The Fisher Memorial Program 2016
Is Fair Lending Fair for All?*

I. Introduction – Larry Young

Good morning. Welcome to the 2016 Fisher Memorial Program. I am going to tell you a little bit about Fred Fisher and then I am going to introduce our panelists and the moderator, and I will turn it over to John Ropiequet, who will be moderating the program.

The Fisher Memorial Program, as the name indicates, is a memorial to Fred Fisher, who was the long-time Chairman of the Governing Committee of the Conference on Consumer Finance Law and who, after graduating from Bowdoin College summa cum laude and service in the Army in World War II and Harvard Law School, started a career with Hale and Dorr.

It was there that he followed probably the dream and the nightmare of every young lawyer, to become both famous and infamous in one breath, because he was mentioned in the McCarthy hearings on the Department of the Army. Now, this was a time when there was a Red Scare and there was a fear of Communists in every aspect of American life. The Cold War had begun. It was 1954. McCarthy was finding Communists under every rock and tree, most of the time fabricated. And he held hearings on whether Communists had infiltrated the Department of the Army. Joe Welch, a partner with Hale and Dorr and a wonderful trial lawyer, was hired to represent the Department of the Army in these hearings.

What was significant about these hearings was not just the times and the scare and all of the blacklisting that would keep people from having employment or endanger their livelihood, but, historically, this was the first time that a congressional hearing had been nationally televised. Television was relatively new. The backstory on this is that, in law school, Fred had joined and had been a member of the National Lawyers Guild, which is kind of a left-leaning law student and lawyers' organization, and he was originally assigned to assist Joe Welch in the hearings in representing the Department of the Army. He got down to D.C. along with Jim St. Clair of his firm, another lawyer who became very well known, and Joe Welch determined that Fred's past membership in the Lawyers Guild could be a problem, so he sent him back to Boston.

So, it came as quite a surprise when McCarthy opened the hearings and, probably in an effort to throw Joe Welch off balance and to ruffle him, said: "Mr. Welch, I have it on good authority that a member of your firm, a Mr. Fred Fisher, is a member of a Communist front organization, the Lawyers Guild." To which Joe Welch responded, "Until this moment, Senator, I think I have never really gauged your cruelty or your recklessness. Fred Fisher is a young man who went to the Harvard Law School and came into my firm. He is starting what looks to be a brilliant career with us. Little did I dream you could be so reckless and so cruel as to do an injury to that lad. It is true he is still with Hale and Dorr. It is true he will continue to be with Hale and Dorr. It is, I regret to say, equally true that I fear he would always bear a scar needlessly inflicted by you. If it were in my power to forgive you for your reckless cruelty, I would do so. I like to think I am a gentleman. But your forgiveness will have to come from someone other than me."

McCarthy tried to renew the attack. Welch interrupted him, "Senator, may we not drop this? We know he belonged to the Lawyers Guild, let us not assassinate this lad further, Senator. You have done enough. Have you no sense of decency, sir? At long last, have you left no sense of decency?"

McCarthy tried to ask him another question about Fisher. Welch cut him off, "Mr. McCarthy, I will not discuss this further with you. You have sat within six feet of me and could have asked me about Fred Fisher. You have seen fit to bring it out and if there is a God in Heaven, it will do neither you nor your cause any good. I will not discuss it further."

The gallery erupted in applause. The camera panned in on a close-up on McCarthy. You saw the cracks begin to appear in the image. Two months later, he was censured by the Senate and his reign of terror was over.

Now, Fred went on to become a partner in Hale and Dorr. He was the President of the Massachusetts Bar. He was very active in the American Bar Association (ABA). He chaired many committees here. He was a member of the House of Delegates. And he died in 1989 while lecturing in Tel Aviv. I knew Fred for twelve years and he was a warm, mirth-filled man, and anybody that came into his orbit was better for having been touched by him.

The proceedings that I just described were shown in a documentary, "Point of Order," which still airs periodically on PBS and on the History Channel. And there was also a made-for-TV movie about this called "Tailgunner Joe," where Burgess Meredith played Joe Welch and Joe Boyle played McCarthy. And there were probably other things in the media about it since. So, that is the origin of the name of the Fisher Memorial Program. Fred, we salute you.

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Now it is also my privilege to introduce our participants. I want to start with Karla Gilbride. Karla is seated immediately to John's left. Karla has made a career of doing well by doing good. After Swarthmore and Georgetown Law, she clerked on the United States Court of Appeals for the Ninth Circuit. And then she began to become a disability rights advocate. She represented people who were blind and were seeking equal access to websites. She also sought inclusion of people with disabilities in Los Angeles County's emergency plans. She represented consumers with disabilities before the Public Utilities Commission and applicants seeking accommodations in professional license exams. She then went on to a private law firm where she brought wage and hour and employment discrimination cases as well as cases under the Fair Housing Act. Since 2014, she has been a part of Public Justice, where she has endeared herself to Alan Kaplinsky by challenging mandatory arbitration and class action waiver provisions in consumer contracts. Karla, we welcome you here.

I am going to skip around a little bit. Marsha Courchane, you are there at the far left end where I can't see you. That is not a political statement. Marsha, your Ph. D. is in economics, correct? And she is the Vice President and Practice Leader of the Charles River Associates and heads the financial economics practice in the U.S. and U.K. She is a leading expert in the areas of mortgage and consumer lending. She has written for numerous publications that look like they have never even considered letting lawyers sully their pages with their writing. And they are too numerous to name. She is also Executive Vice President of the American Real Estate and Urban Economics Association.

Now directly in the middle is Jean Noonan. Is there anybody who doesn't know Jean Noonan? If there is, raise your hand. There was an old joke in Texas when I first got there about the graduate of a certain Texas educational institute who moved to Oklahoma and immediately increased the IQ of both states. The person who formulated that joke never met Jean, who is from Oklahoma, because I had her on a previous panel when I was moderating for this program and I began to truly appreciate what an intellectual force she is. Jean has had an incredible career. She was the General Counsel for the Farm Credit Administration. She was Director of Enforcement of the Federal Trade Commission (FTC) for consumer financial services laws. She is a partner with Hudson Cook and is the managing partner of the firm's Washington D.C. office. And personally, she is an absolute delight. If you don't know Jean, you should.

That is our panel. Our moderator is John Ropiequet, and I can also say, is there anybody here who doesn't know John Ropiequet? In looking at John's bio, I was struck by the fact that his career has been marked by his service to this profession. John is, as most of you know, the Co-Editor of the *Annual Survey of Consumer Financial Services Law* in *The Business Lawyer*. He has been a contributor to the treatise on *Truth in Lending* edited by Alvin Harrell. He is the Chair of the Governing Committee of the Conference on Consumer Finance Law, which sponsors this program, and we appreciate the co-sponsorship of the Consumer Financial Services Committee and the other committees of the ABA. I admire John almost as much as I do John Chiles, who used his advocacy skills to get John Ropiequet to do this for him today. So with that, I am going to turn this over to John and the program is underway.

II. Overview of the Program – John Ropiequet

Thank you, Larry. I want to welcome everybody on behalf of the Conference on Consumer Finance Law, which is co-sponsoring this program with the ABA Consumer Financial Services Committee and the Banking Law Committee. The Conference was founded in 1927 and has been affiliated with the ABA for all that time. We also publish the *Consumer Finance Law Quarterly Report*. Here is my demonstrative evidence [holding a copy of the *Quarterly Report*] where we – and some of the issues are pretty thick – we publish a lot of information on consumer finance law. We also distributed a membership application if anybody would like to subscribe to it. In addition, we have resumed sponsoring an Annual Conference which we are going to hold in Chicago in September.

We're going to be speaking into the microphones. I want to let you know that you count as the fourth member of this panel. We want your questions, at least after we are done with our opening statements. If you are going to be a member of the panel asking questions, please use the microphones, because this program is being recorded. It will be available on the ABA website, and we are going to have it transcribed and published in the *Quarterly Report*. The issue I held up has the 2013 program and we have the last two more in the works. That also means I would like you to state your name for the record if you do have a question, because we want your name in there, with your permission of course, so that we can publish the full transcript when it's ready.

Our topic today, as advertised, is: "Is Fair Lending Fair for All?" We started with a field of seventeen candidates for our panel of speakers and over time, it has been winnowed down to three. We are going to be debating the pros and cons of fair lending.

The way the program will proceed is, I am going to give, I was going to say a short overview and then I looked at what I had written down and I am not going to say short, of where we are to set the stage for today's discussion. We have additional background materials on the ABA Business Law Section website. There is also an article that just came out in the *Annual Survey*, it's available now online. Jean and I had a little bit to do with that one, and I have a much longer article coming out in the *Quarterly Report*.[1] I just got an email today saying that's out, and I call it exhaustive because I was certainly exhausted by the time I finished it. The panelists are each going to give their opening

1. John L. Ropiequet, *Does* Inclusive Communities *Point the Way to a More Limited Future for Fair Lending Claims?*, 69 Consumer Fin. L.Q. Rep. 83 (2015).

remarks after I do that and then I am going to throw some questions out to them.

Now, what are we talking about today? We're talking about the disparate impact theory for claims of discrimination. To paraphrase what Justice Alito said in the *Inclusive Communities* case last summer,[2] everyone agrees that disparate treatment, which is intentional conduct against a protected group, whether it's racial, ethnic, or otherwise, is a bad thing. We all agree about that. So, what's this debate about? The other theory, disparate impact, is very different; because at least in theory, it's not intentional misconduct, it's the discriminatory effects of conduct rather than discriminatory conduct itself.

The theory comes from two different statutes, which we'll be talking about. It couldn't possibly be a program here at the Business Law Section unless we had some acronyms, so ours are, first, the FHA for Fair Housing Act; this only covers mortgage lending. There is another federal statute, the Home Mortgage Disclosure Act, or HMDA, plus Regulation C, that provides direct evidence of borrowers' characteristics that lenders are required to collect and report to the government. But that's only for mortgage lending. The question is, is there direct evidence available about which borrowers really belong to a protected group and what happens with the interest rates that they pay?

The second statute is somewhat different. It's the Equal Credit Opportunity Act. We may call it the ECOA, plus Regulation B. This covers all types of lending, auto finance, installment loans, student loans, credit cards, and mortgage lending. But, Regulation B restricts collecting evidence on borrowers' racial and ethnic backgrounds. So, to show discrimination in the form of disparate impact, where you are not dealing with mortgage credit, you have to use indirect evidence to show the effects of lenders' practices on protected groups.

There's another wrinkle for auto finance, which is sometimes, though inaccurately, called indirect lending; they call it that because the auto finance companies that purchase retail installment sales contracts don't deal with the consumers. Auto dealers deal with the consumers. They are the ones that enter into the contracts at a stated Annual Percentage Rate (APR) and then they sell the contracts to the auto finance companies, so it's an indirect type of relationship, though not a "loan."

Our panelists have a great deal of experience with all of the issues that the disparate theory gives rise to and over the years, starting really in 1977 at the U.S. Court of Appeals level, there have been many decisions that have accepted that the FHA includes disparate impact liability. This was challenged in some recent high-profile cases, and certiorari was granted not once but three times (how often do you see that?), in order to examine the question of whether the FHA does include disparate impact liability as well as disparate treatment liability. We got a ruling about this last summer in *Inclusive Communities*.

It was a very close question. Five of the Justices said yes, the FHA includes it, but there are safeguards. Number one, there's a robust causation requirement that ties disparate impact to a policy or practice, and you need more than statistical evidence to make that connection. There's another decision in 2011, *Wal-Mart Stores, Inc. v. Dukes*,[3] that has some pertinent holdings. Well, that was the majority. Four Justices found that the language of the FHA does not support disparate impact liability at all.

What these opinions did not address, of course, was ECOA, a different statute which has different language. Does that one include disparate impact liability? There have been some cases that say that. Normally, that's where you have a double-barreled shotgun type of claim, FHA and ECOA, and in the few cases where the courts have looked at the question of ECOA, they say, of course it does, too. That's pretty much the extent of the analysis that they make.

The disparate impact theory has fueled an enormous amount of litigation and enforcement activity over the years and this was especially true during the Obama Administration, coming from the Department of Justice, from the Bureau of Consumer Financial Protection (CFPB), from the FTC, and from the U.S. Department of Housing and Urban Development (HUD). Private class actions really vanished after the *Wal-Mart* case in 2011, as that case held that the exercise of discretion by numerous decision-makers that was not tied to a single policy or practice can't form the basis for an employment law class action, since the glue, as Justice Scalia put it, needed to establish commonality is missing, but enforcement actions based on the same kind of evidence have continued in the fair lending arena. We also have a round of hotly-contested fair lending cases that have been brought by municipalities. We have gotten them in Atlanta, Los Angeles, Chicago, and Miami.[4] There has also been a pair of recent U.S. House Banking Committee reports that sharply called into question the CFPB's use of disparate impact and the fairness of its application to the consumer finance industry. We may be talking about that as well.

So with that background, I'm going to turn it over to our panelists to give their opening remarks, beginning with Karla.

III. Opening Remarks of Karla Gilbride

Thank you, John. So, to follow up on John's excellent overview, I want to make a couple of points about considering disparate impact as a form of discrimination and discrimination being a loaded term. And I think that for purposes of a lot of the discussion that we are going to have here today, there are two strands of it. The first strand is, should we be talking about this at all, is it fair? And that's implicit in the title of the panel. Is it fair to ask

2. Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Cmts. Project, Inc., 135 S. Ct. 2507 (2015).

3. 131 S.Ct. 2541 (2011).

4. *See, e.g.*, Ropiequet, *supra* note 1, at 88 – 97.

lenders to try to react to, and be exposed to, liability for disparate impact, *i.e.*, to react to what enforcement agencies might do or take proactive steps themselves to address the effects of their policies and to mitigate the adverse impact that they are having on protected groups.

And then the second strand is less morally loaded. It's going to address data and statistics and what are the most reliable methodologies that we can use to get at the disparate impact and to factor out things that we don't want to be considering. The latter relates to things that we want to control for. But we will get into more of the details of all of that.

I think that it is important, at the outset, to deal with the first piece, the morally-loaded, judgment-loaded issue and saying that this whole body of law and regulation and policy that we are going to talk about falls within the rubric of discrimination. Because when people hear "discrimination," they think, you know, you are calling me a racist. You are calling me a sexist. I am not a bad person. I wouldn't do that. And it can make all of us feel defensive and feel attacked and feel that we are being called morally bankrupt.

So I want to take that on and explain the reason that disparate impact has been recognized as a form of discrimination in the law dating back to the 1971 case of *Griggs v. Duke Power Co.*[5] and in various legislative enactments by Congress, including the Fair Housing Act and ECOA, and we will get into why I am willing to say that disparate impact was clearly intended to be included in ECOA in 1976 when it was amended to include race. But what disparate impact is getting at is that in a nation that has the history of discrimination that ours does, including things as overt and devastating in their impact as slavery and Jim Crow, and where you had de jure segregation and discrimination as a matter of law for so long, the historical impacts of those policies are going to linger on and continue for generations after.

And even if we eliminate all vestiges of disparate treatment, intentional discrimination, and say all of that is illegal now, and we are not going to do that anymore, there are still going to be serious inequities, inequities in education, inequities based on geographic segregation of where people live, because of where they have been allowed to live, when housing discrimination was permitted. And financial effects, in terms of access to wealth and liquidity and the ability to start a business or purchase things that you want to purchase in the market. And that's where access to credit comes in.

The race- and gender-based differences in wealth were recognized at the time that the ECOA was passed and they persist to this day. So, there was evidence introduced in the Congressional Record about the vast wealth disparities in 1974 when the ECOA was first introduced and then in 1976 when it was amended.

But I want to talk about more recent data. In the 2010 Census, the middle twenty percent, so basically what you would call the middle class or middle income, accumulated wealth. So savings, wealth in the form of housing investments, for whites was over $110,000. For African Americans it was $6,000, and for Hispanics, it was approximately $7,500. So, you know, that's about a fifteen-to-one ratio. And in the light of those realities, simply having a policy that we can't discriminate is not going to move the needle, is not going to move us to a more level economic and financial playing field.

Now, this is a philosophical question. Some people might say, well, that's not our problem to sort of correct the vestiges of these historical practices because I didn't cause them, that's been in existence long before I got here, and so I'm just going to act neutrally from now on. But societally and legally, we have made the determination that this is not enough. And when I say we, I am talking about governmental actors as well as private actors, because the *Inclusive Communities Project*, which is the Supreme Court case that John was talking about,[6] dealt with the allotment of housing subsidies in low income communities in Texas. So it's government actors as well as private actors in the economy.

And in this case, we are going to focus on lenders. When we are implementing policies that are neutral on their face, we also need to be conscious of what effects those policies are going to have and whether they are going to disproportionately impact the groups that we have identified as needing special protection, ethnic minorities, racial minorities, and women. And under the ECOA, discrimination on the basis of age and marital status are also criteria that we need to focus on. So it means identifying those criteria, those protected criteria, and making sure that the policies that we enact are not disadvantaging those groups relative to whites and men.

And I don't want to use up too much time here since we want to get to the Q & A, but I'll make two other quick points. So the kind of framework in which I want us to be thinking about disparate impact is having that conscious awareness of the effects of your policies. Now, what does that mean in terms of operationalizing that, especially on a large scale, if you're a lender or another large company? In order to really assess the impact of your policy on a large scope -- a long period of time and a large number of people that you are interacting with in the market, you need to use statistics. And that's why, in the history of all of these disparate impact cases, whether you are looking at employment or you are looking at housing or lending, statistics come up over and over again because that is the way that we measure whether something is having an adverse impact on a large-scale basis.

And it's also something that we shouldn't shy away from. There seems to be some hostility to the idea of using statistics and we do want to make sure we are using the right statistics, but it's also a way to make sure that we are being fair across the board, and that we are controlling for things that we want to control for because when you want to see if a policy is having a disproportionate impact on African Americans or on women, you want to control for all of the other factors and hold race and

5. 401 U.S. 424 (1971).

6. *See supra* this text and notes 1 & 2.

gender out as the dependent variable in the study, so it is a matter of figuring out what we need to be controlling for so that all of those neutral non-suspect factors are the same for everyone, for example, with respect to creditworthiness.

When ECOA was passed in the seventies, it was focused on people who were being denied loans outright because of their race or gender. But as you know, the market has evolved. We have seen what's happened in the subsequent decades; reverse redlining and targeting people of color and Hispanics for subprime loans with particularly punitive interest rates and fees became more and more of a problem. And we can see the effects of this if you look at the height of the mortgage crisis in 2005 and 2006; blacks and Hispanics were more than twice as likely to be given subprime loans, even when they qualified for a prime mortgage. And in the United States Department of Justice proceedings against Countrywide, they had over 200,000 separate instances that their expert reports cited to showing how equally-qualified black and Hispanic borrowers, equally-qualified in terms of income, in terms of credit, were steered into these subprime loans.

And then the last thing I want to mention in my intro is about discretion. So, John mentioned the *Dukes v. Wal-Mart* case,[7] and that case, which dealt with a Title VII employment class action, said that if the only policy, the only thing that is holding your class members together, is that the managers of their respective stores all over the country exercise discretion, that's not enough, that's not enough "glue," as Justice Scalia put it, to hold the class together.

But that doesn't mean that excess discretion within a certain framework can't be a discriminatory policy that leads to a finding of disparate impact, whether that's under the FHA as in *Inclusive Communities* or under Title VII. There was a Seventh Circuit opinion in 2012 called *McReynolds v. [Merrill Lynch]*,[8] the investment company, which found that the company had policies that trickled their way down to the individual supervisors of these financial analysts. One of the policies was teaming. And this is an opinion by Judge Posner of the Seventh Circuit, and he said that the teaming policy which allowed financial analysts to form teams and work together and manage their accounts in teams, which they weren't required to do but it was permitted and that was a policy that came down from the highest levels of the company, led to a disparate impact because white analysts were more likely to team up with other white analysts. And there are lots of effects based not on overt discrimination but a sort of implicit and unconscious bias by people who will tend to work with people that they feel more comfortable with, more similar to, that was making it harder for black managers, of whom there were fewer, to find people who were willing to work with them in a team.

So, without spending a lot of time on the *McReynolds* case, it's a great illustration of how the fact that there is discretion being exercised at a lower level of a sort of pyramid doesn't preclude there being a policy that is at issue that can lead to a disparate impact. And we will talk more about that later when we talk about indirect auto lending.

So, I've gone on for a while and I want everyone else to have a chance, but those are just some initial thoughts regarding why disparate impact is important, why we should care about it and that statistics are not the enemy here. They help us to analyze how we're doing but they always have to be tied to a policy, that was true before the *Inclusive Communities* decision, and it's still true. You look at statistics in order to judge the effects of your policy. You're not looking at them in a vacuum.

IV. Opening Remarks of Jean Noonan

Though it may surprise many of you, I agree with much of what Karla said. As Larry pointed out in my bio, I spent the first fourteen years of my legal career at the Federal Trade Commission enforcing the fair credit law. I was the Equal Credit Opportunity Act manager, the manager of the enforcement program and it has always remained my first love in the law. We all agree, certainly on this panel and I suspect in the entire room, that disparate treatment is unacceptable, bad public policy, and illegal. That is not what we are discussing here, although I would suggest that when we talk about many of these disparate impact cases, we are really talking about disparate treatment cases, but let me come back to that later.

The original case of *Griggs v. Duke Power*[9] that Karla noted was a case in which an employer had a discriminatory history in hiring African Americans. That became illegal, and so they adopted another policy that had pretty much the same effect. It wasn't perfect in eliminating African Americans from its workforce, but it had the overwhelming effect of doing so. And it is that sort of subterfuge that was really what gave birth to the disparate impact theory in the case law. And when we look at Regulation B, which I take to bed every night and commend it to all of you for the same purpose, and we look at the special rules in Regulation B, all of them are grounded in the testimony that gave rise to the original ECOA, of ways that lenders and other creditors discriminated, maybe not by name, but they had policies that had that effect.

And so, let me note one of the clearest examples, except that it has become so outdated that it's hard to remember, because who remembers life before cell phones? Who remembers the White Pages? Who remembers that in the White Pages, there was a time when only one name was listed for the family landline? And it was almost always in the husband's name. If it was a woman who was living alone, she frequently paid to have an unlisted number for privacy. Or she used initials or something else that camouflaged the fact that the phone was listed in a woman's name. Well, creditors, especially credit card issuers in the early seventies, had policies of requiring successful applicants to have telephone

7. 131 S. Ct. 2541; *see supra* this text and note 3.

8. 694 F.3d 873 (7th Cir. 2012).

9. 401 U.S. 424; *see supra* this text and note 5.

listings in their own name. That was a big disqualifier for women, married women and to a somewhat lesser extent, single women. And what Regulation B says is, you cannot consider whether or not an applicant has a telephone listing in her own name. You can consider whether or not the applicant has a telephone in their home. How many people no longer have a telephone in their home? The younger among us say that's increasingly true. But this was a perfect application of disparate impact in the 1970s and the eighties and most of the nineties as well, before cell phones. Somewhere along the line, the White Pages figured out that they could put John and Mary's name on the line for the telephone listing and that problem pretty much went away. But also, before this went away, the ECOA took care of the problem for women credit applicants.

Okay, that is only one example. Questions about child-bearing, all of those issues, as we might understand, fall disproportionately on women. All of the things that were part of the testimony got written into Regulation B and those were the problems, the disparate impact problems of the seventies, and they were all grounded in overt discrimination, maybe not bad-intended. You know, Karla talked accurately about the stigma that attaches to discrimination. I might say, hey, it's easier for me to confirm that John Ropiequet has a telephone in his home by going to the White Pages and seeing his name, but if it's his wife and she's not listed in the White Pages, then it's harder and that's inconvenient for me. So there are other ways to do that confirmation that don't have the effect of illegal discrimination and that is the third step, isn't it, of disparate impact.

We talk about disparate impact a lot as having a disproportionate adverse impact on a protected group. And that is the first step, but it is only the first step. Let's look at creditors. Virtually every legitimate consideration that a creditor considers has a disproportionate adverse impact on a protected group. Income, assets, credit history, those are not things, as Karla pointed out, that are randomly distributed in our society. We might all wish that they were, but they are not. And so the next step of the disparate impact analysis is whether or not the creditor has a legitimate business justification for for it.

As a matter of fact, the CARD Act, you know, tells creditors that they have to consider the applicant's ability to repay.[10] During the 2004 – 2005 period, asset-based lending was rampant in the subprime world, causing people to get mortgages to finance houses that they could not afford. And the defaults were terrible. So creditors, forget about the legitimate business need for a creditor who is putting its own capital on the line to extend credit to have a reasonable chance of being repaid. It's not doing the applicants any good, either, to receive credit that they can't possibly repay or that they even probably can't repay. So that's Step Two in the disparate impact analysis: Is there a legitimate business justification?

And Step Three is, even if there is a business justification, is there a less discriminatory alternative? Now this is a tough standard. It was used originally in the employment cases for business justifications that were considered pretexts for discrimination. I'm going to require all of my ditch diggers to have a high school diploma. Well, why do you need a high school diploma to dig a ditch? Well, they might have to read instructions on how to use the shovel. Fine then, give them a reading test. Don't require a high school diploma. This was the court's way of knocking down these silly pretextual explanations for their business justifications.

That can be taken far too far, however. If I'm a creditor and I have my policies that through my own experience or through my statistical analysis are the best policies to predict risks, but Marsha can come up with a factor that never occurred to me that does an even a better job, Marsha, if you had only told me, I would have gladly used it. So when we ask creditors to say, well, you know, is there a less discriminatory alternative, that's a bit like saying be cleverer than you were. It's not the same as – although it should be and it always has been until quite recently – saying, oh come on, if that is really your business justification, there's something that does just as good a job like a reading test that doesn't have the same negative impact in its net effects.

So, how have we gotten from those very sensible rules to where we are now? Now I guess some members of the Supreme Court would not agree with me that those were sensible rules, but I think they are sensible rules. And yet they have gotten to the point that we have dealers who are pricing people slightly differently for reasons that we know of on a group level, because there's a lot of research on this, but we don't know the reasons on a transactional level. And it's adding up to sometimes rather small differences, maybe not even at that dealer, but in a secondary market portfolio. And the only policy that the consumer advocates or the government can point to is, the finance company that later purchased the credit contract let the original creditor set the interest rate with the consumer. But of course the dealer had the discretion to do that. The only discretion I have, if I'm the finance company or the bank, is to buy that contract, without any knowledge of how that contract got to be priced exactly as it was, only knowing that it was in a range that my policies say is acceptable over my buy rate. And the purchasers certainly knew nothing about any customer's sex or race or about the dealer's decision-making in pricing a particular contract and had no actual intention and no veiled intention to discriminate on a prohibited basis.

Karla mentioned one other thing and that is the social inequities. We do not all have the same wealth, the same income, the same quality of education, in some cases, the same extent of education, as these things are not randomly distributed. And the closer we can get to a fair, just, and equal society in these things, the better I personally think we will be. And there are things that the government can do and does do through tax policy and other ways, student loans and other things, to try to eliminate or narrow some

10. Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat 1734 (2009); *see also* The Law of Truth in Lending ¶ 15.10 (Alvin C. Harrell ed. 2014).

of these inequities, though it's been with mixed success, I think we would all say. So is it the credit industry's – the private credit-granting industry's – responsibility to achieve those equal outcomes, rather than individuals' or the government's responsibility? That can't possibly be the answer. It can't be put on creditors to extend credit regardless of creditworthiness, profitability, and other factors, *i.e.*, to treat people the same who are not similarly-situated as the law requires.

V. Opening Remarks of Marsha Courchane

I'm an economist. We can sum everything up with two statistics. So, the first thing I want to say is, this song kept running through my head as the other panelists were giving their opening remarks, something like "I have looked at life from both sides now, from win and lose, but still somehow…." And then the song goes on to talk on about an illusion which I think matters here.

For those of you that don't know me as well as you know Jean, though many of you do, I came into this in 1994. I was actually blissfully happy living in Canada where, of course, there are very few discrimination laws and certainly no fair lending laws, so you don't have to think about those things. And I came down to the U.S. upon request, just to look at fair lending, which I'd never heard of, in 1994. So I went to the Office of the Comptroller of the Currency (OCC), where they were doing no statistical analysis because they didn't actually have data to do it with and they were sort of trying to do what I guess lawyers did back then -- they had long yellow legal pads and they had columns of things and they would try to match up characteristics and sort of infer what might have happened.

So, it was great coming into this as someone who did statistics, thinking that there's a little value we can add here. And it felt that way for a long time. It felt like being an economist, working with lawyers to look at questions we all care about, was actually important. Not that it's not now, I will get to that. But as times changed, what I find has happened is that the use of statistics has really escalated, in questions of discrimination, and the law has plodded along somewhat slowly. So, we were talking about disparate impact at the OCC in 1999, and we finally get *Inclusive Communities* when, 2015, 2016? So it is fifteen, sixteen years later before the law changes, as Jean mentioned, and she should know because she sleeps with it and I do not.

I know, Regulation B is kind of nice. I have to agree with that. But in fact, those kinds of questions, those kinds of issues, people wanted to bring statistics to bear on them. I like that. After all, I love working, it's really been fun. But what I don't like is for statistics to be taken out of context, footnotes ignored, and other misuses of statistics.

Now, I want to say Karla talked about this as two questions: question number one, the moral issues about discrimination; and question number two, the use of statistics. For economists, the use of statistics is a moral question. We actually care a lot about how statistics are used. And the one number that flashed through my head as Karla was talking is in the Countrywide settlement, *e.g.*, that people are steered by X numbers into subprime loans when they could have afforded prime.

If you go back and look at that steering literature, there is a paper I wrote with a co-author at Freddie Mac in the early 2000s, which had a very tiny dataset and was very specific. And was qualified with what we as economists thought was a number of footnotes, with a few that would say this is applied to this dataset and cannot be taken out of context. That paper is cited almost more than any paper I wrote to show how bad the subprime steering was.

The other paper I wrote, on measuring APR differentials in discrimination, actually said we aggregated data across a number of institutions, you should not do this and this is not what you should do if you're looking at legal questions, because every individual institution might have their own policies, their own procedures, you should not look at this with aggregated data. In every discrimination litigation I am involved with, the other side always cites my paper to say that, in this paper, Courchane found a five-basis-point disparity aggregating across whatever spectrum, as proof of discrimination, even though all of the qualifiers are there. So, it is hard measuring discrimination. It was hard measuring it when it was questions of disparate treatment.

Now let's talk about disparate impact. Questions of impact are challenging in so many dimensions. The first of those, I think, is the historical background that we all look at in the United States. You are right, there have been overt, and many of them, instances of discrimination. I'm going to focus just on housing because that's the area in which I work. There have been instances of discrimination in housing, in allotment of vouchers, in neighborhoods, and inclusive restrictions on who can or can't live in a neighborhood.

I don't dispute at all that there is discrimination and has been discrimination. What I'm most concerned about here, and why I agreed to be on this panel today, is that you can't twist statistics to find discrimination. You can't say that, well, there has to be a business justification to justify what you've done using some standard that didn't exist back when you were making the policy. It matters how you use statistics, so every time either side here will talk about their point of view and why we should be looking at lenders for disparate impact and how we would use statistics to measure that, I'm just going to jump over both of them and say, you can't do it that way. It just doesn't make sense. It's completely wrong or it's biased.

So, my favorite example and the one that I want all of you to keep in your minds this afternoon is this: How many of you know right now your credit score? How many of you know at least within a range of fifty points your credit score? Okay, so we have everyone here knowing your credit score. How many of you know that if you plot distributions in any sort of metropolitan statistical area (MSA) in the United States, credit score distributions are not uniform across race and ethnicity groups? They're simply not.

Okay, so let's agree to this: The three standards by which mortgage lenders

would have judged creditworthiness through the early 1990s up until the subprime crisis, when the standards were loosened for reasons we won't go into today, were, first, the loan-to-value ratio, how much money can you put down. In the U.S., that used to be twenty percent as a requirement with the establishment of Freddie and Fannie, among other things. You could take out mortgage insurance to protect the credit risks for those who had less money to put down and loan-to-value ratios crept up to, say, ninety percent. With the Federal Housing Administration, FHA loans, they crept up to 95 to 97 percent. No one questions the fact that the more money you have to put down is correlated with your wealth, your assets, and your income. Those are not distributed uniformly. There is an impact if you look at loan-to-value ratios. That's given.

The second criterion one looked at was credit-worthiness. So this is the early nineties. FICO didn't have a lock on the market and so one would look at things like public record items, bankruptcies, you know, poor credit, bad payments on department store credit or finance charges, things like that that were not distributed equally. So if you look at a credit score now, the sort of standard for the summation of your credit history, that will have a disparate impact, there is absolutely no question.

And the third variable was the debt-to-income ratio. Well, if you have a lot of income and a lot of wealth, it's actually relatively easy to keep your debt-to-income ratio low. And if you're scraping by, it's quite difficult. You actually need to finance different things over your life cycle like loans or medical bills or putting your children through school and those debt-to-income ratios are not uniformly distributed around the population, across races, ethnicities, or the other protected classes we haven't been talking much about. So, there will be an impact. Now my question is, given that if it turns out that *Inclusive Communities* gets more broadly applied and Regulation B changes or whatever legal thing you need to change to get Regulation B to change, what can you do about it?

One thing Karla recommends, or has talked about in her comments and I'm just relating them to the conclusions, is whether you can be proactive to make sure that your neutral policies do not have a discriminatory impact. Well, let me talk about a little part of ECOA that Jean didn't, which is, as a modeler, you are actually not allowed to use race or ethnicity in your modeling efforts. You can't put in race dummies, you can't put in ethnicity dummies. Even if you knew the BISG (Bayesian Improved Surname Geocoding method) vectors, you can't use them to build a model that predicts risk. There is nothing you can do to include that under the current standards.

So, you're winging it in building this credit model in trying to come up with your policies, models, and procedures that mean you are trying to be as neutral as possible, given that you're loaded with a pile of variables that might predict risk but we all can imagine have a disparate impact. So, you are sort of between a rock and a hard place and the question is, how do you do the best job you can?

The best modeling job could be done, absolutely, by taking race and ethnicity up front as control variables when you are building these models and actually measure whether or not the number of tradelines or the number of inquiries or the number of bankruptcies is highly correlated with race. Or the number of phone lines in your home or the number of insurance policies. If I could use that information, I could build a model that has less of an impact, but I can't use that information. Could I do a better job of measuring discrimination if I knew race and ethnicity? Yes, you could, hence the result in the mortgage world, where we have race and ethnicity. But we don't have that for credit cards, student loans, auto loans, indirect auto credit, or anything else. So, collect it. You know, as economists, we want good and clean data and we love to build models that actually address the socioeconomic issues as well and as fully as we can.

But that requires actually having real data that might measure what it's supposed to measure. I personally would come down and say that the proxies we are using right now for that measurement are horrific and we need to do better. How would we do better? We'd actually use the data to build better models that looked at those correlations. But we can't.

So, I think the discussion today is not only about whether disparate impact is legal or not, but, if we are actually going to assess liability based on that theory, how will we measure it? How will we measure disparities? How will we assess damages using very flawed models and very flawed data? And that's what I'd like you to keep in mind, knowing that to every single decision and discussion here, I'm going to be appending a footnote saying that you can't do that, that those statistics don't make sense. Or if they do, I'll say that as well. So I am only here as the economist devil's advocate to either side of this discussion. Keep that in mind. It's a pleasure being here, thanks for letting an economist crash.

VI. Panel Discussion – Question One

A. John Ropiequet

At this point, I am going to start throwing out some questions to the panel. So here is the first one: Is there a real problem with discrimination against minority customers for mortgages, auto finance, and loans, or are we dealing with a problem of a statistical artifact, particularly where, unlike some of the employment cases that we talked about, that the disparate impact idea came from, there is no history of intentional discrimination or subterfuge for intentional discrimination.

B. Karla Gilbride

Well, I will start with the last part of your question, and I'm not going to spend a lot of time on this because I think we have a lot of consensus among us up here that there is a history of overt discrimination and subterfuge in the housing market and the mortgage lending market and basically everything that you said, to the extent that it's been studied.

I will just give a couple of examples aside from the evidence of redlining,

where you can draw a map and show, you know, where loans were being made and where loans weren't being made and that correlated with the large concentrations of people of color and ethnic minorities in a venue. And you also have evidence that comes from testers. You know, testers going in asking to rent a unit, being denied when it was the African American tester. They have done the same thing on the basis of disability with deaf people going in, people with other disabilities going in, being denied, no, we don't have any units available. Then the white person or the person without a disability goes in and all of a sudden, miraculously, there are units available or they are quoted different prices. The same thing has been replicated with regard to auto lending, with testers going in.

And one of the things I think we are going to talk about, or I will just start talking about it now, is that, you know, what auto dealers are reacting to and the reasons that you have different levels of markup by the dealership and it tends to adversely impact minorities isn't because of any sort of discrimination, but it's because some people are better at bargaining and maybe the person who winds up getting the lower rate, they have shopped around more, they have more competitive offers that they bring to the table, and, you know, maybe there are people who have more of a history of bargaining and of negotiating because they learned it from their parents or whatever reason. And that tends to be truer of more educated white men than it is of women and minorities.

Well, these testing studies control for that by having people go in and say all the same things and try all the same negotiation tactics, mention competitive offers and the like, and still you find that black and Hispanic testers are quoted higher rates, less favorable terms than white people are. So it continues to happen. And why does it continue to happen? It's a complex answer to that question, but certainly there is demonstrable evidence that similarly situated people are being treated differently. And again, that's disparate treatment, that's not even disparate impact.

But where you have not only a history or a legacy of disparate treatment, but disparate treatment that is ongoing to this day, I think you know the premise of the question that maybe this isn't a real problem is something with which I quite vigorously disagree. So, yes, I think it's a problem. And one other thing I want to just focus in on a little bit about disparate impact is crafting policies so, you know, we go through this three-step process which Jean described very cogently. There is the first step of assessing the impact of the policy with, usually, statistics and Marsha will tell us that whatever statistics we use are wrong.

And then the second step, and this is typically the defendant's burden when this comes up in litigation, is explaining the business justification and saying this is the rational business purpose for which we have this policy. It's managing risks. It's assessing who are going to be the most creditworthy applicants. And then the third step is whether there is a less discriminatory alternative to achieving that legitimate business purpose, assuming that that is a legitimate business purpose.

So when we walk through that three-step process with regard to these policies that really involve giving a lot of discretion to the ultimate decision-maker, what I would like to hear some people, my co-panelists, addressing is, what is the legitimate business purpose? Because I can think of lots of less discriminatory alternatives to just handing discretion to the end-of-the-line person with very few controls in place, but it's not happening, especially when you are looking at something like the auto finance market, where the buy rate is being set and this already factors in credit risk and a lot of the financial ability-to-repay factors, so they're already controlled for across the board. What is the business reason, recognizing that discrimination is very likely to result from allowing discretion above and beyond that point?

C. Jean Noonan

Ok, I'll address these points, Karla. Let's take auto finance, for a moment. I am going to be an auto finance company. I don't have desks in all of those dealerships to do direct loans, to finance the purchase of vehicles. So I'm going to be buying contracts that dealers have already originated and I can't make any money as an auto finance company unless I buy contracts, that is, unless dealers are willing to sell me their contracts. And if I'm a "captive," that's all my business is, so if I'm the captive finance company I have no choice but to buy available contracts. But even if I'm a bank or a more general finance company, I need to buy credit contracts.

Dealers own these contracts. They want to be paid for them. And it becomes a bit of an auction, doesn't it? Dealer A says, "I have marked this contract up 200 basis points over your buy rate and I know you will pay me eighty percent of that differential for my contract." That payment is probably more important than what the ultimate consumer's rate is.

Dealers sometimes will try to get the lowest rate for a consumer because they want to make the consumer happy. But the most important thing to the dealer is the margin, because as Marsha has pointed out in some of her literature, dealers don't make any money these days on the sale of new cars. They make a little bit of money on the sale of used cars, they make a little more money, and we're not talking about rich fortunes in many cases, in the servicing. And if anyone has taken your car to a dealer for servicing recently, you know that there is some markup there. And finally, they make money on finance and insurance.

To keep their doors open, they rely on the income from the sale of these credit contracts to finance companies and banks. And to its credit, the CFPB recognizes that dealers perform a valuable service and they are entitled to be compensated for their efforts to originate these contracts and sell them. So, the dealer is looking at this: Here is my captive, here is my bank, here is another finance company; all three will buy these contracts; I have also gotten positive responses back from DealerTrack or Route One. They will buy these contracts; now, which is going to be the most profitable deal for me? And the dealer will choose that alternative and sell the contract to that financing source.

Now, in the hypothetical that I just gave, the dealer already had priced the contract before it was sold. And sometimes that happens. Spot deliveries, especially on the West Coast, can be a majority of the transactions. Sometimes they wait to price the vehicle until they get those bids back from the finance companies on DealerTrack or Route One. And they say okay, this finance company will buy the contract at this rate, this one will buy it at a slightly lower rate. If the compensation to me is the same, I'll do the lower rate (because that helps me make the sale), unless there is some incentive that someone's running that will cause me to want to give more volume to another channel. This is all about secondary market transactions and that's what's going on. Dealers want to make the most money they can on every deal. That is not an immoral position. And they will sell the contract to whichever financing source that they have, if they have multiple offers, that will best meet their business needs.

D. Subsequent Colloquy

1. Karla Gilbride

The legitimate business reason is maximization of profit, right?

2. Jean Noonan

Yes.

3. Karla Gilbride

Okay, are there less discriminatory alternatives that would also allow dealers to maximize profit? I mean, I think there probably are.

4. Marsha Courchane

Well, it is a little hard finding them up front, however, when we can't actually measure for that, because there is no data we can look at as we are building that model to find that out. So, it's a great theoretical question.

5. John Ropiequet

Marsha, hasn't the CFPB come up with a method to measure that?

6. Marsha Courchane

The markup?

7. John Ropiequet

Yes.

8. Marsha Courchane

Oh, measuring markup itself is easy. I mean, you know what it is. I actually thought Karla was going to go down a different path, which is, would you bargain better if you actually knew what your markup was and I think that's probably true.

9. Karla Gilbride

I was holding that for later, but we can go there.

10. Marsha Courchane

So, the measurement of markup itself is straightforward. You know that, you can do that. I was going to go down this path, which is, Jean gave you what happens today. So in the auto finance world, this is what happens. There are these third-party vehicle dealers; of course they want to maximize profit, and there's lots of ways they can do that.

Are there less discriminatory ways, Karla? Maybe, because they don't have to have the markup to make money. They could up that servicing cost, they could also include more add-ons, you know, all those little things that dealers use to pump up the profit -- so I don't know if you have bought many cars but you know how some dealers throw in everything? So you get four years of all of your service and all your stuff and in some cases you are still paying pretty much for your windshield wipers. The dealers can reprice everything. Autos aren't simple to price or look at because the dealer is there for the life of the loan, often. They do service your car, they do buy you parts, they do everything.

It's not like mortgages. Mortgages are clean. You sell the house, or you're the lender, or you're the broker, it doesn't matter; afterwards, you are out of the game pretty much. You don't call the consumer a year later and say, do you need a new roof? Shall I provide some maintenance on your house? You're gone.

11. Karla Gilbride

They do say, "Do you want to refinance?"

12. Marsha Courchane

Not necessarily. Everybody says: "Do you want to refinance?" Not necessarily that same lender. But the point is, they are generally gone.

In autos, it's like a balloon. You push on this little piece of markup and the price goes somewhere else. It goes into add-ons or it goes into insurance, or it goes into servicing or something. I don't think this one's going to be statistically easy to measure, because while there is consensus in litigation, seemingly, on mortgages that they'll quote an all-in price of the mortgage as the APR, there is no consensus in auto finance transactions about what the all-in price of an automobile purchase is. And the markup is just one little dimension. So, I don't think it's simple.

E. Karla Gilbride

I was just going to make two quick points about that before I forget them, about the differences between mortgages and auto finance. And one of them, you alluded to already, is disclosures and access to information. I think to some extent this is what is accounting for these differentials, *e.g.*, some people are better negotiators or tend to take more time because maybe they are not so desperate, they don't need the car right now, so they have time to kind of walk around and assess all their options.

Providing more information and breaking up the offer into its components would be one way to address

this, whether you price it by trying to maximize profit by insurance products, add-ons, all that sort of thing, having it be an a la carte menu where people can pick what they really want and what they need. And I think a piece of that is what you said. So instead of just telling people okay, good news, I can finance your purchase at eight percent, break that down and tell them how much is based upon their credit and the buy rate that's coming from the shopping around of the finance companies, which is probably the best that they are going to get anywhere, versus how much is the markup that is being done at the dealership level, so people can factor that into their decision.

But the other thing that I wanted to take a step back and point out is that we are talking about whether this is a justifiable business practice, to allow this markup, and to use it as a kind of competitive tool in the marketplace. We used to do that in the mortgage space, too. We used to have yield spread premiums, but we don't have them anymore because of the disparate impact that those were found to have, because it led to upselling and trying to take advantage of people who were often the most vulnerable, which correlates with these protected traits.

F. John Ropiequet

Was that a discrimination problem or was it a taking-advantage-of type of problem, a consumer-fraud type problem, a UDAAP problem?

G. Karla Gilbride

I would say it's both. When you see how many more minorities are being marketed at subprime loans, I would say it's both.

VII. Panel Discussion – Question Two

A. John Ropiequet

One of the things that we haven't really delved into yet is the proxy methodology, using indirect evidence of discrimination, statistical evidence of it. Are there any flaws with that? And given the state of the art that we have for proxy evidence and the enforcement agencies' use of it, how can a consumer finance company predict whether they are or aren't crossing the line into illegal discrimination? And what can they do to prevent discrimination?

B. Jean Noonan

Well, this is really a Marsha question, but let me make one comment first. With disparate impact, we have two potential problems outside the mortgage area. We have the problem in all transactions of whether or not disparate impact is being properly applied, the business justification is being considered, and so forth. Outside the mortgage situation, we have this additional problem which may swamp everything else, and that is, are we even categorizing people correctly? Are we, based on their name and their geography, accurately identifying them? Because if we have errors in that, how can a ten-basis-point difference mean anything? So, Marsha, are there any errors in the proxy methodology?

C. Marsha Courchane

This is such a softball question that I am going to pass until Karla speaks and then come back to that. As you might know, if you know anything about this literature, certainly I am on record as saying the flaws are enormous and adjustments have to be made for those flaws. The flaws are known. The flaws are known by us and by the CFPB and by regulators, but no adjustments are being made right now for the flaws. And I have a couple of small suggestions that I'll turn to after Karla has a chance.

D. Karla Gilbride

Ok, so are there flaws? I'm going to agree with you and say that it's not a perfect system. If the goal of the system is to be a one-to-one correspondence and mapping the proxy onto race and whether someone is of Hispanic heritage. If that – if you want a hundred-percent certainty that you're measuring it – then you're right, we don't have that.

But, I would say two more things. First of all, it's a proxy. We know it is not the data themselves and we can talk about whether that's a problem, that we don't have the data, but let us just live within the reality that we currently occupy. So, it's going to be imprecise, but how close is it and is it tracking -- are there going to be exceptions? Where someone has the last name of Rodriguez but they are not of Hispanic origin, or someone has the name Smith and they are of Hispanic origin?

Sure, there will be exceptions. But we are looking at probabilities. And probabilistically, the methods -- so I guess I'll stop and you can talk about this in more detail, Marsha, because you are able to talk about it, you know, more precisely than I can. But I know enough to say, about the proxy methodology that the CFPB uses, that they are using a combination of geographical data and surnames. It's all census data and we do have racial information from the census of people self-identifying as to their race and we match that up to where they are living. And the surnames come from the 2010 Census, and the most common surnames that are matched up, again, with people's self-reports of their race or ethnicity on the 2010 Census.

So is it accurate? You know, I've heard the number ninety percent, but basically, does the probability that you are black or Hispanic based on this data correspond to or increase in the same sort of linear relation to the probability that you are going to be given less favorable credit terms? It's not going to be that there aren't exceptions, but are the probabilities going in the same direction? And for that, I would say yes, and because the probabilities go in the same direction, I'd say that it accomplishes what it was intended to do.

E. Nessa Feddis (from the Audience)

Just to get in the thread, my name is Nessa Feddis. Now try to figure that ethnic origin. And I am with the American Bankers Association. Regarding your point, you said earlier that discrimination is such a loaded term. And you are going

to accuse somebody of being a racist on a probability that Marsha is now going to address. And that was the question; it's one thing to say, let's look more closely based on some data that might indicate it, and another thing to actually accuse somebody based on flawed data.

F. Karla Gilbride

I'll be very, very quick and then turn it to Marsha. But again, we are not saying that you are being a racist. That's what I was trying to decouple, those two things. We're saying that the policy has a discriminatory impact and that is going to deal with statistical probability by definition. And so once we do that, we need to figure out the best proxy that we can if we are not going to get the data themselves.

I would ask, and this is a good segue to Marsha, what should we be doing differently? Because I agree, we want to be as close to accurate as we can because this does have consequences. We don't want to be wildly inaccurate, but I think the proxy that has been used by other agencies, it's been refined over the years to try to be more precise than it used to be. And in that sense, we are just moving along a continuum here to get better, but it's probably not going to ever be one hundred percent accurate.

G. Nessa Feddis

That's a little unfair, because between press and social media, it doesn't matter that the people in Washington or in one of those white buildings say, well, we're not calling you a racist; everyone else is, but don't mind them. That doesn't help your business and it doesn't help people personally.

H. Larry Young

I want to go back to what Karla was saying about how a less discriminatory measure might be for the dealer to basically disclose all the components of the deal, including the spread over the buy rate.

What occurs to me is, we have a conflicting regulations issue here because I assume as a corollary the dealer would be saying: Well, the buy rate is this but our contract rate is two points over that. And yes, we can eliminate that, but we will have to raise the price of the car otherwise. And I assume if that occurred, then Karla would then be bringing a lawsuit based on a hidden finance charge under Truth in Lending. So, I wonder how you would address that?

I. Karla Gilbride

Well, I would say that it's very different if it's a negotiated term because it's not a hidden finance charge. If it's something that takes place, now, you have certain written disclosures that would guard against the kind of he said/ she said after-the-fact battle over what took place, whether there were facts or deeds that are off limits. So you would just have a written disclosure that breaks everything out. But I think that pricing the car and the add-ons separately is okay, as long as you're doing it up front and it is part of the overall contract. Of course you want to be looking at other legal liability that you might have, but it's something that, again, opens up other options at the dealership level to guard against the unbounded use of discretion.

J. Marsha Courchane

Okay, I am going to respond to only two parts of this. One is the first, as to which Karla is technically correct. Namely, that the BISG – the Bayesian Improved Surname Geocoding method – looks at your last name and where you live. That's how they determine your probability.

Each of you in this room will have six probabilities and you are assigned a probability of being Asian or African American or Hispanic or Non-Hispanic White or Pacific Islander or whatever. So there are six probabilities that each of you get. The next factor looks at where you live. But that threshold of where you live can be interpreted differently. You can live in a "minority" census tract that is 50.49 percent minority and be labeled as living in a high-minority census tract. It's a coin flip. It could be a difference of five people and labeled a high-minority area.

The next number that I heard Karla say was: I've heard it's ninety percent something. But neither of these thresholds get applied at ninety percent anything. So, once you look at the majority probability of living in the tract, there's no agreement among the agencies over whether a majority tract means fifty percent, seventy percent, ninety percent, eighty percent, or anything. There's no agreement yet. For example, the FDIC in a recent matter I was working on didn't use the BISG at all. They only used surname, not where you live. So there's no agreement on these issues.

Number two, based on the probabilities of your race and ethnicity, the CFPB, at least recently, and Jean has a number of these cases also, isn't using some threshold such as you are a minority if there is a ninety percent vector. So, for example, if there are a hundred people in this room and you each have one one-hundredth probability of being African American and I add you all up, there is said to be one African American in the room. It doesn't matter if none of you were measurably more than one one-hundredth African American or Hispanic or anything, you are added up and there will be a resulting count. And you know this; everybody knows this. When we apply these vectors, you can count how many people were added up from actual probabilities of less than ten percent. So you just take the room, and you add up these people, and you have this count of "minorities" where everyone in that count might be less than ten percent minority. Or odds of being minority. That's flawed. I'm sorry, but that's just a flawed measure. So could you apply threshold effects? Yes, but they don't. Could you actually verify first? Yes, you could, but they don't.

So, going on to the point about the bad press, how about this as an outcome? When you are deciding that there's going to be a settlement with the regulatory agency and you are announcing how many millions of dollars that lender is on the hook for, or that finance company is on the hook for, we don't splash that around the pages of the newspapers unless we identify the actual minorities, who then have to be verified by some

mechanism. If you are among that measured group who have been identified, what were the actual disparities ex post once I know what they are, and what would that dollar amount be?

This isn't what happens now. If you want Ally to be an eighty-million-dollar settlement, how many months did it take to even start giving out the Ally money? They couldn't figure out the methodology. But the announcement of the settlement predated that by over a year. So unless the CFPB is simply trying to make headlines, what I would recommend is to take a more cautious approach. Root it out, certainly, if there's discrimination. I am all about full disclosure also, so I don't disagree with you on that, but let's not put the headline out there until we actually measure the damage that might have been inflicted on the borrowers who truly might have been a protected class.

K. Chris Peterson (from the Audience)

My name is Chris Peterson. I'm a law professor at the University of Utah and also an advisor in the Director's Office at the Consumer Financial Protection Bureau. But I'm only asking my question in my individual capacity.

It seems to me that Congress, and the Federal Reserve Board of Governors before it, banned yield spread premium compensation in the mortgage market because, one, it's an untransparent method of pricing mortgage loan interest rates and two, because it's structurally amenable to both intentional and unintentional discrimination. And since Congress banned it and the CFPB implemented that ban, the mortgage market has been better off for it. Everybody, all the mortgage officers, all the mortgage brokers, are still getting paid. Loans are still getting originated and the claims of discrimination in the mortgage market have largely, at least with respect to that particular feature, started to subside.

So my question is, why don't the trade associations that represent the banking industry and the car dealership industry unilaterally join together and have a voluntary best practices that phases in gradually the elimination of dealer markups in the car dealership market, because I think that you probably get some good press from that. And who knows, maybe some of the investigations and the litigation would go away.

L. Jean Noonan

Let me ask Chris something. Chris, Nessa has said it's called antitrust and that is, you know, getting together to collude to set prices and that is not something that any of us would want to be doing. Why not have the CFPB do a rulemaking that sets a standard for everyone that we can all comply with? You can come back to the mic and tell us.

M. Marsha Courchane

I want to say one more thing in response to Chris. If I heard you correctly, you said that banning yield spread premiums necessarily led to everything being better off in the mortgage industry, so why don't we do something like that? I don't mean to use the word "everything" out of context. But, the rule change that hit the mortgage markets really said that what we're going to do is to be clear about whether closing costs are lender-paid, or whether they are borrower-paid, and whether or not they're payments from lenders to the brokers.

One big outcome of that change has been that the wholesale mortgage market share of the mortgage market has drifted to levels incredibly below what they were before. So the wholesale market has been seriously impacted by that rule change. People don't want to deal with brokers any more. They've closed entire wholesale divisions. So these are outcomes that impact the access of consumers to credit. They are not just all rosy outcomes that say, *e.g.*, full disclosure means everything got better. Instead, it means that a part of it has had a direct impact on the wholesale market itself.

The same thing could happen here. Instead of an auto finance system where you go to your car dealer and you look at, buy and finance your car, everything could be shoved right into the buy rate and then everyone's going to have to go to their bank and separately negotiate their car loan before they shop. That is a potential outcome and it's one that might be addressed with a rulemaking.

N. Karla Gilbride

Well, I think that it's not as simple as saying that everything has to go into the buy rate. There are other ways that you can still have something happening between the finance company and the end point dealership that is different from what we have now. Because what we have now, and let's just leave to the side the statistics and the proxies because we're not going to agree, is not just the CFPB in enforcement actions but other people studying this from academia have found that there is a disparate impact with the status quo and it's traced to the policy of having a set buy rate and then this sort of dealer discretion above and beyond that of the markup up to a cap.

So what you could do is, first of all, limit the dealer's discretion, still have the discretion, but cabin it, right? You can have more controls being placed, not by the CFPB, but by the lenders, by the finance companies, to sort of act as checks up front; to guard against discrimination, to put those brakes in there to prevent the exercise of discretion from having the effects that, if left unchecked, we can expect it to have. Or you could just say, instead of going 250 basis points, you can only go to 150 or 100 because when you reduce the amount of discretion, you will reduce the magnitude of those effects.

You could have a flat rate above the buy rate that dealers can mark up, but it has to be the same across the board. Now, that's going to disadvantage people who otherwise would get a better deal, because now that better deal won't be available to them. And you could build that back in by maybe structuring the loans -- we talked about add-ons and other products that people can take or not take. And another way to do that would be to look at the other terms of the credit, *e.g.*, the ratio of the financing to the cost of the vehicle. There are other pricing models that haven't been tried because we have

just been stuck in this one-size-fits-all model of dealer markups. And we could at least find out whether these alternatives would have a less discriminatory impact.

O. Jean Noonan

Let me say one thing there. Those are all interesting ideas that might make things better. The problem we have is a transition problem. I don't think I have a single client who would mind paying flats. They know, however, that if today they would start paying only flats, they would see their market share get eviscerated. The economists here have talked about how easy it is for a dealer to shift its finance sources. It's the sort of the thing where one can see one's market share disappear in a matter of days, weeks.

P. Marsha Courchane

A month, anyway, but it has disappeared. A couple of the early movers to flats lost virtually all of their market share in the first couple of months after moving to flats. That's correct.

Q. Joseph Rodriguez (from the Audience)

My name is Joe Rodriguez. I'm with Morrison & Foerster. So, I have a couple of questions, and lots of thoughts on this. Prior to Morrison & Foerster, I was the Southeast Regional Counsel in the CFPB's Office of Fair Lending. Karla, I think you must have joined just as I was leaving the CFPB, so I'm sorry we never had a chance to work together.

First, some thoughts and questions about developing business justifications and best practices and all that. When I was at the CFPB, a part of my job was to evaluate those justifications that companies were submitting, to work closely with the economists. Some justifications were very robust, but some quite frankly were not. Now that I'm in private practice, I work with clients on developing those. And I have some thoughts about what best practices are and methodologies for developing them. But I would love to hear from the panel and get your viewpoints on that.

Secondly, a question about *Inclusive Communities*. I would like to get the panel's view. To me, the case largely reiterated the law and spoke about the need to have causation, but things like that had been set forth previously in cases like *Watson*. I didn't really see it as changing much, maybe raising the bar a little bit. And I think there is some good language in there about lenders being able to conduct their business. But, I wanted to get your thoughts about that as well, and whether you view *Inclusive Communities* similarly or thought that it did in fact actually set out a different standard than we've seen in the past about what it takes to develop a business justification.

R. Jean Noonan

I would say that *Inclusive Communities* set out a pretty good standard for what I have thought the law was. And so, in that sense, it's not a sea change. The sense in which it is a sea change is that it's a different standard than what the agencies and many class action lawyers have argued that the law was. I talked to your former boss, Joe, about this, not long after *Inclusive Communities*, and she dismissed all of that as dicta in the opinion, suggesting that the CFPB was not going to be bound by it. So, that's my answer to your question.

S. Marsha Courchane

I'll take a shot at the first part of Joe's question, which is the business justification part. It is, I would say, rare that when we look at policies and procedures, they ever lay things out as clearly as I might like. And I still believe in file review. I still believe in looking at whether the model did not predict that, it predicted something exactly the opposite. If so, explain to me what happened, I must be missing something. Please talk to me, and the answer will be it's just, you know, we've done this a lot, we've been in the business a lot, it's our gut reaction. I never, ever, want to hear that phrase again.

I want the explanation to point to something else. So, you cannot, I think, underestimate, and I don't think Karla would disagree with this, the importance of a full and complete effort to understand what has happened and why it might have happened and how to prevent it happening again. And I think that's a service you can continue to provide to all of your clients. There is no, and I think I can say "no" pretty clearly, set of policies and procedures that I have looked at over twenty years, and I look at a lot of policies and procedures, that are as precise and clear and forward-looking as I might want. It used to be the case that a disparate impact analysis required you to look at actual performance data, so you can't look at what the impact of the model outcome is without knowing how the loan is going to perform.

The secondary market makes that difficult in some sense because you might be the originator, but you don't actually have the performance data. You sold the contracts. And it becomes very difficult to link the relevant factors - well, the business justification is because the loan will perform better if I do X - when you can't measure performance, because there's a separation of those factors. In the mortgage industry, they are trying to address this partly by carrying the same loan identification number through the entire transaction from origination to servicing to whatever, so you might be able to better measure that. There's nothing like that in the auto industry.

The other thing I would say is that it's easy to talk about auto finance right now because BISG popped up in auto finance. But these issues of disparate impact really have to be looked at across all dimensions. As I was telling Karla beforehand, department store credit card rates are still thirty percent even if you have an 800 credit score. That's a whole lot higher than an auto loan rate. Another example that always troubles me, if we are talking about socioeconomic history and education, is the fact that federal government interest rates on student loans remain several hundred basis points above prime. But nothing gets done about that. That's kind of a markup in my mind. So

there are lots of things we could talk about. I'd like to talk about it before the headlines occur, not necessarily after.

T. Karla Gilbride

A couple of comments. First, on *Inclusive Communities*, I agree with what Jean said. I agree that the holding and the thing that everybody was waiting for from that case and why the issue went up two other times previously, was that disparate impact claims are cognizable under the Fair Housing Act. That was the holding of the case.

And when Justice Kennedy walked through the reasons why they're cognizable, looking at the legislative history, and the amendment of the FHA in 1988 in light of all of the federal courts of appeals that had found disparate impact claims cognizable, I think all of that really could be ported over directly into the ECOA context and they would all apply. So I think that's very instructive as far as that goes.

The second part of the opinion, while it wasn't necessary to the holding, also didn't break new ground. It repeated a lot of the cautions and factors in terms of the three-part test that have existed under Title VII disparate impact case law for years. So I think it did basically track the existing law. And I think that what was interesting or surprising, if anything, to me about the opinion was not saying anything one way or another about the intervening HUD rule that had been enacted while the case was working its way up through the courts.

And then to turn to the issue of training, I completely agree that training in this area, particularly just making people aware of the factors that they may be considering, whether they are conscious or unconscious and that the broader context in which these transactions are taking place, makes a ton of sense. I also agree with being proactive, the last thing that Marsha said, which is let's not wait for the headlines, and I think if I can channel Brian [Kreiswirth] from the CFPB, who is not here, he would agree that the CFPB is doing a lot of things and if finance companies can take this on and be proactive and monitor their own compliance and get out in front of these issues before it becomes an enforcement action, then the CFPB can devote its resources to working on other things.

And I also agree with what Marsha said - we're agreeing on a lot - about other sectors where we need to be looking and not just focusing exclusively on auto finance. But I think, again, it does require the use of imprecise statistics to measure your own policies and the impact of your policies, but that doesn't mean it's not worth doing because you'll learn what the aggregate trends are and you can start making corrections to address those. And it is helpful if you can show that you're doing that before the disparities become large -- when it's a little disparity, it's a lot easier for you to address it directly and it's less likely that the enforcement agencies are going to start paying attention to you, than if you leave those things to go on for years and become big disparities.

VIII. Panel Discussion – Question Three

A. John Ropiequet

Rulemaking was mentioned. At this point, what we have is the CFPB announcing after the fact that people have violated the law through the mechanism of complaints and consent orders. Is that fair? Or should it be done through rulemaking?

B. Jean Noonan

Well, I think what ought to be done through a rulemaking is to set a standard that would go into effect at one time for pricing, if we are going to change the way auto contracts are priced, bought and sold. In an extremely competitive and dynamic market, we all have to have the same rules that go into effect at the same time so we don't become the person who says: "I'm going to have my own best practice and go out of business, good for me." And so, that's the point of rulemaking for me, is to be able to have a standard.

Now, I know why the CFPB, at least I think I know why the CFPB hasn't done a rulemaking here. The auto dealers are very opposed to a rulemaking because they are concerned that the change that the CFPB might impose through rulemaking would hurt their business and that could lead to protracted litigation over the rulemaking with an uncertain outcome. And so the CFPB has tried to do it through orders, and that has been with pretty mixed success. And what every company right now has to look at, if they are facing a CFPB order, is the hundreds or thousands of banks that are out there that are still happily going along with their two-hundred-basis-point markup. So, you know, Honda and Toyota are not competitors with each other. It's all the banks that are offering dealers more and potentially eating into their market share.

C. Subsequent Colloquy

1. Karla Gilbride

I agree you have a collective action problem or free rider problem, whatever you want to call it, with nobody wanting to stick their neck out. And…

2. Jean Noonan

And lose their business. It's not just courage here to stick your neck out, you know.

3. Karla Gilbride

Well, that's the thing. If everyone stuck their necks out simultaneously.

4. Jean Noonan

In an inclusive way?

5. Karla Gilbride

Right, if everyone volunteered. And you can say it's fear of antitrust if you want, or you can say it's just, hey, I'm going to get the advantage. If I don't have to comply, I won't, and I'll hold out and do what's best for my company's bottom line. And that's why sometimes you need, even if people know what's in their economic self-interest, an outside regulator to give them the impetus to do

it simultaneously and to the same degree. Otherwise, with market forces, people are going to see what advantage they can get.

6. Marsha Courchane

I am just going to say that even HMDA, which we have all known and loved since 1994, went through a series of focus groups, a series of conversations, lots of back-and-forth on the rulemaking and took X years to actually implement the changes to an already existing regulation. That should have been done here. Something should have been done other than announcing a new methodology in 2013, and then applying it to what companies did in 2011.

So, forward-looking, I'm all about planning forward. But if it's antitrust, can I just say Charles River actually has a fantastic antitrust practice. Just call us, and I'll get you to the right people. Thank you.

IX. Conclusion – John Ropiequet

All right. With that, I want to thank our panel and audience for participating and contributing to this program and article.