TESTIMONY OF

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SUBCOMMITTEE ON THE

CONSTITUTION, CIVIL RIGHTS, AND CIVIL LIBERTIES

REGARDING

"PROTECTING THE AMERICAN DREAM, PART II:
COMBATING PREDATORY LENDING UNDER THE FAIR HOUSING ACT"

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Introduction

Thank you, Mr. Chairman, for the opportunity to testify this afternoon before the Subcommittee.

My name is Roger Clegg, and I am president and general counsel of the Center for Equal Opportunity, a nonprofit research and educational organization that is based in Falls Church, Virginia. Our chairman is Linda Chavez, and our focus is on public policy issues that involve race and ethnicity, such as civil rights, bilingual education, and immigration and assimilation. I should also note that I was a deputy in the U.S. Department of Justice's Civil Rights Division for four years, from 1987 to 1991, and that during part of that time I supervised the Housing and Public Accommodations Section.

I would like to make four points in my testimony today, Mr. Chairman. (1) It is, and should be, illegal for lenders to treat people differently on the basis of race or ethnicity (in my testimony today, I am going to focus on racial and ethnic discrimination, although of course of the Fair Housing Act forbids other kinds of discrimination, too). (2) Lending practices that do not discriminate in their terms, application, or intent on the basis of race or ethnicity, but simply have disproportionate effects on that basis, are not and should not be illegal. (3) I have no opinion on whether bans on subprime lending are a good idea as a matter of macroeconomic policy, but I would note that one likely effect of such a ban is to make loans of any kind unavailable to people who will be viewed by lenders as unacceptable default risks unless they are charged higher interest rates. (4) Nobody knows exactly what role racial and ethnic discrimination played in the mortgage meltdown, but it is as least as likely that politically correct rather than politically incorrect discrimination played a serious role—and, accordingly, it would be quite foolish for the federal government to repeat its policies during the Clinton and Bush administrations of pressuring lenders to make more home loans to people whose creditworthiness is marginal.

Disparate Treatment, Disparate Impact, and Federal Policy on Lending

Disparate treatment in lending on the basis of race and ethnicity. If a lender refuses to make home loans to people on the basis of race or ethnicity, or makes such loans only under different terms and conditions, this violates federal law, including the Fair Housing Act. So, for example, if a lender refused to make home loans to African Americans, or charged them higher interest rates, because of their race, this would be illegal. I don't believe there is anyone who would disagree with this statement, and there are few who would wish it otherwise and who would push to see the law changed.

Disparate impact in lending on the basis of race and ethnicity. Suppose, however, that a lender has a policy that does not discriminate by its terms on the basis of race or ethnicity, nor is it applied unequally on that basis, nor was it adopted with discriminatory intent – but nonetheless it turns out that the policy has a disproportionate effect on some racial and ethnic groups versus other racial and ethnic groups. That is, suppose that a lender will not make loans to individuals with a poor credit history or work

history, or requires a certain down payment, or will not make loans on homes that are priced below or above certain values – and these practices turn out to have disproportionate effect on a particular racial or ethnic group. Is this illegal?

In my view, this does not violate the Fair Housing Act, as I explain in a column I wrote some years ago for *Legal Times* (see appendix to my testimony). The Supreme Court has never resolved the question whether there is a "disparate impact" cause of action under the Act, although the courts of appeals have almost all recognized it, which is too bad. It is hard to predict what the Supreme Court will do, if this issue ever does come before it, although I will note that the current Court is correctly wary of the disparate-impact approach (see *Ricci v. DeStefano*, 129 S. Ct. 2658 (2009), including Justice Scalia's concurrence noting the constitutional problems that the approach raises). See also *Smith v. City of Jackson*, 544 U.S. 228 (2005) (suggesting that most justices are not willing to recognize an "effects" test for a law absent statutory language supporting it).

As matter of policy, I do not like the disparate-impact approach to civil-rights law enforcement, as I explain in, for example, a 2001 monograph, *Disparate Impact in the Private Sector: A Theory Going Haywire* (published by the National Legal Center for the Public Interest); this monograph expands on an earlier article, "The Bad Law of 'Disparate Impact,'" *Public Interest* (Winter 2000), at 79 [link: http://www.nationalaffairs.com/public_interest/detail/the-bad-law-of-disparate-impact]. In this regard, I would also like to cite testimony recently given to this Subcommittee in "Part I" of these hearings, by Professor Kenneth L. Marcus (on March 11, 2010) [link: http://judiciary.house.gov/hearings/pdf/Marcus100311.pdf]; see also Robert R. Detlefsen, *"HUDlining": Disparate Impact and Insurance* (Oct. 1977 Policy Brief published by the Center for Equal Opportunity) [link: http://www.ceousa.org/content/view/750/138/].

I will not rehash all I've written on the subject here. I will just say that disparate-impact discrimination is really not discrimination at all, and that the threat of disparate-impact lawsuits – in which a judge or jury will use dubious criteria to second-guess business judgments, making the outcome hard to predict, and which are expensive for defendants, win or lose – inevitably pushes potential defendants into either getting rid of perfectly legitimate selection criteria, or overlaying those criteria with quotas, or both. There is an obvious irony here: In the name of civil-rights enforcement, disparate-impact claims actually cause discrimination.

The claim is always made that disparate-impact lawsuits are an essential tool because it is too difficult to prove disparate treatment, but this is not true. Parties bring and win disparate-treatment cases all the time, especially in the housing area, and it is perfectly permissible to use statistical and circumstantial evidence in these cases. Furthermore, it is disturbing for the government to say, since we are having trouble proving an offense, we are going to fix the problem by making it illegal to do something that is not offensive. What's worse, in this area, even if the defendant can prove that he had no discriminatory intent, he will still be held liable.

Unintended consequences of discouraging subprime lending. I am a lawyer and not an economist, so I'm not really in a position to offer much in the way of advice on what the government's role should be with respect to subprime lending.

Of course, as noted above, I think that it is illegal racial discrimination if the lender engages in disparate treatment on the basis of race, but it should not be considered illegal racial discrimination if there is only a disparate impact. So, if a lender is charging African Americans higher interest rates than Asian Americans, because of race, then that is and should be illegal. On the other hand, if it turns out that his racially neutral policy of charging higher interest rates to those with poor credit histories has a disparate impact on the basis of race, that is not and should not be illegal.

Putting aside the (quite correct) ban on racial discrimination, as a conservative I am generally inclined to say the government should let private parties negotiate their own contracts. It may be plausible, however, that in this area an exception should be made and there should be government regulation, on the grounds that there might be aggregate and unacceptable macroeconomic consequences when there has been widescale subprime lending and the economy suffers a downturn. But this is an economic issue, not a civil-rights issue.

And let me add this caveat: An unintended consequence of government limits on subprime lending may be to make loans unavailable *on any terms* to people with marginal creditworthiness, even from otherwise willing lenders. That is, a lender might be willing to make a subprime loan to someone, but if the government intervenes and starts to dictate the conditions of that loan, the lender may decide simply not to make a loan to that person, period. Now, this might actually prevent the prospective lendee from entering into a bad bargain, but it might also prevent someone from buying a home under terms that he was happy with and could have met.

By the way, if there was an uptick in subprime lending in the recent past, it may have come about because lenders were being pressured by government and quasi-government agencies to make more loans to individuals with marginal creditworthiness. The response of the lenders might have been, "Fine, but if we have to make these loans, we will have to charge higher interest rates to make them economically feasible." Thus, the same people who are lamenting "predatory lending" may have caused it by pushing for more loans to members of this or that racial, ethnic, or income group.

Discrimination and the mortgage meltdown. I noted earlier that I am not an economist, so there is little point in me giving you my opinion on what caused the mortgage meltdown in general or, specifically, what role racial and ethnic discrimination played in it. I hope that the other witnesses today who are not economists, and the members of the Subcommittee who are not economists, will likewise be cautious in the conclusions they draw – especially since there is no consensus even among economists about the cause of the Great Recession, or the Great Depression, or many other things.

I will note, however, that there is strong evidence that politically correct racial and ethnic discrimination played at least as important a role as politically incorrect racial and ethnic discrimination in the mortgage crisis. In this regard, I would refer the Subcommittee to an important report: United States Commission on Civil Rights, *Civil Rights and the Mortgage Crisis* (September 2009). Other experts have concluded that, indeed, government efforts to push lenders to make more loans to certain racial, ethnic, and income groups helped cause the crisis. See, for example, Stan J. Liebowitz, *Anatomy of a Train Wreck: Causes of the Mortgage Meldown* (2008) [link: http://www.independent.org/pdf/policy_reports/2008-10-03-trainwreck.pdf]; Thomas Sowell, *The Housing Boom and Bust* (Basic Books, 2010); Howard Husock, "Housing Goals We Can't Afford," *N.Y. Times* (December 11, 2008) [link: http://www.nytimes.com/2008/12/11/opinion/11husock.html]; see also Paul Taylor, "The Risks Posed to National Security and Other Programs by Proposals to Authorize Private Disparate Impact Claims Under Title VI," 46 *Harv. J. Legis.* 57, 105-06 (2009); Editorial, "Covering Their Fannie," *Investor's Business Daily* (April 3, 2010) [link: http://www.investors.com/NewsAndAnalysis/Article.aspx?id=529897]; Editorial, "The Subprime Lending Bias," *Investor's Business Daily* (December 22, 2008); Hans von Spakovsky, "It's Time to Uproot the Real Cause of the Mortgage Crisis," *Pajamas Media* (December 20, 2008) [link: http://pajamasmedia.com/blog/its-time-to-uproot-the-real-cause-of-the-mortgage-bailout/].

It seems to me, Mr. Chairman, that the last thing the government should do is encourage lenders to worry about anything other than creditworthiness in making loans. We are not out of the woods of the Great Recession yet, and, when we are, we certainly don't want to turn around and go back into those woods. Ramping up the use of disparate-impact civil-rights enforcement, and any other kind of pressure on lenders to make sure that they get their racial and ethnic numbers right, is a bad idea.

Conclusion

In sum, Mr. Chairman, our fair housing laws should and do make it illegal for lenders to treat people differently on the basis of race or ethnicity, and that is how they should be enforced. As a matter of law, legal policy, and economics, those laws should not be used to coerce lenders into arriving at politically correct statistical results.

Thank you again for the opportunity to testify today.

Appendix

Legal Times

October 7, 2002
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Section: Points of View; Discriminating Eye

HOME IMPROVEMENT

THE COURT SHOULD KILL AN UNFAIR HOUSING STRATEGY WITH NO BASIS IN LAW.

Roger Clegg

Cuyahoga Falls v. Buckeye Community Hope Foundation, scheduled for Supreme Court argument this term, has received relatively little publicity so far. But one of the issues for which the Court granted cert is extremely important: Whether the federal Fair Housing Act's ban on racial discrimination can be violated by someone who does not engage in racial discrimination.

The answer to that question ought to be an obvious no. But unfortunately the federal courts of appeals have generally allowed "disparate impact" claims to be brought under the statute. These claims do not allege, and need not prove, that individuals were treated differently because of their race. Instead, it is enough to show that a neutral practice has a disproportionate effect--that is, a disparate impact--on some racial group.

For instance, if a landlord refuses to rent to people who are unemployed, and it turns out that this excludes a higher percentage of whites than Asians, then a white would-be renter could sue. It would not matter that the reason for the landlord's policy was race-neutral and had nothing to do with hostility to whites. The landlord would be liable, unless he could show some "necessity" for the policy. This, in turn, would hinge on whether he could convince a judge or jury that the economic reasons for preferring to rent to the gainfully employed were not only nondiscriminatory but essential. And that is a role of the dice.

More-Disparate Impact

There are lots of other examples of race-neutral policies that can be challenged because of the disparate impact they have in the housing market. Suppose a lender refuses to make home loans to felons--or simply to people with poor credit ratings. Those practices also will have a disparate impact. The same is likely true if a city makes a particular zoning decision (the underlying controversy in Cuyahoga Falls) or has per-house or per-apartment occupancy limits (an increasing area of controversy in many communities).

Federal regulations under the Fair Housing Act also cover insurers. This raises additional disparate-impact issues. Suppose an insurance company refuses to write policies for homes more than 40 years old, or if their market value is less than $40,000. Such rules of thumb are in fact common, and they tend to have a disproportionate impact on certain (often minority) neighborhoods.

In Cuyahoga Falls, the plaintiffs include a nonprofit corporation that sought (ultimately, with success) to build a low-income apartment complex in the city. Despite some public opposition, the city council approved the plan, but subsequently opponents invoked a referendum process. The U.S. Court of Appeals for the 6th Circuit held, among other things, that the city's decision to allow the referendum subjected it to liability under the Fair Housing Act, even if no discriminatory intent were shown.

It is a good sign that the Supreme Court has granted review in Cuyahoga Falls. A majority of the justices are clearly uncomfortable with the disparate-impact approach in a variety of contexts, and rightly so. It is a powerful engine in favor of quotas and racial preferences and against rational and economically sound selection criteria (so it's no surprise that the civil-rights left is so enamored of it). Thus in the two past

terms, the Court has raised questions about the legality of federal regulations that use the disparate-impact approach (Alexander v. Sandoval in 2001) and granted review in another case (Adams v. Florida Power Corp., dismissed earlier this year as improvidently granted) that challenged the approach under the Age Discrimination in Employment Act.

The last time the disparate-impact controversy made it to the Supreme Court in a housing case was in Town of Huntington v. NAACP (1988). The Reagan administration filed a brief urging the Court to reject the "disparate impact" approach. But the Court decided the case on other grounds, and expressly reserved the disparate-impact issue for another day. The first Bush administration continued the Reagan administration's policy of not adopting the disparate-impact approach under the Fair Housing Act, but the Clinton administration reversed it. The current Bush administration has filed an amicus brief in Cuyahoga Falls supporting the city, but the brief explicitly states that it "does not address the disparate impact question."

The heart of the Fair Housing Act is 42 U.S.C. Section 3604(a) and (b), which ban all discrimination in selling or renting dwellings "because of" race or national origin, among other things. It's impossible to square the "because of" requirement with the disparate-impact approach. The Supreme Court itself, in Personnel Administrator v. Feeney (1979), makes this point: "It ['discriminatory purpose'] implies that the decisionmaker... selected or reaffirmed a particular course of action at least in part "because of,' not merely "in spite of,' its adverse effects upon an identifiable group."

The statute's text uses not only the phrase "because of" race but also "on account of" (Section 3606) and "based on" (Section 3604(c)). It's very hard to see how all of these phrases can be read to include a disparate-impact cause of action. All of them, to the contrary, are naturally read to require a showing of disparate treatment.

The phrase "on account of" appears not only in Section 3606, but also in Section 3617. Plaintiffs would, presumably, insist that in the former the phrase allows disparate-impact causes of action. But it is quite implausible for it to be interpreted that way in the latter Section , which bans coercion and intimidation of those exercising fair-housing rights. And reading language one way in one Section and another way in another Section is disfavored.

Likewise, the law includes Section 3631, which delineates certain fair-housing violations as crimes. It is very hard to see how any criminal provision would be interpreted to allow prosecutions based on a disparate-impact theory. Yet Section 3631 uses the same "because of" language as Section 3604. Once again, a construction of the statute that interprets a phrase one way in one Section and in another way elsewhere is implausible.

Indeed, the disparate-impact approach would render many of the provisions in the statute regarding the handicapped superfluous. For instance, the failure to make or allow "reasonable modifications" and "reasonable accommodations" as required by Section 3604(f)(3)(A) and (B), respectively, could have been attacked under a disparate-impact theory without those provisions.

More broadly, an effects approach will require judges and juries to conduct a standardless "balancing" test of discriminatory effect versus myriad, hard-to-quantify interests of the city. Congress should be held to a clear statement rule in this area. If it wants to make something illegal, it must say so, and plaintiffs must prove that Congress did so. Lack of a clear answer means defendants win.

There is overwhelming evidence in the legislative history of the original, 1968 act that the statute did not allow a disparate-impact cause of action. Respondents may argue, however, that somehow extensive amendments made to the act in 1988 negate that. But there was no amendment in the wording of the relevant parts of the statute. The natural reading of that text is to require a showing of disparate treatment. That was not changed.

Moreover, by 1988, the Supreme Court had repeatedly--for example, in Washington v. Davis (1976), City

of Mobile v. Bolden (1980), and Guardians Association v. Civil Service Commission of New York (1983)--noted the important distinction between disparate-treatment causes of action and disparate-impact causes of action. Yet Congress still failed to spell out that disparate-impact causes of action were going to be allowed under the 1988 amendments.

Congress knew and knows how to do so. It codified the disparate-impact approach when it passed the 1982 amendments to the Voting Rights Act; it spelled out a disparate impact cause of action under the Americans With Disabilities Act in 1990; and it codified that approach for Title VII of the Civil Rights Act of 1964 in its 1991 amendments to that statute. These are the only three federal civil rights statutes that explicitly contain a disparate impact cause of action, and the Court has not recognized one under any other statute. (To be sure, it did so for Title VII before it was explicitly codified, although it soon thereafter refused to do so for Title VI.)

And so President Ronald Reagan, in signing the 1988 amendments, stated his understanding that the statute "speaks only to intentional discrimination." And the president's understanding of legislation is as important as Congress'; they are both participants in the lawmaking process.

If there is no textual support for a disparate-impact cause of action in the 1988 amendments, and if there is no definitive support for it in the legislative history, the remaining argument to support disparate impact in fair housing law is that many lower courts had recognized a disparate-impact cause of action under the original 1968 version of the act. That means, so the argument goes, that Congress implicitly endorsed the approach when it reenacted the statute in 1988 with full knowledge of those decisions.

But Congress also knew that the Supreme Court had not resolved this question. During the summer of 1988, while the amendments were still before Congress, the Justice Department was arguing to the Supreme Court that it ought to grant certioriari in Huntington and rule against a disparate-impact approach (the 2nd Circuit's Huntington decision was cited in a House report dated June 17). In other words, Congress could hardly be said to have been endorsing settled case law by passing the 1988 legislation, because no settled case law existed.

Reading the Law

Finally, the conservatives on the Court have been reluctant to allow legislative history to trump statutory text. It is not speeches and hearings and committee reports that Congress enacts into law, but the words of a bill. By the same token, the justices ought to be reluctant to allow the meaning of statutory text to be trumped by lower court interpretations and by an unrealistic assumption that senators and representatives were aware of and approved those decisions.

No one has any quarrel with the proposition that there is liability under the Fair Housing Act if a policy singles out particular racial groups for disparate treatment. And there's also no quarrel with enforcing the law if an ostensibly race-neutral policy is in fact unequally enforced, or even if a neutral policy--classically, a "grandfather clause"--is deliberately adopted because it will tend to exclude members of a racial group. The issue, rather, is whether a policy that is racially neutral by its terms, in its application, and in its intent can nonetheless be treated as illegal discrimination because of racially disproportionate results.

And the issue is a very real one. Earlier in this column I alluded to the possibility that a lender's reluctance to make loans to people with poor credit ratings might be challenged as having a disparate impact. This isn't a far-fetched horror story. On Sept. 13 the Federal National Mortgage Association-- Fannie Mae--was sued because it "focuses overwhelmingly on a prospective home buyer's credit score" and "Credit scoring systems routinely penalize minority applicants with higher interest rates or outright denials of mortgages." And so the complaint alleges, among other things, a disparate-impact violation of the Fair Housing Act.

The disparate-impact approach is dubious as a matter of policy, and lacks support in the text of the Fair Housing Act. The Supreme Court has a great opportunity in Cuyahoga Falls to set the law straight.