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January 17, 2012

Via E-Rulemaking Portal: http://www.regulations.gov

Regulations Division, Office of General Counsel
Department of Housing and Urban Development
451 7th Street SW, Room 10276
Washington, DC 20410-0500

Re: Docket No. FR-5508-P-01
Implementation of the Fair Housing Act's
Discriminatory Effects Standard

Dear Sirs:

The following comments are submitted on behalf of the Independent Bankers Association of Texas (IBAT). IBAT is a trade association representing approximately 500 independent, community banks domiciled in Texas. Virtually all of its members make home loans and will be affected by this proposal. We appreciate the opportunity to comment. IBAT and its members are strongly committed to fair lending principles. However, IBAT believes that this proposal is premature based on pending litigation. More significantly, we also believe that the "disparate impact" analysis engrafted onto the Fair Housing Act by regulatory fiat will have the unintended consequence of actually reducing credit availability for many low to moderate income home buyers including many in protected classes.

Proposal

On November 16, 2011, the above referenced docket was filed in the Federal Register. This proposal would amend the Fair Housing Act (FHA) regulations by amending section 100.120 relating to the making of loans by adding a new subparagraph (2) that prohibits "providing loans or other financial assistance in a manner that results in disparities in their cost, rate of denial, or terms or conditions, or that has the effect of denying or discouraging their receipt on the basis of race, color, religion, sex, handicap, familial status, or national origin." A new Subpart G—Discriminatory Effect would also be added to the rules. This new subpart would prohibit practices that have a "discriminatory effect," which is defined through disparate impact. The statistical analysis identifying a disparate impact could be refuted by establishing a "necessary and manifest relationship to one or more legitimate, nondiscriminatory interests of the respondent." However, there cannot be another practice that arguably has a less discriminatory effect. Finally, subpart G provides a shifting burden of proof. The complainant or plaintiff has the burden of proving that the challenged practice has a "discriminatory effect." Then the respondent or

defendant has the burden of proving a necessary and manifest relationship to one or more legitimate, nondiscriminatory interests. This may then be countered by the complainant or plaintiff by showing that the challenged practice can be served by another practice that has a “less discriminatory effect.” These provisions relating to disparate impact are taken from employment law.

Recent Court Developments

On November 7, 2011, the United States Supreme Court granted certiorari in the case of *Magner v. Gallagher* to determine whether disparate impact is a valid theory of liability under the FHA, and, if so, what standard should be applied. Independent Community Bankers of America, the national organization that exclusively represents community banks, has filed an amicus curiae brief in that matter, which we would suggest appropriately demonstrates the lack of statutory support for disparate impact as a theory of discrimination under the FHA. The grant of certiorari occurred after the proposal was crafted but before the Federal Register publication. The Supreme Court could uphold the test, strike it totally, or subject it to limitations. In any event, action on this proposal is premature at this time. We strongly urge HUD to withdraw this proposal pending final court action.

Lack of Statutory Support for Proposal

In the event the proposal is not withdrawn, we would make the following comments regarding the legal support for the rule and the industry impact of the rule as drafted.

First, the disparate impact analysis is taken from Title VII of the Equal Employment Opportunity Act and has no statutory basis in the FHA. Title VII has an explicit statutory framework for disparate impact. See 42 USC §2000e-2(k). Congress could have amended the FHA at any time during the last four decades to mirror Title VII and has not done so. That indicates that Congress has no intent to apply that “disparate impact” concept to the FHA. In short, this proposal exceeds the agency’s authority.

Section 100.120

The proposal adds a new subparagraph (b)(2) that would affect the pricing and underwriting of mortgage loans if a practice would have the “effect” of denying or discouraging such loans on a prohibited basis. Although the regulation is silent as to the manner of determining the “effects” test, in practice banking regulators (in the absence of regulatory constructs) have used a statistical analysis to establish that a facially neutral policy or practice has the effect of impermissibly discriminating. IBAT members have reported to the organization that these statistical analyses have found, for example, that pricing on loans can be statistically significant, resulting in a finding of a fair lending violation, when rates to minorities or women were higher than rates to non-protected classes by as little as 0.125%. In addition, the statistical analyses are a blunt instrument. They do not take into consideration all of the nuances in a credit relationship. However, the result of such a test is devastating. If an examiner concludes that there is a “pattern or practice” of discriminatory pricing, the bank is referred to Department of Justice (DOJ) for further action. The bank’s Community Reinvestment Act rating is reduced to no better than unsatisfactory. This means that the institution cannot branch, expand its activities, hold state public funds, or qualify for long term FHLB advances. All of that occurs without the right of appeal, pending the DOJ action. IBAT is extremely concerned with any effort to belatedly

create a regulatory framework that, after the fact, validates the analytical approach used to bash community banks.

Applying the disparate impact test broadly to cost, rate of denial, and terms and conditions of credit creates a level of uncertainty for lenders that ultimately leads to either cookie cutter loans with rigid criteria or an exit from certain credit products due to the regulatory compliance cost and enforcement/litigation cost arising from the uncertainties created by an ambiguous rule. This is especially true when the analysis used to determine the adverse "effect" is based on unspecified, ill-conceived statistical analyses. This is particularly problematic as to pricing of loans. To avoid any problem, a bank with branches in a variety of very different areas must ignore the differences in competition and the marketplace and simply price every loan exactly the same. While such a "loan in the box" approach may work for loans to be sold in the secondary market, it is totally inappropriate for loans that don't qualify for secondary market criteria but which a community bank is willing to make and keep in its own portfolio. The losers in this scenario are the consumers who can't get traditional mortgage loans but who could qualify for an in-portfolio loan made by the local branch. The loan officers, who may know the prospective borrower's capacity and desire to repay based on prior transactions, will not be able to use that to benefit the applicant. In short, community banks will have to abandon community banking principles in order to achieve a safe level of compliance with a disparate impact test as contemplated by this rule.

Subpart G—Discriminatory Effect

In addition to the concerns expressed above, IBAT believes that the new sections dealing with legally sufficient justification and with burden of proof create new, expanded impediments to lending and will over time reduce credit availability as to mortgage loans. Here are our more specific concerns.

First, a lender must identify not only an appropriate business justification for a particular practice, but that rationale must establish a "necessary and <u>manifest</u> relationship to one or more <u>legitimate</u>, nondiscriminatory interests of the respondent…" [emphasis added] The underscored terms inject potential subjective review of the countervailing business support for a practice. We fear that a differential in interest rates for in-portfolio loans (even though such loans have a higher risk of repayment than loans that are to be sold) could be struck if an examiner (or court) substituted its judgment for the lender and concluded that although the differential might be a logical business action, it was not manifestly <u>necessary</u>. The ultimate effect could be the elimination of in-portfolio mortgage loans at many community banks. These loans fill an important niche in providing more tailored loans to customers who may not qualify for a secondary market transaction. The losers in that event are the consumers who can't find any source of mortgage credit, the builders who can't sell their homes, and the community which loses the expanded property tax base.

The burden of proof provisions also present concerns. After a lender demonstrates a business justification for a policy, the complainant or plaintiff can simply allege that there is another practice that has a less discriminatory effect. This ignores the fact that there are likely to be an array of practices that are possible in a loan program. The ultimate structure of a mortgage lending product will take into consideration interest rate risk, credit risk, reputation risk, repayment risk, legal risk, and a variety of other applicable factors. Subpart G does not require an alternative policy to evaluate any

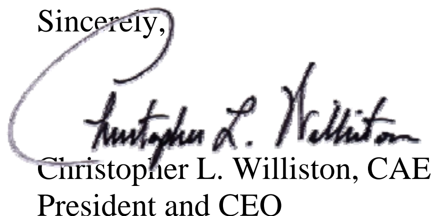
factor other than whether or not it is "less" discriminatory. Every other concern is irrelevant (apparently) under the Subpart G burden of proof analysis.

Conclusion

IBAT urges that this proposal be withdrawn pending final action by the United States Supreme Court. If that court should conclude that the plain language of the FHA can be ignored and a new standard involving "disparate impact" is permissible, we urge the agency to go back to the drawing board. The final standards should be objective rather than subjective. Once a bank establishes a clear business justification for a policy or practice, the inquiry should stop. Most significantly, there should be clear intent on the part of the lender rather than a mere statistical analysis that arguably shows different treatment. Further, if that point is ignored, we strongly urge the agency to establish rational, supportable standards for analysis.

Thank you for this opportunity to comment.

Sincerely,



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