On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in regard to the Department of Housing and Urban Development’s (HUD) proposed rule on its implementation of the Fair Housing Act’s disparate impact standard. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 118 million consumers with personal and small business financial service products. Historically, credit unions have emerged as sources of affordable credit in communities that were neglected by other lenders, and this tradition informs our industry’s distinguished commitment to fair lending. Credit unions strongly support laws and regulations aimed at detecting and preventing discrimination, as well as the legal mechanisms used to protect fundamental consumer interests. As cooperatives that are directly accountable to their member-owners, credit unions are focused on developing long-lasting, trusted relationships with their communities—an interest that is best served by adhering to core principles of equality and fairness.

NAFCU’s supports HUD’s objective of updating the Disparate Impact Rule by aligning it more closely with the Supreme Court’s decision in Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc., (Inclusive Communities). The proposed changes to the legal framework used for evaluating disparate impact claims are reasonably tailored to ensure that only artificial, arbitrary, and unnecessary practices are targets of disparate impact liability. They also affirm the Court’s view that “disparate-impact liability must be limited so employers and other regulated entities are able to make the practical business choices and profit-related decisions that sustain a vibrant and dynamic free-enterprise system.”

**General Comments**

Title VIII of the Civil Rights Act of 1968 — commonly referred to as the Fair Housing Act (FHA) (42 U.S.C. § 3601 et seq)—prohibits discrimination in the sale, rental and financing of dwellings based on race, color, religion, sex or national origin. The FHA also makes it unlawful “[t]o
discriminate against any person in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith,” because of those same protected characteristics.

Compliance with fair lending laws, such as the FHA, constitutes an essential part of financial institution supervision and NAFCU supports agency efforts to detect and eliminate discrimination in all forms. Some discriminatory practices may be obvious while others may be more difficult to detect. Disparate impact claims have been used to uncover less obvious instances of prohibited conduct. Specifically, these claims are permitted where there is evidence of discrimination even where there is no discriminatory intent by demonstrating that facially neutral policies have a disproportionately negative effect on a protected class.

In general, HUD’s Disparate Impact Rule requires covered entities, such as financial institution lenders, to assess whether adverse fair housing consequences result from any business practice, even if the practice has no explicit discriminatory features. The Disparate Impact Rule utilizes a burden shifting framework for analyzing such claims and the lender bears the burden of showing that the challenged policy or practice serves a legitimate business purpose.

In Inclusive Communities, the Court held that “[a] disparate-impact claim relying on a statistical disparity must fail if the plaintiff cannot point to a defendant’s policy or policies causing that disparity.” In addition, the Court held that “before rejecting a business justification—or, in the case of a governmental entity, an analogous public interest—a court must determine that a plaintiff has shown that there is an available alternative . . . practice that has less disparate impact and serves the [entity’s] legitimate needs.”

NAFCU agrees that the changes in the proposed rule are responsive to the legal guardrails articulated by the Supreme Court in Inclusive Communities. The proposed rule does not fundamentally alter the core elements of disparate impact liability, but rather serves to update the framework used to establish and evaluate a prima facie case. NAFCU believes that this limited objective is appropriate given the current rule’s lack of alignment with what the Supreme Court’s requirement that disparate impact claims satisfy a “robust causality” requirement.

**New Burden Shifting Framework**

Under HUD’s current rule, when a plaintiff alleges a violation of the FHA under the disparate impact standard, the plaintiff has the burden of proving that the challenged practice caused or predictably will cause a discriminatory effect (i.e., step one). Once the charging party or plaintiff satisfies this initial burden of proof, the defendant has the burden of proving that the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests of the respondent or defendant (i.e., step two). If the respondent or defendant satisfies step two, the charging party or plaintiff may still prevail upon proving that the substantial, legitimate, nondiscriminatory interests supporting the challenged practice could be served by another practice that has a less discriminatory effect (i.e., step three).

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3 See id. at 2518 (quoting Ricci v. DeStefano, 557 U. S. 557, 579 (2009)) (internal quotation marks omitted).
4 See id. at 2523.
The proposed rule adopts a more comprehensive approach; at the pleading stage, a plaintiff alleging that a specific, identifiable, policy or practice has a discriminatory effect must offer facts supporting five distinct elements.

1. The first proposed element would require a plaintiff to plead that the challenged policy or practice is arbitrary, artificial, and unnecessary to achieve a valid interest or legitimate objective.

2. The second proposed element would require a plaintiff to allege a robust causal link between the challenged policy or practice and a disparate impact on members of a protected class.

3. The third proposed element would require a plaintiff to allege that the challenged policy or practice has an adverse effect on members of a protected class. This element would require a plaintiff to explain how the policy or practice identified has a harmful impact on members of a particular “race, color, religion, sex, familial status, or national origin.”

4. The fourth proposed element would require a plaintiff to allege that the disparity caused by the policy or practice is significant.

5. The fifth proposed element would require a plaintiff to allege that the complaining party’s alleged injury is directly caused by the challenge policy or practice.

This expanded framework for establishing a prima facie case reasonably supports the Supreme Court’s recommendation that disparate impact liability not be interpreted so expansively as to displace “valid governmental and private priorities” or result in second-guessing between two reasonable approaches. It also establishes appropriate legal guardrails to prevent unjustified claims that are premised merely on the suggestion of a disparity that does not result in a direct or significant injury. NAFCU supports the new framework.

**Defenses for Algorithmic Models**

HUD has proposed new defenses specifically aimed at underwriting models that rely on algorithms to inform human decision making. NAFCU generally supports these new defenses which may be asserted at the pleading stage to rebut an assertion that the cause of a discriminatory effect is a model used by the defendant. On balance, NAFCU believes that the proposed defenses for algorithmic models could help facilitate credit union adoption of financial technology that improves access to credit, but greater clarification in some areas is first needed.

Proposed § 100.500(c)(2) provides that, where a plaintiff identifies an offending policy or practice that relies on an algorithmic model, a defending party may defeat the claim by:

(i) Identifying the material factors that make up the inputs used in the challenged model and showing that these factors do not rely in any material part on factors that are

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5 *Id.* at 2512.
substitutes or close proxies for protected classes, and that the model is predictive of credit risk or another similar valid objective;

(ii) Showing that the model is produced, maintained, or distributed by a recognized third party that determines industry standards, the inputs and methods within the model are not determined by the defendant, and the defendant is using the model as intended by the third party; or

(iii) Showing that a neutral third party has analyzed the model in question and determined it was empirically derived, its inputs are not substitutes for a protected characteristic, the model is predictive of risk or other valid objective, and is a demonstrably and statistically sound algorithm.

As an initial matter, NAFCU notes that the lack of a proposed definition for “algorithmic model” is problematic for analyzing the substance of the new defenses. NAFCU recommends that the definition of an algorithmic model be developed in consultation with other federal financial regulators, including the National Credit Union Administration, given that there is no uniform framework in federal consumer financial law for distinguishing between human and computer-driven underwriting—particularly where the latter is the likely target of the proposed language.

The National Institute of Standards and Technology (NIST) defines an algorithm as “a clearly specified mathematical process for computation; a set of rules that, if followed, will give a prescribed result.”6 Most underwriting, whether automated or performed by an individual, is algorithmic insofar as it relies upon a set of mathematical rules. If the goal of the proposed language is to offer defendants a structured defense where there is reliance on any type of standardized model, then a broad definition may be appropriate. In fact, it is entirely possible that a plaintiff might assert that even traditional, human-executed underwriting practices are algorithmic.

If HUD’s objective is to limit the use of algorithmic defenses to instances where the model is highly complex, then a narrower definition may be appropriate. Either way, the creation of specific defenses does not limit a plaintiff’s right to assert that an underwriting model has produced a significant disparity and direct injury without knowing all of its specific inputs. As a consequence, HUD should avoid the suggestion, implicit or not, that claims targeting complex algorithmic models are subject to reduced pleading or evidentiary standards. Not only would this undercut the substance of the proposed changes and the robust causality requirement, it would potentially invite abuse of the burden shifting framework by threatening defendants with costly and prolonged, technical reviews of software code.

NAFCU generally supports the proposed framework insofar as it better manages the defendant’s burden of production in cases where an underwriting model may, in fact, be highly complex. Often the most sophisticated, machine-learning powered underwriting models are described as “black boxes” by regulators—even if this vastly understates the lender’s supervision of its own lending programs and unfairly presumes that the model is unreliable. We appreciate HUD’s recognition that the inputs of a model should be the starting point of disparate impact analysis in this context,

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6 https://csrc.nist.gov/glossary/term/Algorithm
but such analysis should be consistent with the Supreme Court’s cautionary statement that disparate impact claims not invite second-guessing of two reasonable approaches. Accordingly, we urge HUD to clarify its approach for determining the materiality of factors in non-standard, algorithmic models.

Research produced on the subject of proxy discrimination by artificial intelligence has observed that machine learning processes will search for proxies of directly predictive characteristics when direct data on these characteristics is not made available to the AI due to legal prohibitions. As a result, simply denying access to the most intuitive proxies tends to result in AIs searching for less intuitive proxies. HUD should consider how this type of adaptation might proceed as it develops a legal framework with the potential to chill adoption of legitimate and nondiscriminatory inputs of creditworthiness.

Lastly, NAFCU supports the defense articulated in proposed § 100.500(c)(2)(ii) which allows a lender to show that a recognized third party, not the defendant, is responsible for creating or maintaining an industry standard model. Many credit unions rely on standard models produced by the Government Sponsored Enterprises—particularly, Fannie Mae’s Desktop Underwriter. In such circumstances, the third party, rather than the credit union, should assume the responsibility of responding to disparate impact claims, particularly where the model’s inputs are outside the credit union’s control. NAFCU asks that HUD clarify how it will determine whether a third party is “recognized.” The proposal does not indicate whether this qualification is measured based on total number of originations generated, by number of financial institution customers, or by some other combination of metrics.

NAFCU recommends that HUD develop a more detailed proposal regarding defenses for algorithmic models through a separate notice and comment rulemaking. Doing so would give credit unions more time to consider the practical effects of setting narrow or broad definitions, particularly in the context of third party defenses, and allow HUD to efficiently conform its rule to the reasoning in Inclusive Communities.

**Burdens of Proof for Discriminatory Effect**

The proposal states that when a party alleges facts sufficient to show a prima facie case of disparate impact liability, the case proceeds beyond the pleading stage. Under paragraph (d)(1), the proposed rule provides that the plaintiff has the burden of proving by a preponderance of the evidence each of the elements of the prima facie case, established not by statistical imbalances or disparities alone, but through evidence that is “not remote or speculative.”

The proposal notes that HUD has not developed a definition for evidence that is not remote or speculative. As a general principle, NAFCU believes that a definition which adopts a case-by-case or totality of the circumstances test should be disfavored as it would only cause greater confusion for both plaintiffs and defendants. To ensure that disparate impact claims are appropriately targeting arbitrary policies, which serve no valid business justification and result in direct and

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8 See id.
significant injury, appropriate evidence should be quantitative and demonstrate measurable harm. The data should also be responsive to any unique legal or regulatory restrictions that are imposed on the lender, such as field of membership.

**Conclusion**

NAFCU appreciates the opportunity to provide comments on HUD’s proposal regarding the disparate impact standard. NAFCU supports strong and effective fair lending rules for credit unions that are responsive to technological change. We also support the revised pleading standards which are appropriately tailored to ensure that valid and neutral business decisions do not become targets of speculative litigation. As credit unions explore the use of new technology to expand access to credit in communities across America, whether they be rural or urban, we ask that HUD clarify how it will implement and define critical elements of its new defenses for algorithmic underwriting models. While we generally support these additions to the Disparate Impact Rule, key details must be resolved to avoid confusion and potential discouragement of innovation. Should you have any questions or require additional information, please do not hesitate to contact me at (703) 842-2266 or amorris@nafcu.org.

Sincerely,

Andrew Morris
Senior Counsel for Research and Policy