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SUBMITTED VIA REGULATIONS.GOV

Office of the General Counsel
Rules Docket Clerk
Department of Housing and Urban Development
451 Seventh Street SW, Room 10276
Washington, DC 20410-0001

**Re: Reconsideration of HUD's Implementation of the Fair Housing Act's
Disparate Impact Standard, Docket No. FR-6111-P-02**

Dear Sir or Madam,

I am writing to you on behalf of the Consumer Data Industry Association (CDIA) to offer comments in response to the above-docketed notice ("Notice") concerning proposed changes to the disparate impact standard (Proposed Rule) as interpreted by the U.S. Department of Housing and Urban Development ("HUD"). The existing Disparate Impact Rule (Existing Rule) requires revision to implement the guidance of the Supreme Court of the United States.¹ CDIA members appreciate the thought that has clearly gone into this proposal. Additional clarification is needed, however, to make the Proposed Rule useful to consumers and businesses.

CDIA is the voice of the consumer reporting industry, representing consumer reporting agencies, including the nationwide credit bureaus, regional and specialized credit bureaus, background check and residential screening companies and others. Founded in 1906, CDIA promotes the responsible use of consumer data to help consumers achieve their financial goals, and to help businesses, governments, and volunteer organizations avoid fraud and manage risk. Through data and analytics, CDIA members empower economic opportunity all over the world, helping ensure fair and safe transactions for consumers,

¹ *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, 135 S. Ct. 2507, 2511 (2015) (*Inclusive Communities*), available at: <https://casetext.com/case/texas-dept-of-housing-and-community-affairs-v-inclusive-communities-project-inc>.

facilitating competition, and expanding consumers' access to financial and other products suited to their unique needs.

CDIA members provide a critical role in the housing marketplace; buying, selling, and renting. In the rental housing marketplace, CDIA members help landlords and property managers protect their properties and help create safe living environments for other tenants. CDIA members will help rental communities by conducting credit and criminal background checks, and eviction histories, so that landlords and property managers can make lawful screening decisions to protect themselves and their tenants. CDIA and its members recognize that not all adverse credit, criminal, or eviction information carry the same weight, yet CDIA's members help their business customers make thoughtful, lawful decisions to protect the safety of tenant communities.

Algorithmic Models

The Proposed Rule establishes criteria for determining when a defendant may establish that a plaintiff's allegations do not support a prima facie case of discriminatory effect.² One method of doing so relates to the defendant's use of an algorithmic model that predicts risk or other valid objectives.³ The Proposed Rule provides three methods through which to establish that plaintiffs have not alleged a disparate impact claim. CDIA's comments focus on this part of the Proposed Rule.

HUD correctly notes that algorithmic models are an increasingly common tool for extending access to credit to underserved communities. Using objective factors that accurately predict risk, these models increasingly replace traditional judgmental evaluation systems and typically result in higher approval rates and lower risk. Especially for "credit invisibles," who may lack traditional indicia of creditworthiness yet possess the ability and willingness to repay, algorithmic models play a vital role in increasing the availability of credit.

These models also have a second important fair lending benefit – they replace human discretion with objective criteria that have a demonstrable ability to predict risk. They remove the possibility of overt or unconscious bias in decision-making. As we learn more about the ingrained nature of unconscious biases, it is especially important to remove the chance that they might affect a consumer's access to housing or housing credit. CDIA

² 24 C.F.R. § 100.500(c).

³ 24 C.F.R. § 100.500(c)(2).

commends HUD's effort to support the appropriate use of algorithmic models, which benefit both consumers and the businesses that use them.

We turn next to the three forms the disparate impact defense pertaining to algorithmic models can take. Paragraph (c)(2)(i) provides that a defendant may defeat a claim by identifying the model's inputs and showing that these inputs are not "substitutes or close proxies" for FHA protected classes and that the model is predictive of risk or other valid objectives. This method is appropriate when the defendant built the model and thus knows the inputs and the model's predictive power.

A. "Substitutes or Close Proxies"

The second prong of this test – that the model is predictive of risk – is clear and appropriate. The first prong, however, is far from clear. The Proposed Rule states that the variables in the model may not be "substitutes or close proxies" for prohibited characteristics, without explaining what that phrase means. A substitute or proxy might refer to a factor the creditor intends to take the place of a prohibited characteristic as a way of circumventing the rule against discrimination. But if HUD means to employ a scienter requirement, it should do so explicitly.

On the other hand, if HUD means that a correlation must not exist between any input and a prohibited basis, it is doubtful a creditor could ever meet this test, rendering the defense worthless. After all, a correlation exists between almost every common credit underwriting criterion and one or more prohibited bases. For example, two of the most widely used credit criteria, income and credit history, correlate with prohibited bases. Men have higher incomes, on average, than women. Asians and whites have higher credit scores than Hispanics and African Americans. Yet the strong relationship between these factors and creditworthiness have protected these factors from creating disparate impact liability.

The discussion of this test in the supplementary information adds to the confusion. The meaning of this statement is not clear:

The first defense allows a defendant to provide analysis showing that the model is not the actual cause of the disparate impact alleged by the plaintiff. It allows the defendant to break down the model piece-by-piece and demonstrate how each

factor considered could not be the cause of the disparate impact and to show how each factor advances a valid objective.⁴

What is meant by “the cause of the disparate impact”? Imagine that a model declined minority mortgage applicants at a higher rate because, on average, minority credit applicants had lower incomes, higher debts in relation to income, and lower credit scores. No one would credibly argue that a lender would violate the FHA by considering income, debts, and credit history when underwriting mortgages. Factors that may permissibly be considered judgmentally cannot become illegal under a disparate impact theory simply because they are in an algorithmic model.

The “cause of the disparate impact” must mean more than a simple correlation between any factor in the model (or the sum of the factors) and a prohibited basis.

For example, a mortgage lender might use a model that includes credit history in determining whether to approve mortgage financing and the terms of the loan. A minority plaintiff might assert that she was denied a loan based on her score in the model and challenge, in particular, the model’s use of credit history. She might allege a correlation between race and credit history. In this example, the plaintiff’s poor credit history was the principal reason her score was not sufficient for approval. Does this fact mean the factor was “the cause of the disparate impact”? Credit history was admittedly a contributing factor in the credit denial. If this fact is enough for the plaintiff to show credit history caused the disparate impact, this defense will prove worthless. We suspect this is not HUD’s intent, however. HUD’s clarification of this language in the final rule is vitally important.

On the other hand, there may be some correlations that are so high that a factor might be viewed as a “substitute” for a prohibited basis. Knowing an applicant’s census block (or ZIP+4) will often allow a reasonably accurate prediction of race and ethnicity because, in many regions, residents of very small geographic units share the same race or ethnicity. On the other hand, knowing an applicant’s income or credit score does not allow an accurate prediction of the applicant’s race or sex. Is an applicant with an income of \$45,000 a year black, white, or Hispanic? Male or female? Any guess is likely to be wrong, even though income and credit score correlate with sex or race.

⁴ 84 Fed. Reg. at 42859.

We note that standard for a high correlation cannot be “statistical significance.” A correlation can be weak yet still satisfy a test of statistical significance at a 95% confidence level. We suspect HUD is concerned about factors, like the census block example, where the overlap between having a certain characteristic and being a member of a protected group is very high. If so, we would urge the agency to consider articulating the test in this way. For example, HUD might say that a factor is a substitute or close proxy for a prohibited factor when the collinearity of the facially neutral challenged factor and the prohibited basis is very high, such that it approaches 1. We expect that factors like ZIP+ 4 would be ruled out by such a test, based on its likely high correlation with race, but traditional creditworthiness factors, such as income and credit history, would not be considered substitutes or close proxies under such a test. This approach would allow creditors to use these traditional factors in their algorithmic models and defend them for a disparate impact challenge.

In the alternative, we ask that HUD focus exclusively on the creditor’s need to show how each factor advances a valid business objective, without reference to “substitutes or close proxies.” This approach recognizes that many creditworthiness factors correlate to some extent with prohibited bases yet are permitted under a disparate impact analysis if they advance a valid business objective. This approach has the virtue of avoiding drawing lines in complicated statistical analyses and places the emphasis where it belongs – on the creditor’s legitimate business need for including the factor in its model.

B. “Third Party That Determines Industry Standards”

Paragraph (c)(2)(ii) provides that a defendant may defeat a claim by showing that a recognized third party, not the defendant, is responsible for creating, maintaining, or distributing the model and that this third party “determines industry standards.” HUD does not provide examples of the models it believes meet this test, and the public would find it helpful to know at least the more common models HUD intends to cover.

Two types of models come to our mind. First are credit scores, derived from information in consumers’ credit histories. The FICO[®] scores and the VantageScore[®] are the two best known examples. The FICO[®] score is created by Fair Issac Corp. and the VantageScore[®] is created by a joint venture of Equifax, Experian, and Trans Union, the three major consumer reporting agencies. Fannie Mae and Freddie Mac, which back nearly half of U.S. mortgages, require credit scores for most mortgage loans they purchase.

The second type of model we believe HUD may have in mind are the risk assessment models used by Fannie Mae (Desktop Underwriter) and Freddie Mac (Loan Prospector). These models set the industry standard for originating conforming mortgage loans that can be sold to Fannie Mae and Freddie Mac. CDIA asks that the final rule, or its supplemental information, provide a non-exclusive list of the third parties it believes determine industry standards.

Doing so will not only clarify HUD's intent with this standard, but also avoid distracting and expensive litigation and retain the flexibility that is vital in a dynamic market.

C. "Validated by an Unbiased and Neutral Third-Party"

Paragraph (c)(2)(iii) is similar to and shares the problems of Paragraph (c)(2)(i), in addition to concerns unique to this provision.⁵ Paragraph (c)(2)(iii) provides that a defendant may defeat a claim by showing that the model has been validated by "an objective and unbiased neutral third party" and has found that the model was "empirically derived and is a demonstrably and statistically sound algorithm." Like the first method, Paragraph (c)(2)(iii) requires that none of the factors be "substitutes or close proxies" for FHA protected classes.

It is not clear to us when a creditor would use the standard in Paragraph (c)(2)(i) versus (iii) or what practical differences are intended. An explanation on this point would aid in commenting on this provision.

Designing and evaluating credit algorithmic models is a specialized profession and best done by an expert with extensive experience in this industry. Many, if not most, of the experts work in model design or analysis, either with vendors to the credit-granting industry or with consulting firms. Such experts often have advanced degrees in statistics or economics and years of experience in building models to predict risk, analyze the models' effect on protected groups, and similar work. We recommend that the final rule make clear that a third-party is not considered to be biased or not neutral because the organization or the individual expert has done work for the credit industry. Without such clarification, HUD would eliminate many of the most qualified experts and invite unwarranted attacks on the expert's credibility.

⁵ Specifically, this paragraph repeats the "substitute or close proxy" language. Because we discuss our concerns with this concept in connection with Paragraph (c)(2)(i), we do not repeat them here.

In addition, we note that this requirement is limited to objectivity and does not speak to the third-party's qualifications to render the opinion. At a minimum, we recommend that the final rule state that the third-party must be qualified by training and experience to opine on whether a model is empirically derived and demonstrably and statistically sound.

100.500 (c) (1)– Failure to allege prima facie case –Material limitation on discretion by third party

It would be helpful for HUD to articulate examples of laws and rules in (c)(1) that materially limit a covered party's discretion. For example, several federal, state and local statutes, regulations, and guidance substantially limit the discretion of rental housing providers in using credit, rental, and criminal history in their selection of tenants. Housing providers following these mandated criteria may have a complete defense available to them, in some circumstances, where their compliance with mandated processes and practices result in unintentional discrimination against one or more protected classes. For example, where following a new tenant screening ordinance results in accepting more of protected class A and fewer of protected class B than before the enactment of the ordinance, the housing provider following such an ordinance may be able to rely on (c)(1) to defeat a disparate impact claim brought by class B.

CDIA appreciates the opportunity to submit these comments. Please let us know if you have any questions or we can provide additional information.

Sincerely,



Eric J. Ellman
Senior Vice President, Public Policy & Legal Affairs