black-bank-lawsuit/; Eric Rasmussen, *Banking While Black': Police video shows how cashing a paycheck led to handcuffs*, KTSP News, December 7, 2021 (updated January 10, 2022).

[42] Robert W. Fairlie, et. al, *Black and White: Access to Capital among Minority-Owned Startups*, National Bureau of Economic Research Working Paper No. w28154, 5, 32, November 2020, https://ssrn.com/abstract=3739651.

[43] Robert W. Fairlie & Alicia M. Robb, *Disparities in Capital Access between Minority & Non-Minority Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBE's*, US. Department of Commerce, Minority Business Development Agency, 21, January 2010, https://www.mbda.gov/sites/default/files/migrated/files-attachments/DisparitiesinCapitalAccessReport.pdf.

[44] BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, REPORT, ECONOMIC WELL-BEING OF U.S. HOUSEHOLDS IN 2021 48, May 2022, https://www.federalreserve.gov/publications/files/2021-report-economic-well-being-us-households-202205.pdf.

[45] DANA M. PETERSON & CATHERINE L. MANN, CITI GPS, CLOSING THE RACIAL INEQUALITY GAPS: THE ECONOMIC COST OF BLACK INEQUALITY IN THE U.S. 59-60 (2020).

[46] Sabrina T. Howell, et. al, *Lender Automation and Racial Disparities in Credit Access*, Working Paper No. 29364, 26, October 2021 (Revised November 2022), https://www.nber.org/system/files/working_papers/w29364/w29364.pdf (finding suggestive evidence that preference-based discrimination helps to explain lower rates of PPP lending to Black-owned businesses among smaller conventional lenders).; See also, Rachel Atkins et. al, *Discrimination in lending? Evidence from the Paycheck Protection Program*, 58 Small Bus Econ 843 (2022), https://doi.org/10.1007/s11187-021-00533-1.

[47] Nick Noel, et al., *The Economic Impact of Closing the Racial Wealth Gap*, MCKINSEY INST. FOR BLACK ECON. MOBILITY (Aug. 13, 2019), https://www.mckinsey.com/industries/public-and-social-sector/our-insights/the-economic-impact-of-closing-the-racial-wealth-gap.

[48] *Price Waterhouse v. Hopkins*, 490 U.S. 228, 264 (O'Connor, J., concurring).

viewed as a mechanism for re-allocating the costs Americans collectively bear for racial and other social disparities that distort our economy and restrain national prosperity.

Opponents of disparate-impact liability often accept this analogy but frame disparate impact theory as form of strict liability. Yet this view of disparate impact liability underappreciates the constraints set forth by the majority in *Inclusive Communities*, as well as the guidance regulators have provided in the context of administering fair lending laws for many years, which instead frames the doctrine more like a negligence regime.

The key differences between strict liability and torts regimes center upon the extent to which taking reasonable precautions to avoid harm to others can reduce a defendant's potential liability. In a negligence regime, a defendant may escape liability by demonstrating that it employed appropriate protective measures to avoid causing the alleged harm. No such defense is available to a defendant under a strict liability regime. Although the latter approach makes it easier to hold a defendant accountable for harm, the increased risk of liability can sometimes lead to a reduction in socially useful activity, where additional precautions may be difficult to identify, cost-prohibitive, or nonexistent.[49] As discussed above, this is one of the core concerns expressed by opponents of disparate impact, who warn of potential reductions in access to financial services for those who need it most.[50]

However, as explained by the court in *Inclusive Communities*, a defendant's "policies are not contrary to the disparate-impact requirement unless they are 'artificial, arbitrary, and unnecessary barriers.'"[51] In other words, disparate impact liability permits a defendant to escape liability where it can justify its conduct as reasonable under the circumstances.[52]And although the official disparate impact doctrine does not explicitly limit liability for taking protective measures, federal agency guidance on disparate impact liability under fair lending laws has consistently indicated that the presence of robust internal monitoring, risk reduction, and self-correction protocols by covered institutions will be "considered as a substantial mitigating factor…when contemplating possible enforcement."[53]

Understood this way, a statute that explicitly empowers a regulatory agency like the CFPB to address lending discrimination through applications of disparate impact theory is no more radical or illogical than environmental regulations that have saved millions from toxic air, water, and other substance pollution over the past half century.

Conclusion

There may, admittedly, be merit to Justice Thomas's insistence that we "should not automatically presume that any institution with a neutral practice that happens to produce a racial disparity is *guilty* of discrimination."[54] Quite certainly, context matters.

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[49] *See Indiana Harbor Belt Railroad Co. v. American Cyanamid Co*., 916 F.2d 1174 (7th Cir. 1990).
[50] *See supra*, note 19 and 20; *see also Inclusive Communities Project, Inc.*, 576 U.S. at 557 (Alito, J., dissenting).
[51] *Inclusive Communities Project, Inc.*, 576 U.S. at 519. (quoting *Griggs*, 401 U.S., at 431).
[52] "Both the business-necessity defense and the less discriminatory alternative doctrine consider whether an employer acted reasonably." Kenneth R. Davis, *The Invisible Ban: Negligent Disparate Impact*, 70 AM. UNIV. L. REV. 1879, 1907 (2021), https://amunlawreview.wpengine.com/wp-content/uploads/2021/08/Davis.to_.Printer-FINAL.pdf.
[53] *See* supra, note 24.
[54] *Inclusive Communities Project, Inc.,* 576 U.S. at 554 (Thomas, J., dissenting) (emphasis added).

However, where business practices produce substantial, disproportionate harms between persons distinguishable primarily by characteristics of social identity, and these differential effects are consistently observed across a large population over many years, skepticism rather than acquiescence should be the presumptive response. This is the lesson to be drawn from the abundant historical evidence on the origins of lending discrimination, as well as contemporary evidence showing that "communities of color are less likely to have access to traditional financial services; pay more to open and maintain their accounts; and are more likely to be denied mortgages and small business loans and to be offered loans on worse terms."[55]

Nevertheless, with Justices Alito and Thomas holding more dominant influence on the Supreme Court's jurisprudence as a result changing personnel on the bench in recent years, it is unclear how much longer disparate impact theory will remain a viable option for addressing racial disparities, in any context, absent unambiguous legislative direction from Congress.

[55] *Fairness in Financial Services: Racism and Discrimination in Banking: Hearing on Before the Senate Banking Committee,* 117th Cong. 5 (2022) (Written Testimony of Janai Nelson, Pres. NAACP Legal Defense and Ed. Fund, Inc.), https://www.banking.senate.gov/imo/media/doc/Nelson%20Testimony%2012-1-22.pdf.