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FTC Hits the Brakes on Disparate Impact

SPEAKERS

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In this episode of *Moving the Metal*, hosts Brooke Conkle and Chris Capurso break down the FTC's landmark policy statement officially abandoning disparate impact enforcement and what it means for dealers and auto finance companies. They cover the agency's two core justifications — statutory authority under Section 5 of the FTC Act and ECOA, and President Trump's executive order on meritocracy — and explain why, despite the federal reprieve, companies should not treat this as a green light to abandon fair lending compliance programs altogether. From the compliance side, Chris walks through the careful recalibration businesses should consider, while Brooke flags that pending litigation and active state-level efforts to codify disparate impact liability mean the risk landscape is far from clear. The episode closes with a preview of Part 2, where the hosts will be joined by Chris Willis to dig deeper into the history and future of fair lending law.

Transcript

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Episode: FTC Hits the Brakes on Disparate Impact
Hosts: Brooke Conkle and Chris Capurso
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Brooke Conkle (00:10):
Welcome to *Moving the Metal*, the premier legally focused podcast for the Auto Finance Industry. I'm Brooke Conkle, a partner in Troutman Pepper Locke's Consumer Financial Services Practice Group.

Chris Capurso (00:20):
And I'm Chris Capurso, of counsel in Troutman Pepper Locke's Consumer Financial Services Practice Group.

Brooke Conkle (00:25):
Today we'll be discussing a new development from the FTC, the death of disparate impact. But before we jump in, let me remind you to please visit and subscribe to our blogs. We have two great ones that may be of interest to you: troutmanfinancialservices.com and consumerfinancialserviceslawmonitor.com. And also, we have a bevy of other podcasts that you might find interesting. *The Consumer Finance Podcast*, which as you might guess, is all things consumer finance related. *The Crypto Exchange*, devoted to trends, challenges, and legal issues in Bitcoin, blockchain, fintech, and regtech. *FCRA Focus*, a podcast dedicated to all things credit reporting. And finally, *Payments Pros*, a great podcast focused exclusively on the payments industry.

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For today, as I mentioned, we'll be discussing the FTC's new disparate impact policy. And Chris, before we start out, I'll sort of set the stage on what exactly disparate impact is. In terms of dealers and auto finance companies, traditional discrimination claims really are based on allegations that someone intentionally treated a customer differently because of their race or another protected characteristic. Disparate impact, on the other hand, it's different. It says a policy or practice can be illegal because it produces different outcomes for different groups, even if no one intended to discriminate.

For examples that are relatable for dealers and auto finance clients: pricing discretion policies, dealer markup practices, or add-on product offerings that statistically result in minority customers paying more on average, even without any intent behind it. Now, previously, the FTC has used really two legal hooks for disparate impact claims: Section 5 of the FTC Act and the Equal Credit Opportunity Act, what we lovingly call ECOA. Chris, give us sort of the compliance angle and why this matters.

Chris Capurso (03:06):
Right. Just based on everything you've said, those out there who aren't already dealing with this, you're probably not saying this now after dealing with this for decades, but you may be saying to yourself, "How do you check for something like this?" And it is the great question. There are a lot of different ways to check for it because for compliance, you've had to account for kind of a risk that a neutral, consistently applied policy could still trigger a federal enforcement act where you implemented a policy that you thought was facially neutral, but then the outcomes were enough to breed disparate impact liability. You had to have some kind of ongoing tests, right? Because you couldn't have just set the torpedo in the water, so to speak, of this neutral policy and just say, "It's gone from me now. I don't really have to deal with this anymore."

So how do you do that? You had to do statistical monitoring, fair lending audits. The policy statement specifically refers to BISG methodology, Bayesian Improved Surname Geocoding, for those keeping score at home, and that's basically trying to infer a consumer's race from surnames or geographic locations, which, as you can guess, with surnames and geographic locations, there could be higher error rates with things like that. So all of these different monitoring processes could be used to try to figure out whether a process that you set in place to be facially neutral could potentially have disparate impact. But it's, again, it's never going to be perfect.

So you essentially had this position where businesses had to watch out not just for kind of the bad intent, disparate treatment, but also for bad outcomes, the disparate impact. And those are very different kinds of issues to be looking for, different kind of compliance postures that you have to be considering. We've talked about what disparate impact is and what folks in the industry have had to deal with as far as trying to comply with that. Now we have the FTC coming along. And Brooke, what did they say?

Brooke Conkle (05:01):
Well, Chris, the FTC issued a formal policy statement saying officially it will no longer pursue disparate impact claims in any context, full stop. And the agency gave really two core reasons in the statement. The first, statutory authority. The FTC concluded that it actually never had legal power to bring these claims to begin with. Section 5 of the FTC Act is a consumer protection statute, not an anti-discrimination statute, according to the FTC. It doesn't mention discrimination, protected classes, or disparate impact at all. Also, ECOA is an anti-discrimination law, but the FTC now agrees with the DOJ and that ECOA only covers intentional discrimination and not disparate impact.

So statutory authority on one hand. On the other hand, the FTC pointed to President Trump's recent executive order, Restoring Equality of Opportunity and Meritocracy, directing federal agencies to deprioritize disparate impact enforcement. So statutory authority and an executive order, those are the two legal benchmarks for the policy statement. The litigator in me will give us one important flag here. Prior unfair discrimination theory under Section 5 has always been controversial. It was advanced on party-line votes, and the prior FTC majority did not litigate this issue in cases that went to court. And the policy statement calls this out directly. Now, Chris, give us what we should know about ECOA going forward.

Chris Capurso (06:36):
This really feeds into the ECOA piece. But one of the more notable things about this order, specifically from an auto finance standpoint, an automotive industry standpoint, is that the policy statement specifically calls out three prior settlements with dealers and specifically talks about the application of this theory, basically just saying, "We're not going to pursue these claims anymore. These claims aren't valid. We're going to basically erase them." And that's notable because in one of the more recent ones in the last year or two, Chairperson Ferguson was on the FTC for it. And we've talked about this before, in fact. He released a concurring statement with the order.

And we've always kind of brought it up in the context of the CARS Rule and this idea of the price advertising and saying he didn't like the disparate impact angle of the action, but he didn't say anything negative about the price advertising part. So we've always been kind of approaching it from that part of the equation where it's like Chairperson Ferguson has no negative things to say about the price advertising angle. He had a lot of negative things to say about disparate impact. And it really feeds as the basis for this order, talking about everything that Brooke said, that there's no kind of legal basis for it under either ECOA or Section 5, and just saying that these types of claims should not be pursued by the FTC.

And that all leads into ECOA. Because from the UDAP standpoint and the Section 5 FTC Act standpoint, the argument is the same as the argument that was made against the CFPB when they tried to put unfair discrimination into UDAP, which is there are specific unfair discrimination laws out there that cover these types of activities. UDAP has been around… In this case, the FTC Act UDAP has been around for over a hundred years. And the idea of putting unfair discrimination in there is a novel theory, quote unquote, that hadn't existed in the 100 years prior. And now all of a sudden it's there and it's always been there.

Chairperson Ferguson, when he was merely Commissioner Ferguson, was not a fan of that. And as Chairperson, he is still not a fan of that. So that's kind of the UDAP Section 5 angle. The ECOA angle, he makes very clear in the policy statement that ECOA is still a thing. The FTC is still going to enforce ECOA and especially disparate treatment, outright discrimination, discouragement, all those different types of things that are actually baked into

ECOA and Regulation B. The difference is that disparate impact will not be part of that enforcement, which is very similar to what the CFPB has done with ECOA.

The thing to keep in mind is the Equal Credit Opportunity Act is not disappearing. This isn't some kind of regulatory repeal of what the Equal Credit Opportunity Act says. It's still going to be enforced, just under this administration, it's going to be enforced by the letter of the law, by what the law and Regulation B say, and disparate impact isn't going to be part of that process moving forward. We talked about what was, what is now, and now the question: what is to be? What is there to worry about with this? And for dealers and finance companies, this is honestly probably a relief.

As I've discussed, disparate impact is a difficult thing to test for because you're trying to test something that in the beginning had no intent whatsoever that could later on have some kind of impact. So you don't need to fear, at least from the FTC's standpoint, those kinds of enforcement actions and consent order settlements if you have it. But I would caution that just because the FTC and the CFPB have said we're not going to pursue disparate impact anymore, it doesn't give the green light to abandon these kind of analyses altogether. On the one hand, the state AGs could still look at disparate impact, unfair discrimination as a UDAP-type thing.

Again, similar kinds of authorities with unfair and deceptive acts or practices, but maybe the states aren't going to take the same position that it's a hundred-year-old law and we've never seen this before, so why would it exist now? And from the state legislative standpoint, states are already starting to build out bills that counteract this and build in disparate impact liability at the state level. So federal reprieve breeds potential state law compliance. It's the song we've all heard before where you get rid of kind of a federal overlay and you can still face kind of the patchwork idea. So you can't get rid of those kinds of ideas altogether.

You can also face risk from private plaintiffs, obviously. If they… Of course if the state has a law about disparate impact, you're going to face that. If a state UDAP law has a private right of action, you could be facing that. And I think another thing to keep an eye on going forward is this is a policy statement, and we're two years and some change away from another election. You never know the way things are going to swing. And obviously, right now, the FTC, CFPB saying disparate impact isn't something we're going to be looking for. But two years from now, what happens if this policy statement just disappears and then you're left trying to scramble for the prior two years where maybe you're like, "That's not a big deal. I'm not going to do any of these kinds of testing. I'm not going to do any kind of monitoring of our policies to make sure that there's no disparate impact." Then you're all of a sudden kind of in a world of trouble.

So it's not the green light to just go ahead and ignore these types of things. It's just a reprieve from enforcement from the FTC. That's the way I would look at it. And also, of course, intentional discrimination is still going to be illegal. The FTC has said so. ECOA says so. And obviously, that is not something that should be part of your practices anyway. But you got to be cognizant of that. And again, intentional discrimination doesn't necessarily need to be, "I am going to discriminate." I mean, there could be policies that maybe above the level of disparate impact, that may be facially discriminatory. That maybe the intent wasn't there. But you just got to be able to think about all these different types of things and try to understand, is what I'm doing going to be compliant with fair lending laws going forward? Again, it's not a free pass by any means, but it is the reprieve from the FTC. So, Brooke, that's kind of the compliance angle. What are you thinking from the litigation side?

Brooke Conkle (12:51):
From the litigation side is really not all that different. The policy statement does not retroactively resolve any pending matters. This is good news moving forward. But if you're already involved in litigation that has a disparate impact angle, this is not essentially a silver bullet. The landscape may have shifted, but you still need to treat those allegations extremely seriously. Some of the good news, though, this statement certainly signals that courts likely would have rejected an unfair discrimination theory under Section 5. So if you were facing that type of claim from a regulator, the legal footing was already pretty shaky.

Just as you mentioned though, Chris, the states are actively looking to counteract this switcheroo from the federal regulators. So just as you mentioned, just because there is kind of a reprieve at the federal level, do not assume that that means for litigation purposes everything is home free and you don't need to worry about the states in which you are operating. So, Chris, for our practical takeaways, what should we do now from a compliance angle?

Chris Capurso (14:03):
The first thing, as always, don't overreact. This is an FTC policy statement, as I said, and that is the way the federal government is going, especially in light of President Trump's executive order that has kind of fed all of these different types of policy statements and orders and what have you. But the states, as we said, could have their own disparate impact type claims available. So the real thing is the never get too high, never get too low mantra. Stay balanced and really assess everything. Don't overreact and say, "Okay, we're just going to dump our programs now." That doesn't make sense.

But what might make sense is to reassess, try to understand, is there a way to kind of recalibrate what we have to more align with this view while still being ready for any potential state claims or any potential change in administration or anything like that. It's just look at the situation, potentially recalibrate where you are, but always stay balanced. So that would involve reviewing your compliance program, obviously your fair lending program. Of course, keep any controls that are specifically tied to ECOA and Reg B standards alive because that is obviously still law, it is still regulation, and it is still being enforced, even by the FTC, as they said in the policy statement.

So it's careful recalibration, I think, is what I would say. And of course that includes, like I said, compliance program, fair lending program, making sure policies and business rationales and everything else are just in line with the way you want to approach this right now. Brooke, what are your thoughts on practical takeaways?

Brooke Conkle (15:41):
If you are a dealer or an auto finance company and you're receiving an outreach from a regulator, do not presume that this policy statement is going to insulate you. It can be good news. It's not a panacea. The other thing that I think is really important, Chris, when we looked at this policy statement, the first thing we said was this has the auto finance industry written all over it. This is a policy that applies broadly across the FTC and all of the sort of lines of business that they regulate. But it just shows the FTC's focus is on dealers and auto finance companies. It's not bad news, but it's also a realization that auto finance remains a priority for this FTC. And lastly, the FTC has made clear that every customer needs to be treated the same. A meritocracy means that your criteria apply equally, not that anything goes.

Chris Capurso (16:39):
And with that, we'll wrap it up for today's podcast. Obviously, this is a very big development, and this is going to

be the first part of our discussion on the FTC's disparate impact policy statement, but also just kind of disparate impact generally. And we may have a special guest, the Podfather Chris Willis, join us next time to discuss his extensive experience with fair lending laws, how we got here, and where we are and where we're going. That's a little bit of a sneak peek for the Part 2 there, but thank you for tuning in for this Part 1.

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