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Consumer Lending in the COVID-19 Crisis - Fair Lending Concerns

April 16, 2020 | Catherine M. "Cathy" Brennan

The world has been struck by an unthinkable humanitarian crisis - COVID-19. We have never seen anything like this before, and this virus impacts every aspect of our lives. It is in this environment that creditors seek information about how they can take COVID-19 into account when making decisions about how to operate their businesses. Specifically, originators of unsecured or personal property secured consumer credit may be wondering whether they can decline to provide credit in certain geographies based on rates of COVID-19 infection. Creditors may also be wondering whether such creditors may modify underwriting guidelines to discount certain types of employment, such as hourly work or self-employment.

The Equal Credit Opportunity Act ("ECOA") and Regulation B[1] prohibit creditors from discriminating against "applicants"[2] during any part of a credit transaction, including application, underwriting, and denials, on the bases of race, color, religion, national origin, sex, marital status, or age (each, a "prohibited basis").[3] "Disability" is not a protected characteristic under the ECOA.[4] It also prohibits discrimination on the fact that the applicant relies on income from a public assistance program or has, in good faith, exercised rights under the federal Consumer Credit Protection Act.[5] In *Brothers v. First Leasing*,[6] the U.S. Court of Appeals for the Ninth Circuit held that consumer leases, as defined by the Consumer Leasing Act, are subject to the ECOA. The appellate ruling in *Brothers* is binding law in California and other states within the jurisdiction of the Ninth Circuit, and is being enforced in those states by the Federal Reserve and other regulatory agencies.[7] The Federal Reserve Board has not, however, otherwise applied Regulation B to leasing.[8] There are good arguments as to why *Brothers* was wrongly decided; however, leasing companies should also be mindful of these considerations as it thinks about how the ECOA applies to its business.

Discrimination Based on Geography & COVID-19 Infection

The ECOA prohibits disparate treatment between applicants where a prohibited basis is at least one factor in the treatment of applicants.[9] Disparate treatment analysis generally focuses on whether discretionary decisions, such as underwriting exceptions, are applied differently to borrowers in protected groups. Regulation B contains a number of specific rules designed to implement the general prohibition against discrimination on a prohibited basis.[10] Disparate treatment is usually established either by overt evidence of discrimination, such as statements that a lender explicitly considered prohibited factors,or by differences in treatment of applicants that are not adequately explained by legitimate nondiscriminatory factors.

In addition, the legislative history to the ECOA indicates that Congress intended to apply an "effects" test to its anti-discrimination provisions (i.e., a disparate impact test). Disparate impact generally occurs when a lender applies a neutral policy or practice equally among all of its credit applicants, but the policy or practice disproportionately excludes or burdens certain persons on a prohibited basis. The U.S. Supreme Court has affirmed that claims based on a disparate impact theory were valid under section 804 of the Fair Housing Act, a statute that is analogous to the ECOA.[11] Current law permits disparate impact for an ECOA claim, and any underwriting policy must be examined under the effects test. Under a disparate impact test, a court would consider the following issues in the following three steps:

> (1) Does the challenged practice have a disproportionately negative impact on a protected group? If so, the burden shifts to the creditor for the second step.
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> (2) Does the creditor's practice meet a legitimate business need? Creditors should be able to establish a compelling business justification for the practice. If there is no such justification, the practice is unlawful. If a business justification exists, the burden shifts back to the plaintiff for the third step.
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> (3) Could the creditor's business need have been met by other means that are less discriminatory in their net effects and less disparate in their impact? If not, then the creditor's challenged practice is legal.[12]

The Federal Financial Institutions Examination Council (FFIEC), which is the interagency body composed of the five banking regulators, has published an Interagency Fair Lending Examination Procedures Manual that explains this burden-shifting analysis for the disparate impact test. The FFIEC manual explains the process as follows:

> The fact that a policy or practice creates a disparity on a prohibited basis is not alone proof of a violation. When an Agency finds that a lender's policy or practice has a disparate impact, the next step is to seek to determine whether the policy or practice is justified by "business necessity." The justification must be manifest and may not be hypothetical or speculative. Factors that may be relevant to the justification could include cost and profitability. Even if a policy or practice that has a disparate impact on a prohibited basis can be justified by business necessity, it still may be found to be in violation if an alternative policy or practice could serve the same purpose with less discriminatory effect. Finally, evidence of discriminatory intent is not necessary to establish that a lender's adoption or implementation of a policy or practice that has a disparate impact is in violation of the FHA or ECOA. [13]

As applied, this burden-shifting analysis asks whether a creditor's business justification is compelling as well as proportionate. With respect to this analysis, one federal appellate court stated, "[c]ourts should not be overzealous to find discrimination" once a party can present a valid reason for a challenged practice.[14]

To the extent a creditor uses publicly available COVID-19 infection geography data to deny applicants because of potential COVID-19 infection, this use could disparately impact members of a protected class (such as racial minorities or older people). Therefore, creditors should take careful precautions when considering any geographic infection information or rates when underwriting a loan application to ensure there is a justified business necessity to use such data.

Discrimination Based on Source of Income

One of the protected classes under the ECOA, which bans discrimination, is an applicant's reliance on income from a public assistance program.[15] Even though the ECOA does not prohibit discrimination based on other types of income (e.g., hourly or self-employment income), the "disparate impact" analysis described above would apply to any underwriting policy that considers any type of non-protected income. Additionally, the ECOA has special rules around income that comes from a protected source, as well as part-time and self-employment, that creditors must observe. Let's consider a few of these income sources.

Public Assistance Income. The ECOA and Regulation B prohibit a creditor from discriminating on the basis that an applicant's income derives from a public assistance program.[16] In a judgmental system of evaluating creditworthiness, a creditor may consider whether an applicant's income derives from any public assistance program only for the purpose of determining a pertinent element of creditworthiness.[17] Thus, a creditor *cannot* disallow Aid to Families with Dependent Children ("*AFDC*")/Temporary Assistance for Needy Families ("TANF"), disability, foster care or adoption assistance, or welfare/public Assistance and Social Security benefits. When considering income derived from a public assistance program, creditors may consider, for example:

- The length of time an applicant will likely remain eligible to receive such income;
- Whether the applicant will continue to qualify for benefits based on the status of the applicant's dependents (as in the case of TANF, or social security payments to a minor); and
- Whether the creditor can attach or garnish the income to assure payment of the debt in the event of default.[18]

In 2014, the U.S. Court of Appeals for the Seventh Circuit discussed the ability of creditors to make inquiries into income, including protected sources of income.

> Plaintiffs' complaint and appellate brief suppose that federal law blocks a bank from asking either the nature of the disability (from which the likely duration of benefits can be inferred) or the probability that the paying agency will continue the benefits. Yet the statutes forbid *discrimination,* not requests for knowledge that will enable banks to apply uniform standards. Section 805(a) of the Fair Housing Act, 42 U.S.C. § 3605(a), makes it unlawful for anyone in the residential real-estate

> business "to discriminate against any person in making available such a transaction ... because of ... handicap". The Rehabilitation Act, 29 U.S.C. § 794, says that "[n]o otherwise qualified individual with a disability ... shall, solely by reason of her or his disability, be excluded from the participation in ... or be subjected to discrimination under any program or activity receiving Federal financial assistance". Title III of the Americans with Disabilities Act, 42 U.S.C. § 12182(a) provides that "[n]o individual shall be discriminated against on the basis of disability in the full and equal enjoyment of" places of public accommodation. None of these statutes forbids asking applicants for information that will be used to apply the same standards that govern non-disabled persons.
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> If all disability benefits were locked in for life, then a request for information might be gratuitous. Yet Social Security disability benefits depend on the continuation of the disability-and plaintiffs, who have declined to reveal the nature of their disabilities, do not contend that the Bank knew (or should have known) that their entitlement to benefits was bound to last indefinitely. Benefits based on obesity, for example, lapse if the recipient loses weight and regains ability to work. Benefits based on many conditions can end if improved medication (or a person's improved ability to stick to a schedule of medication) improves his condition. The recipient's level of education can be important; if a person goes back to school and expands the range of jobs he can do, benefits may cease.
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> Disability benefits under private programs likewise can change. One kind of program that employers provide as a fringe benefit awards payment for two years if the person can no longer do his job, but after two years only if the person cannot perform any job in the economy. Benefits under a program such as this can end without any change in the recipient's education or physical condition. The possibility of such changes makes it prudent for potential lenders to know what kind of disability an applicant has and how that disability is treated by the public or private payor. That's why the Equal Credit Opportunity Act permits requests for information about all public-assistance benefits. A potential lender likewise wants to know what kind of job an applicant holds, for how long, and whether that job is likely to last-for that matter, whether the employer is likely to remain in business. Learning about the probable duration of disability benefits is no different in principle.[19]

The Ninth Circuit, however, took a different position on the issue. In *Gomez v. Quicken Loans Inc.*, Quicken Loans, Inc. allegedly asked an applicant for a mortgage loan for "medical proof of his current and future disability."[20] The Ninth Circuit stated that although information about an individual's receipt of disability income may serve a legitimate purpose, the statutes do not insulate all behavior related to the evaluation of creditworthiness from judicial review. The ECOA "merely allows a lender to inquire into the source of an applicant's disability income, not the medical reason for it."[21] Gomez alleged that Quicken treated individuals receiving disability income with special scrutiny by requiring them to divulge medical information in order to obtain mortgage loans. In other words, disabled individuals like Gomez were subject to the presumption that their SSDI award letters were insufficient evidence of income and asked to meet a higher standard of proof than other applicants. Drawing all reasonable inferences in Gomez's favor, the court concluded that Gomez's complaint gave rise to a plausible inference of intentional discrimination. The court further noted that "(u)nderwriting materials published by Fannie Mae emphasize that SSDI income is 'considered stable, predictable, and likely to continue' and that a lender 'is not expected to request additional documentation from the borrower.' *Selling Guide: Fannie Mae Single Family* § B3-3.2-01 at 276 (Dec. 30, 2009)."[22]

Part-Time Employment & Retirement Benefits. In evaluating an application for credit, a creditor cannot discount or exclude from consideration the income of the applicant because of a prohibited basis or because the income is derived from part-time employment or is an annuity, pension or other retirement benefit.[23] Thus, a creditor cannot consider self-employed income, gratuities or tips, military allowance, military pension, pensions, IRA, annuities, 401K, retirement, and tax-free investment income with this restriction in mind.

Alimony, Child Support, and Separate Maintenance Income. Regulation B prohibits a creditor from inquiring about whether income stated in an application is derived from alimony, child support, or separate maintenance payments unless the creditor discloses to the application that the income does not need to be revealed if the applicant does not want the creditor to consider it in determining the applicant's creditworthiness.[24] However, as with public assistance payments, a creditor may consider the amount and probable continuance of any income in evaluating an applicant's creditworthiness.[25] When an applicant does rely on alimony, child support, or separate maintenance payments, a creditor must consider such payments as income to the extent that they are likely to be consistently made.[26] Thus, a creditor cannot disallow alimony and child support.

In determining the likelihood of consistent payments of alimony, child support, or separate maintenance, a creditor may consider factors such as whether payments are received pursuant to a written agreement or court decree; the length of time that the payments have been received; whether the payments are regularly received by the applicant; the availability of a court or other procedures to compel payment; and the creditworthiness of the payor, including the credit history of the payor when it is available to the creditor.[27]

Other Income Considerations. A creditor may generally request any information in connection with a credit transaction.[28] Generally, a creditor cannot request any information concerning the spouse or former spouse of an applicant. However, a creditor may request any information concerning an applicant's spouse (or former spouse) that the creditor may request about the applicant if the applicant relies on the spouse's income as a basis for repayment of the credit requested or the applicant relies on alimony, child support, or separate maintenance payments from a spouse or former spouse as a basis for repayment of the credit requested.[29] Examples of the type of income you can exclude include allowance/trust fund/inheritance, compensatory award from courts, investment income, rental income and royalties.[30]

[1] 12 C.F.R. Part 202.

[2] Applicant means any person who requests or who has received an extension of credit from a creditor and includes any person who is or may become contractually liable regarding an extension of credit. For purposes of § 1002.7(d), the term includes guarantors, sureties, endorsers, and similar parties. 12 C.F.R. § 202.2(e). Applicants includes consumers as well as business-purpose borrowers or debtors.

[3] 12 C.F.R. § 202.2(z).

[4] See, e.g., *Thiel v. Veneman*, 859 F. Supp. 2d 1182 (D. Mont. 2012), at 1188.

[5] 15 U.S.C. § 1691(a).

[6] 724 F.2d 789 (9th Cir.), cert. denied, 105 S. Ct. 121 (1984).

[7] Those states include, in addition to California, Alaska, Arizona, Hawaii, Idaho, Montana, Nevada, Oregon and Washington.

[8] 50 Fed. Reg. 48018 (November 20, 1985).

[9] Disparate treatment analysis generally focuses on whether discretionary decisions, such as underwriting exceptions, are applied differently to borrowers in protected groups.

[10] *See, e.g.,* 12 C.F.R. § 202.6(b); 12 C.F.R. § 1002.6.

[11] *Texas Department of Housing and Community Affairs v. The Inclusive Communities Project*, 135 S. Ct. 2507 (2014).

[12] Commentary ¶ 1002.6(a)-2.

[13] *Interagency* Fair Lending Examination Procedures (August 2009) at p. iv, available at: http://www.ffiec.gov/pdf/fairlend.pdf.

[14] *Mountain Side Mobile Estates Partnership v. Secretary of Housing and Urban Development*, 56 F.3d 1243, 1253 (10th Cir. 1995).

[15] 15 U.S.C. § 1691(a).

[16] 12 C.F.R. § 1002.1(b). Regulation B intends to promote the availability of credit to all creditworthy applicants without regard to race, color, religion, national origin, sex, marital status, or age (provided the applicant has the capacity to contract); to the fact that all or part of the applicant's income derives from a public assistance program; or to the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The regulation prohibits creditor practices that discriminate on the basis of any of these factors.

[17] 12 C.F.R. § 1002.6(b)(2)(iii). Courts have affirmed that it does not constitute discrimination (under the ECOA) for a creditor to collect information about whether the applicant's income derives from any public assistance program if such inquiry is for the

purpose of determining the amount and probable continuance of income levels, credit history, or other pertinent element of credit-worthiness. *See, e.g., Wigginton v. Bank of America Corp.*, 2013 WL 4854373, 2013 U.S. Dist. LEXIS 129337 (N.D. Ill. 2013).

[18] Commentary ¶1002.6(b)(2)-6.

[19] *Wigginton v. Bank of America Corp.*, 770 F.3d 521 (7th Cir. 2014), at 522-523.

[20] *Gomez v. Quicken Loans Inc.*, 929 Fed. Appx. 799 (9th Cir. 2015).

[21] *Id.* at 801; 15 U.S.C. § 1691(b)(2).

[22] *Id.* at 801.

[23] 12 C.F.R. § 1002.6(b)(5).

[24] 12 C.F.R. § 1002.5(d)(2). The Commentary further provides that since a general inquiry about the source of income may lead an applicant to disclose alimony, child support or separate maintenance income, a creditor making such an inquiry on an application form should *preface* the request with the disclosure. Commentary ¶ 1002.6(d)(2)-2. 3. A creditor need not give the disclosure if the inquiry about income is specific and worded in a way that is unlikely to lead the applicant to disclose the fact that income is derived from alimony, child support, or separate maintenance payments. For example, an application form that asks about specific types of income such as salary, wages, or investment income need not include the disclosure.

[25] 12 C.F.R. § 1002.6(b)(5).

[26] *Id*.

[27] Commentary ¶ 1002.6(b)(5)-2.

[28] 12 C.F.R. § 1002.5(a)(1).

[29] 12 C.F.R. § 1002.5(c)(2).

[30] Note that we assume none of these sources of income would trigger the application of the ECOA on any other prohibited basis. As a practical matter, a creditor may want to establish procedures for obtaining additional documentation to determine how it will view all of these sources of income in underwriting.

on a matter, one should seek the advice of counsel.

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