

OPINION

When 'Disparate Impact' Bites Back

Is the Consumer Financial Protection Bureau guilty of the same discrimination it polices in the lending world?

By RONALD L. RUBIN

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The Consumer Financial Protection Bureau just got a painful lesson in the "disparate impact" theory of discrimination. American Banker magazine reported on March 6 that the CFPB's employee performance-review process is plagued by exactly the kind of disparate-impact statistics that the agency uses to prove discrimination in the industries it regulates. For example, according to confidential CFPB data obtained by the magazine, 20.7% of the agency's white employees received the highest performance rating compared with 10.5% of African-American employees and 9.1% of Hispanic employees. The reviews are taken into account for pay raises and bonuses.

Under the controversial legal doctrine of disparate impact—which ultimately may be limited or discarded by the Supreme Court—policies and practices that have a disproportionately adverse effect on protected classes (minorities, women, etc.) can be declared legally discriminatory without evidence of intentional discrimination.

It would be difficult to find a government agency less vulnerable to charges of discrimination than the CFPB. Its core culture still bears the imprint of its first leader, Elizabeth Warren, the progressive firebrand and rising star of the Democratic Party who is now a senator from Massachusetts. The law that created the bureau, the 2010 Dodd-Frank Act, explicitly requires the agency to combat discrimination in consumer finance.



Consumer Financial Protection Bureau Director Richard Cordray testifies before the Senate Banking, Housing and Urban Affairs Committee November 12, 2013 in Washington, DC. *Getty Images*

While working as a CFPB enforcement attorney in 2011-12, I observed the political correctness that epitomizes the agency. Workforce diversity was a top priority in hiring some 1,000 employees. Regular meetings of the "Culture Club" provided a forum for workers to air concerns about issues like discrimination. Experts applied the latest human-resources concepts. Internal surveys and other extraordinary efforts were made to ensure that unspoken resentments did not fester.

It seems inconceivable that CFPB's management could be discriminating against its workers. But

disparate-impact statistics equal discrimination. Or at least that's what the CFPB tells the businesses it regulates.

Last March, the CFPB issued Bulletin 2013-02 to provide "guidance" on indirect lending by car dealers. Indirect lending typically occurs when a car buyer seeks financing in the showroom. In most cases, the dealer (the "indirect lender") sends the buyer's financial information to the actual lender (usually a bank, or an affiliate of a bank or auto manufacturer), which then replies with the lowest rate at which it is willing to lend for that auto sale. Lenders provide incentives for dealers by paying them a "reserve" if they negotiate an interest rate "mark-up" above the lenders' lowest offered rates—the higher the interest rates that car buyers pay, the more money the dealers make.

The CFPB claims that indirect lending results in illegal discrimination based on research (the statistical validity of which is questionable) that found disparities between the rates paid by different protected classes. In other words, the CFPB's studies indicated that minorities and women paid higher interest rates on car loans arranged by dealers and concluded that the dealers must have discriminated.

The CFPB's conclusion disregards many possible nondiscriminatory causes for the interest-rate disparities—for example, different income levels among the different groups, multiple showrooms operated by dealers in different locations with different demographics, different car models purchased more often by certain groups, and different cultural attitudes and awareness regarding interest-rate negotiation.

Worse, the conclusion contradicts logic and common sense. The car dealer operating in such a lender arrangement is already 100% motivated to seek the highest possible interest rate he can negotiate—bias can't increase that motivation. The dealer's priority is to close the deal and get the car off the lot, and he is reluctant to risk losing a profitable sale when a customer threatens to leave the showroom to shop for a cheaper loan. For informed buyers, there is little difference between bargaining over the interest rate and bargaining over the car's price.

The CFPB's questionable "guidance" would be of little concern were it not for the implied threat of a CFPB investigation, which can cost businesses hundreds of thousands of dollars in legal expenses, even when an investigation is closed without enforcement action. Those who do not want to be the test case that defeats the bureau's disparate-impact theory have little choice but to follow the CFPB's suggestions until somebody else takes a stand.

Issuing guidance in this manner allows the CFPB to effectively sidestep administrative rule-making, which would likely stall if the problems with the agency's application of disparate impact were debated in public. Most vexing to the auto industry is the fact that Dodd-Frank specifically exempts car dealers from CFPB jurisdiction. Despite this roadblock, the bureau has found a way to impose its theories on car dealers by threatening the regulated lenders who do business with them.

The lesson the CFPB should learn from its own disparate-impact experience: Statistics are complicated. Numbers don't lie, but people often misinterpret them. Effect does not necessarily equal cause.

Are the CFPB's managers discriminating based on race, despite the agency's best intentions? Were the statistical disparities caused by cronyism, elitism or some other problem? A thorough inquiry should be conducted, and CFPB Director [Richard Cordray](#) has already ordered one. The more important question is whether the bureau will reconsider its commitment to the disparate-impact doctrine after witnessing its flaws firsthand.

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