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Disparate Impact Liability Is Top of Mind – Is Your Financial Institution Ready?

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As 2026 kicks into high gear, all signs point to another year of jaw-dropping headlines as federal financial regulators move swiftly to implement many of the policy changes found in executive orders and other directives coming out of the White House. In turn, state attorneys general are creating working groups, issuing guidance, finalizing rules, suing lenders, and collecting settlements that deviate – and at times run counter to – many of those policies.

What do these mixed messages mean for financial institutions that simply want certainty and rules of the road that will last beyond an election cycle? When it comes to fair lending and disparate impact liability, the name of the game is to stay informed and ensure your compliance management system aligns with current law. Many of the changes at the federal level are proposals and, when finalized, will be litigated for years to come.

This alert briefly summarizes recent developments at the U.S. Department of Housing and Urban Development (HUD) and the Consumer Financial Protection Bureau (CFPB) and provides an insider perspective on what institutions should expect next so they can efficiently and effectively plan, prioritize, and execute to minimize risk and serve their communities.

What Is Disparate Impact?

Disparate impact is a type of discrimination that has been prohibited under civil rights laws and applied by courts across the country for more than 50 years, including in the credit context. The conduct at issue arises when a lender has a neutral policy or practice that is applied equally to all applicants, but that policy or practice disproportionately harms applicants who share a legally protected characteristic, such as race, national origin, or sex. A policy or practice that has a "disparate impact" is lawful only if the actions of the lender are necessary to achieve legitimate business interests and there are no less discriminatory alternatives.

Why Is Disparate Impact in the News?

Given the Administration's views on discrimination and constitutional principles of equal protection, disparate impact has become a hot topic in the financial services arena. President Trump's Executive Order 14281, titled *Restoring Equality of Opportunity and Meritocracy*, states that the disparate impact legal theory of discrimination is unconstitutional and directs federal agencies (including HUD and the CFPB) to take action to align with this new policy, including by amending regulations. It is important to point out that an executive order generally does not change the law – it is the courts that have the final say on the permissibility and scope of disparate impact under any statute. Nonetheless, the Administration has set its priorities, and federal financial regulators are jumping through hoops, at times with limited and less experienced staffing, to execute on those priorities.

HUD's Proposal to Remove Its Disparate Impact Rule Under the Fair Housing Act

Last week, HUD released a proposed rule to remove its disparate impact regulation under the Fair Housing Act (FHA) – a statute that prohibits discrimination in the sale, rental, or financing of dwellings and in other housing-related activities. This particular action came as a surprise to many since:

1. the FHA itself contains "effects" language triggering disparate impact liability (as confirmed by the Supreme Court in its 2015 *Inclusive Communities* decision); and

2. HUD – the agency tasked with interpreting and enforcing the FHA – has previously issued three separate rules across different administrations, including during the first Trump administration, clarifying the disparate impact legal standard under the statute.

Rather than attempt to once again clarify the disparate impact legal standard under the FHA, the current leadership at HUD instead proposes to eliminate its regulation altogether to align with Executive Order 14281. In doing so, HUD is taking a pass on its responsibility to interpret the FHA and states that it is "[l]eaving to courts questions related to interpretations of disparate impact liability under the Fair Housing Act."

HUD's approach is leading many to scratch their heads since courts may consider agency expertise when tasked with interpreting federal laws. In support of its rationale, HUD points to the Supreme Court's 2024 *Loper Bright* decision, which held that courts must use their independent judgment when interpreting federal laws and not simply defer to an agency's interpretation where the underlying statute is ambiguous.

Rather than embrace its authority to interpret the FHA, HUD believes any disparate impact rulemaking it issues would be susceptible to a reviewing court finding that its interpretation carries no deferential weight. Rather than risk that hypothetical scenario, the agency states that it is appropriate for the courts, not HUD, to interpret disparate impact liability under the FHA.

CFPB's Proposal to Eliminate Disparate Impact Under the Equal Credit Opportunity Act

In November, the CFPB released a proposed rule to eliminate disparate impact liability under Regulation B, which implements the Equal Credit Opportunity Act (ECOA) – a statute that prohibits discrimination in any aspect of a credit transaction.

This action was not a surprise because during the first Trump administration, under Acting Director Mulvaney's leadership, the CFPB stated in a May 2018 statement that it would be reexamining disparate impact under ECOA. At that time, Congress passed (and President Trump signed into law) a Congressional Review Act resolution disapproving a rule issued in the form of guidance known as the "indirect auto bulletin," which reminded indirect auto lenders about disparate impact liability under ECOA.

Acting Director Mulvaney's statement signaled the belief – and the CFPB reiterates it now in its 2025 proposed rule – that, unlike the FHA, which contains "effects" language providing for disparate impact liability, such language is arguably absent from ECOA:

"Given [the Supreme Court's *Inclusive Communities*] decision distinguishing between antidiscrimination statutes that refer to the consequences of actions and those that refer only to the intent of the actor, and in light of the fact that the Bureau is required by statute to enforce federal consumer financial laws consistently, the Bureau will be reexamining the requirements of the ECOA."

The writing was on the wall for a challenge to disparate impact under ECOA. Director Kraninger ultimately did not pursue such a rulemaking and instead issued a Request for Information in 2020 (ECOA RFI), which acknowledged disparate impact as a method of discrimination under ECOA and Regulation B and asked the public whether the agency should provide additional clarity regarding its approach to disparate impact analysis. The priorities at the CFPB have since shifted, and now, under Acting Director Vought's leadership, the CFPB is proposing to clarify its approach to disparate impact by completely eliminating it in compliance with Executive Order 14281.

While disparate impact has been recognized as a theory of discrimination under ECOA and Regulation B for almost 50 years, the CFPB does not believe that certain long-standing provisions in Regulation B align with what it now interprets the statute to permit or require. The agency states in its proposed rule that when the Federal Reserve Board relied on legislative history to amend Regulation B in 1977 to specifically authorize disparate impact, it got it wrong. And while courts have consistently applied disparate impact liability under ECOA over the years, notably, the Supreme Court has not reviewed the ECOA to determine whether it includes this form of liability.

Presumably, the CFPB believes that under *Loper Bright* – in the case of ECOA – a reviewing court will either choose to consider its interpretation and give it some deferential weight or, in the alternative, will not consider the agency's interpretation at all but nonetheless reach a similar conclusion: that the text of ECOA does not state that disparate impact claims are recognized and that the statute itself does not contain effects-based language of the type found in other statutes, such as the FHA.

What Comes Next in the Rulemaking Process?

The proposed rules by HUD and the CFPB will be finalized expeditiously as the agencies move quickly to comply with Executive Order 14281. Comments on HUD's proposal must be received by February 13, and the comment period on the CFPB's proposal closed on December 15. The Administrative Procedure Act (APA) requires HUD and the CFPB to review comments and take them into account as the agencies make decisions on the various proposed actions. The agencies will move quickly in their analysis of the comments and in issuing final rules and will ensure staffing is there to check these boxes.

One need look no further than the 30-day comment period the agencies provided to the public to understand that they will most likely finalize the rules as proposed and without delay. From an administrative law perspective, this was an unrealistic timeline for interested parties to comment on rules of such significance. In fact, Director Kraninger provided the public with 60 days to weigh in on the ECOA RFI, and when the public asked for more time, leadership granted an additional 60 days to allow for meaningful and fulsome feedback.

Here, the decision to only grant a small window of time to comment is a strategic move – it means the agencies will move quickly to finalize as proposed because:

3. that is exactly what leadership wants from a policy and legal perspective;

4. from a rule-writing perspective, it takes less time; and

5. it sets the stage for the CFPB to state that, despite its request seeking input from commenters pertaining to the "specific purported benefits" of disparate impact liability to consumers and industry, it received none and instead only received "speculative, unquantifiable" feedback – such rationale was used a few months ago by the agency when it finalized its rescission of the Non-Bank Registry Rule.

However, in the case of rules that change a fundamental aspect of federal civil rights laws and regulations that have been applied by courts across the country for more than five decades, HUD and the CFPB will certainly have an uphill battle when it comes to proving such changes were not arbitrary or capricious in violation of the APA, but instead were based on data and information that warranted such actions.

The lawsuits challenging the agencies' actions are waiting in the wings and will be filed in courts that have previously taken a favorable view of disparate impact liability. HUD's prior attempt just a few years ago to change the disparate impact standard under the FHA provides insight into how this will likely unfold. A lawsuit (or multiple lawsuits) challenging the final rules issued by HUD and the CFPB means that whatever court hears the matter will certainly delay the effective dates of the rules pending its review of the APA challenges. What this means for lenders is that it may be years before these issues are resolved.

What Should Financial Institutions Do in the Meantime?

While the courts work this out, the law remains unchanged. Financial institutions should continue to monitor their policies and practices for potential disparate impact and take corrective action when necessary for a variety of reasons, including:

6. Lenders must comply with the law that is currently in place.
7. Disparate impact compliance is simply good business because it ensures lenders are extending credit to qualified applicants and removes nondiscriminatory criteria that impede growth in business and service.
8. State regulators continue to examine institutions for compliance with state antidiscrimination laws, including disparate impact.
9. State attorneys general continue to enforce antidiscrimination laws using the disparate impact theory of discrimination.
10. ECOA and the FHA have a private right of action – meaning even if state attorneys general in the geographies where lenders do business are not active on these fronts, individuals and other aggrieved parties may sue in federal and state courts for damages, equitable relief, and attorneys' fees.
11. ECOA provides for a five-year statute of limitations – meaning what lenders do today could be a spotlight down the road if disparate impact liability survives and future regulators under a different Administration decide to enforce it (history is a lesson here).

Should you have any questions about the proposed and eventual final rules by HUD and the CFPB, how these actions may impact your business, or compliance with fair lending and consumer protection laws and regulations, please contact Elena Babinecz, former deputy assistant director at the CFPB and manager of the agency's ECOA rulemakings and guidance.