No. 11-1507

In the Supreme Court of the United States

TOWNSHIP OF MOUNT HOLLY, NEW JERSEY, ET AL.,
PETITIONERS

v.

MT. HOLLY GARDENS CITIZENS IN ACTION, INC., ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF FOR THE AMERICAN INSURANCE ASSOCIATION, THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES, THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA, AND THE INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA AS AMICI CURIAE SUPPORTING PETITIONERS

KANNON K. SHANMUGAM
Counsel of Record
ALLISON B. JONES
A. JOSHUA PODOLL
WILLIAMS & CONNOLLY LLP
725 Twelfth Street, N.W.
Washington, DC 20005
(202) 434-5000
kshanmugam@wc.com

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

In the Supreme Court of the United States

No. 11-1507

TOWNSHIP OF MOUNT HOLLY, NEW JERSEY, ET AL.,
PETITIONERS

v.

MT. HOLLY GARDENS CITIZENS IN ACTION, INC., ET AL.

*ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT*

BRIEF FOR THE AMERICAN INSURANCE ASSOCIATION, THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES, THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA, AND THE INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA AS AMICI CURIAE SUPPORTING PETITIONERS

INTEREST OF AMICI CURIAE

The American Insurance Association (AIA), the National Association of Mutual Insurance Companies (NAMIC), and the Property Casualty Insurers Association of America (PCI) are non-profit trade associations whose members sell homeowner's insurance, subject to state insurance regulations, in every State in the Nation. The Independent Insurance Agents & Brokers of America is a non-profit trade association representing more than a quarter million business owners and employees who offer homeowner's insurance and other insurance products in every State.[1] The Department of Housing and Urban Development (HUD) has interpreted the Fair Housing Act (FHA), 42 U.S.C. 3601-3631, to apply to the provision of homeowner's insurance. See 24 C.F.R. 100.70(d)(4).

Earlier this year, HUD issued a new rule that interpreted the FHA to permit disparate-impact liability. See HUD, *Implementation of the Fair Housing Act's Discriminatory Effects Standard*, 78 Fed. Reg. 11,460 (Feb. 15, 2013). In the preamble to that rule, HUD expressed its view that insurers may be liable on a disparate-impact theory for practices related to the provision and pricing of homeowner's insurance. See *id.* at 11,475. After HUD issued the rule, AIA and NAMIC filed suit in the United States District Court for the District of Columbia, contending that the rule is invalid. See *AIA* v. *HUD*, Civ. No. 13-966 (D.D.C. filed June 26, 2013). As is relevant here, the complaint in that case alleges that HUD exceeded its statutory authority by promulgating its disparate-impact rule because its interpretation is contrary to the plain language of the FHA. See Compl. at 14-15, *AIA*, *supra*. At the request of the Department of Justice, the district court has stayed further proceedings pending the outcome of this case.

---

[1] Pursuant to Rule 37.6, amici affirm that no counsel for a party authored this brief in whole or in part, and that no person other than amici, their members, or their counsel made a monetary contribution to fund its preparation or submission. The parties have entered blanket consents to the filing of amicus briefs, and copies of their letters of consent are on file with the Clerk's Office.

This case presents the question whether disparate-impact claims are cognizable under the FHA. If the Court were to hold that disparate-impact claims are not cognizable under the FHA, that decision would effectively resolve the pending challenge to HUD's new rule. Conversely, if the Court were to recognize disparate-impact claims under the FHA, it would have a direct and significant effect on amici and their members. Accordingly, amici have a substantial interest in the question presented here.[2]

SUMMARY OF ARGUMENT

Amici agree with petitioners that disparate-impact claims are not cognizable under the FHA. The statutory text unambiguously prohibits only disparate treatment, not conduct resulting in a disparate impact in the absence of discriminatory intent. Amici file this brief to bring to the Court's attention further evidence, specific to the insurance industry, that Congress did not intend to create disparate-impact liability in the FHA. Permitting liability to be imposed on the basis of a disparate impact, as opposed to disparate treatment, would strike at core principles of sound insurance practice and would impair state law, which is controlling in the unique realm of insurance regulation.

To begin with, any reliable system of insurance is based on the classification of, and differentiation among, risks. In order to ensure predictable outcomes and to maintain sufficient funds to cover losses, insurers must

---

[2] Another trade association, the Financial Services Roundtable, has informed counsel that it supports the views expressed herein. The Roundtable's members provide banking as well as insurance services, and it has joined a separate brief filed by a group of banking trade associations.

gather accurate data about the risks they insure and set rates that accurately reflect those risks. As courts have noted, however, "[r]isk discrimination is not race discrimination." *Saunders* v. *Farmers Insurance Exchange*, 537 F.3d 961, 967 n.6 (8th Cir. 2008) (internal quotation marks and citation omitted). Insurers have an incentive not to discriminate on the basis of protected characteristics such as race because they are not valid risk factors for insuring property. In fact, homeowner's insurers do not even consider those characteristics in making classification and rating decisions.

State law accords with the foregoing actuarial principles. States permit insurers to differentiate among insureds in the classification and rating process based on factors legitimately related to the risks presented. At the same time, States prohibit insurers from differentiating among insureds presenting risks of the same class or hazard on the basis of protected characteristics such as race. At least one State even forbids collection of data relating to those characteristics. Under the McCarran-Ferguson Act, federal laws of general applicability—such as the FHA—cannot be construed to invalidate, impair, or supersede these state laws.

Interpreting the FHA to permit disparate-impact liability would upend fundamental tenets of the insurance business and contravene the McCarran-Ferguson Act. Perversely, in order to avoid unintentionally causing or perpetuating a disparate effect on protected groups, insurers would be compelled to collect data regarding protected characteristics of insureds and to consider that data in making classification and rating decisions. In some jurisdictions, insurers would be placed in the impossible position of having to decide whether to risk violating state law by collecting and using that data, or to risk violating federal law as a result of failing to do so.

Where a particular practice would give rise to a disparate impact, insurers would have to forgo considering factors that correlate to risk, or to differentiate among insureds on the basis of factors that do not correlate to risk, in violation of sound actuarial principles.

The fundamental stability of the homeowner's insurance system would therefore be severely disrupted if disparate-impact liability were permitted. Congress could not have intended to impose such a severe disruption, in contravention of the McCarran-Ferguson Act, *sub silentio*—or to give HUD the power to do so through rulemaking in the absence of a clear statutory authorization. The disruption that disparate-impact liability would cause to the business of homeowner's insurance underscores that petitioners' interpretation of the FHA is the correct one.

ARGUMENT

DISPARATE-IMPACT CLAIMS ARE NOT COGNIZABLE UNDER THE FHA

A. The Text Of The FHA Unambiguously Prohibits Only Disparate Treatment

Amici agree with petitioners that the plain text of the FHA does not permit disparate-impact claims. See Pet. Br. 17-37. As this Court has consistently recognized, when Congress intends to prohibit conduct resulting in a disparate impact in the absence of discriminatory intent, it uses language specifically focused on the effects of the conduct. Unlike other comparable statutes, the FHA does not include such language. Instead, it unambiguously focuses on the improper motivation of the defendant for a particular action—the classic articulation of disparate treatment.

1. By its terms, the FHA prohibits only disparate treatment: that is, intentional discrimination. The spe-

cific provision at issue in this case, Section 804(a) of the FHA, makes it unlawful "[t]o refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny, a dwelling to any person because of race, color, religion, sex, familial status, or national origin." 42 U.S.C. 3604(a). Another provision, Section 804(b), similarly 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 race, color, religion, sex, familial status, or national origin." 42 U.S.C. 3604(b). A subsequently enacted provision, Section 804(f), extends the foregoing prohibitions to an additional protected characteristic, handicap. 42 U.S.C. 3604(f).

This Court consistently has interpreted similar statutory language as prohibiting only disparate treatment. See *Ricci* v. *DeStefano*, 557 U.S. 557, 577 (2009) (Section 703(a)(1) of Title VII of the Civil Rights Act of 1964); *Smith* v. *City of Jackson*, 544 U.S. 228, 236 n.6 (2004) (plurality opinion) (Section 4(a)(1) of the Age Discrimination in Employment Act (ADEA)); *id.* at 246 (Scalia, J., concurring) (same); *id.* at 249 (O'Connor, J., concurring in the judgment) (same). In materially identical language, the provisions at issue in those cases, Section 703(a)(1) of Title VII and Section 4(a)(1) of the ADEA, make it unlawful "[t]o fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's" protected characteristics. 29 U.S.C. 623(a)(1); 42 U.S.C. 2000e-2(a)(1). Like those provisions, the relevant provisions of the FHA focus on the defendant's discriminatory *motivation* for a particular action against an individual—a clear indication that the statute prohibits only disparate treatment. See *Ricci*, 557 U.S. at 577; *Smith*, 544 U.S. at 236 (plurality opinion).

2. By contrast, when Congress intends to create disparate-impact liability, it does so in clear terms that focus on the prohibited effect. For example, Section 703(a)(2) of Title VII and Section 4(a)(2) of the ADEA, again in materially identical language, make it unlawful for an employer "to limit, segregate, or classify his employees in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual's" protected characteristics. 29 U.S.C. 623(a)(2); 42 U.S.C. 2000e-2(a)(2). By prohibiting actions that "would deprive or tend to deprive any individual of employment opportunities" or otherwise "adversely affect" the employee's status, those provisions "focus[] on the *effects* of the action on the employee rather than the motivation for the action of the employer." *Smith*, 544 U.S. at 236.

The FHA, which Congress enacted shortly after Title VII and the ADEA, does not include similar effects-focused language. The FHA prohibits "refus[ing] to sell or rent," "refus[ing] to negotiate for sale or rental," "otherwise mak[ing] unavailable or deny[ing] a dwelling," or "discriminating * * * in the provision of services or facilities in connection" with the sale or rental of a dwelling, "because of" a protected characteristic. 42 U.S.C. 3604(a), (b). The focus of the statute is thus on the actor's motivation for the conduct at issue, not the effects of that conduct.

In arguing for a contrary interpretation, respondents have compared the catch-all clause of Section 804(a) to the "adversely affect" clauses of the Title VII and ADEA disparate-impact provisions. The only thing that those two clauses have in common, however, is the use of the word "otherwise." Title VII and the ADEA prohibit actions that "otherwise adversely affect" an individual, 29 U.S.C. 623(a)(2); 42 U.S.C. 2000e-2(a)(2), whereas the FHA prohibits actions that "otherwise make unavailable or deny[] a dwelling" to an individual because of a protected characteristic. 42 U.S.C. 3604(a). The latter language focuses on the action taken by the defendant and the motivation for that action, not the effect on a member of a protected class. And if there were any doubt about that proposition, the context of the catch-all clause in Section 804(a) dispels it. A catch-all provision must be interpreted according to the list of specific terms which it completes, see, *e.g.*, *Christopher* v. *SmithKline Beecham Corp.*, 132 S. Ct. 2156, 2171 (2012), and all of the items in that list (which includes, *inter alia*, "refus[als] to sell" and refus[als] to negotiate" because of a protected characteristic) unambiguously involve intentionally discriminatory conduct.

The plain text of the FHA therefore leaves no room for recognition of disparate-impact liability. And where, as here, the "statutory language is unambiguous and the statutory scheme is coherent and consistent," the analysis should come to an end. *Sebelius* v. *Cloer*, 133 S. Ct. 1886, 1895 (2013) (citation omitted).

B. The Disruption That Disparate-Impact Liability Would Cause To The Business Of Homeowner's Insurance Underscores That Congress Did Not Intend To Create Such Liability In The FHA

The relevant statutory provisions make clear that disparate-impact claims are not cognizable under the FHA. To the extent this Court looks beyond those provisions, however, the Court should attach significant weight to the disruptive effect that disparate-impact liability would have on the business of homeowner's insurance. In order for insurance markets to function effectively, insurers must accurately assess risk factors and then group insureds and set rates according to the risks they present. Differentiation among risks is an indispensable component of that process. Personal characteristics of the homeowner such as race are not valid risk factors for homeowner's insurance. Insurers do not differentiate on the basis of those protected characteristics, or even consider them, when classifying risks or setting rates. States approve of, and even require, insurers to employ actuarial practices based on factors legitimately related to the risks associated with insured properties. And States typically forbid insurers from considering inappropriate factors such as race when making classification and rating decisions.

The business of insurance is fundamentally predictive in nature. Insurers make actuarially based decisions that are associated with risks of future losses. An insurer's profitability, ability to offer insurance to customers going forward, and very solvency depend on its ability to make accurate actuarial predictions. A disparate-impact analysis, however, is fundamentally outcome-oriented—focused on the result of an insurer's decisions on protected classes. That focus on outcomes is in irreconcilable conflict with the predictive nature of the business of insurance.

In the McCarran-Ferguson Act, Congress provided that no federal law of general applicability may be construed to impair a state law regulating the business of insurance. 15 U.S.C. 1012(b). The FHA is a general federal law that triggers this reverse-preemption principle of the McCarran-Ferguson Act, and the FHA therefore may not be construed to invalidate, impair, or supersede state insurance laws. Yet that is precisely what a construction of the FHA that permits disparate-impact liability would do. Such liability would impair state laws regarding differentiation among risks of the same class or hazard, as well as state laws specifically prohibiting consideration of personal characteristics such as race in the classification and rating process. It would also undermine the foundational principles of sound insurance practice more generally, calling into question insurers' ability adequately to insure against risk.

Disparate-impact liability is incompatible with the business of insurance, unworkable as a matter of practice, and inconsistent with the McCarran-Ferguson Act. The Court's decision in this case will have serious implications for the provision of homeowner's insurance, and the Court should consider those implications carefully in deciding whether Congress intended to work such a disruption *sub silentio* by exposing insurers (and others) to disparate-impact liability.

1. Differentiating Among Risks Is A Foundational Element Of Insurance

a. At its core, insurance is simply a means of shifting and distributing risk. See, *e.g.*, *Group Life & Health Insurance Co.* v. *Royal Drug Co.*, 440 U.S. 205, 211 (1979). The insurer accepts the risk of a large but uncertain future loss; in exchange for shifting that risk, the insured pays a small but certain premium. See Ronen Avraham, *The Economics of Insurance Law—A Primer*, 19 Conn. Ins. L.J. 29, 38 (2012) (Avraham); 1 Steven Plitt et al., *Couch on Insurance* § 1:6, at 1-16 to 1-18 (3d rev. ed. 2009) (*Couch on Insurance*). The transfer of risk from insured to insurer gives the insured security and protection against potential losses, and it gives the insurer income in return for bearing responsibility for any claims.

Insurers are able to accept that bargain because of the "law of large numbers"—a statistical phenomenon whereby "the sample mean for a probabilistic set nears the expected mean for an occurrence or process in the population as the sample size increases." Avraham 37-38. To put it in non-mathematical terms, a large enough group of individually risky transactions that share similar characteristics (but are uncorrelated) will produce reasonably predictable outcomes. *Ibid.* Based on those predictable outcomes, insurers can determine how to distribute the risks they accept among policyholders in the form of insurance premiums.

b. "The heart of any insurance system is its method of classifying risks and setting prices." Kenneth S. Abraham, *Efficiency and Fairness in Insurance Risk Classification*, 71 Va. L. Rev. 403, 403 (1985) (*Efficiency and Fairness*). In order to take advantage of the law of large numbers, insurers must classify risks, sort applicants into pools corresponding to the difference in expected risks, and then allocate the pooled risks by establishing rates. Insurance markets function efficiently when risks are properly classified and pooled and rates correspond to the expected costs of those risks. The insured pays a premium correlated to the insured's level of risk, and the insurer is able to meet its obligation in the event of an individual loss. So structured, the risk-distribution arrangement functions as intended: the insured gets protection against future losses, and the insurer receives sufficient income to cover its payouts for those losses. See Kenneth S. Abraham, *Insurance Law and Regulation: Cases and Materials* 3-4 (5th ed. 2010) (*Insurance Law and Regulation*).

The first step of the process—risk classification—requires an insurer to determine the probability of loss associated with specific risk characteristics so that the insurer can group insureds accordingly. The goal of risk classification is to devise pools of insureds with similar risk profiles—meaning that the insureds in each pool are similarly likely to suffer the loss the insurer has agreed to cover. "The grouping of risks with similar risk characteristics * * * is a fundamental precept of any workable private, voluntary insurance system." American Academy of Actuaries, Committee on Risk Classification, *Risk Classification: Statement of Principles* 1 (last visited Sept. 3, 2013) <tinyurl.com/riskclassification> (*Risk Classification*). Risk classification protects the financial soundness of an insurance program, enhances fairness, and permits "economic incentives to operate with resulting widespread availability of coverage." *Id.* at 5.

An essential prerequisite for effective risk classification is data collection. Indeed, "all other functions of the insurer rely on its ability to gather data about the risks it intends to insure." Avraham 39. Collecting and analyzing data is the job of actuaries. For homeowner's insurance, actuaries will take into account characteristics such as the age of the home, its location, its market value, and aspects of its construction. See, *e.g.*, Ohio Department of Insurance, *Rates Tip Sheet* 1 (last visited Sept. 3, 2013) <tinyurl.com/ohioratessheet>; Maryland Attorney General's Office, People's Insurance Counsel Division, *What Homeowners Need to Know About Underwriting Guidelines* 1 (last visited Sept. 3, 2013) <tinyurl.com/marylandunderwriting>. Actuaries use the data they collect to create classes, or groupings, of "risk characteristics that are related to expected outcomes." Actuarial Standards Board, Task Force to Revise ASOP No. 12, *Actuarial Standard of Practice: Risk Classification (for All Practice Areas)* § 3.2.1, at 3 (Dec. 2005) <tinyurl.com/asop12> (*Actuarial Standard of Practice*).

The second step of the process—risk pooling—involves examining the risk characteristics of individual applicants and then "sorting insurance applicants into categories believed to correspond to differences in expected risk." Tom Baker, *Containing the Promise of Insurance: Adverse Selection and Risk Classification*, 9 Conn. Ins. L.J. 371, 376 (2003). That step is necessary because, without accurate pooling, "high-risk insureds would adversely select into [less risky] risk pool[s]," causing low-risk individuals either to subsidize higher-risk customers or, to the extent they are permitted to do so, to opt out and self-insure instead. *Insurance Law and Regulation* 144; see *NAACP* v. *American Family Mutual Insurance Co.*, 978 F.2d 287, 290 (7th Cir. 1992). When low-risk individuals choose to self-insure because the cost of subsidizing riskier customers exceeds the value of having insurance, the result is a familiar vicious cycle: the insurer bears a higher net risk, which requires the insurer to increase premiums, which in turn causes more customers to opt out. And if only the highest-risk customers remain, it would make it effectively impossible for the insurer to continue providing insurance. See Avraham 44; 1 *Couch on Insurance* § 1:3, at 1-8.

The third and final step of the process—rating—is nothing more than the allocation of pooled risks by establishing rates. Four general principles guide the ratemaking process. *First*, the rate charged must be an accurate estimate of the expected value of future costs. See Casualty Actuarial Society, Board of Directors, *Statement of Principles Regarding Property and Casualty Insurance Ratemaking* 2 (May 1988) <tinyurl.com/casstatement> (*Statement of Principles*). Specifically, the rate must take into account "the predicted probability that an insured will suffer a loss multiplied by the predicted severity of the loss." *Efficiency and Fairness* 408. *Second*, the rate must provide for the insurer's costs of doing business, including the costs associated with the transfer of risk. See *Statement of Principles* 2; *Efficiency and Fairness* 407; Avraham 38. *Third*, the rate should allow for a reasonable profit. See *Efficiency and Fairness* 407. *Fourth*, the rate must be reasonable and may not be "excessive, inadequate, or unfairly discriminatory." *Statement of Principles* 2; see also National Association of Insurance Commissioners, Property & Casualty Model Rating Law (File & Use Version), NAIC 1775, § 5 (2009); National Association of Insurance Commissioners, Property & Casualty Model Rating Law (Prior Approval Version), NAIC 1780, § 4 (2009). In other words, "[d]ifferences in prices among classes should reflect differences in expected costs with no intended redistribution or subsidy among classes." *Risk Classification* 6.

c. As the foregoing discussion demonstrates, insurers "have a market-driven incentive to accurately assess risk that ensures that the price of insurance will be commensurate with the level of risk that a particular policyholder presents." Matthew J. Cochran, *Fairness in Disparity: Challenging the Application of Disparate Impact Theory in Fair Housing Claims Against Insurers*, 21 Geo. Mason U. Civ. Rts. L.J. 159, 174 (2011) (internal quotation marks and footnote omitted). Should an insurer fail to "adhere to actuarial principles regarding risk classification," it can result in "lack of coverage for lower risk individuals, and * * * coverage at insufficient rates for higher risk individuals, which threatens the viability of the entire system." *Actuarial Standard of Practice* 8.

To be sure, insurers do engage in "discrimination" in the sense that they differentiate among insureds on the basis of risk. See Michael J. Miller, *Disparate Impact and Unfairly Discriminatory Insurance Rates,* Casualty Actuarial Society E-Forum 276, 276-277 (2009)

<tinyurl.com/millercas> (Miller). Such "fair discrimination" results in decisionmaking that is economically sound for insurance companies and fair to insureds, whose coverage and premiums are a function of their insurer's costs. See *ibid.* What insurers do not do, however, is to discriminate among insureds based on factors that are not legitimately related to risk. Such discrimination would undermine the sound actuarial principles on which the provision of insurance is based.

2. *Consideration Of Characteristics Such As Race Is Already Prohibited By State Law*

a. The business of insurance is pervasively regulated by state law. Every State has enacted an insurance code; those codes typically cover all aspects of the business of insurance, ranging from the licensing and operation of insurers, see, *e.g.*, N.Y. Ins. Law § 3201; Cal. Ins. Code § 10225, to the prohibition of unfair and deceptive insurance practices, see, *e.g.*, D.C. Code § 31-2231.11, to the regulation of rates, see, *e.g.*, Colo. Rev. Stat. § 10-4-403(1).

Consistent with the actuarial principles discussed above, States forbid insurers from engaging in unfair discrimination: that is, from differentiating among insureds in the classification and rating process based on factors that are not legitimately related to the risks presented by their properties. See, *e.g.*, *Insurance Commissioner* v. *Engelman*, 692 A.2d 474, 480 (Md. 1997) (defining "unfair discrimination," as employed by the Maryland Insurance Code, as "discrimination among insureds of the same class based upon something other than actuarial risk"). States therefore do not allow rates where "price differentials fail to reflect equitably the differences in expected losses and expenses." Tenn. Code Ann. § 56-5-303(a)(2)(d). And States specifically prohibit insurers from distinguishing among "individuals or risks of the same class or of essentially the same hazard and expense element because of the race, color, religion, or national origin of such risks or applicants." 215 Ill. Comp. Stat. 5/424(3); see, *e.g.*, Alaska Stat. § 21.36.090; Ky. Rev. Stat. Ann. § 304.12-085; Mass. Gen. Laws Ann. ch. 175, § 4C; Me. Rev. Stat. tit. 24-A, § 2303(1)(G); Okla. Stat. Ann. tit. 36, § 985; S.C. Code Ann. § 38-75-1210 (B)(1); Tenn. Code Ann. § 56-5-303(a)(2)(d); Tex. Ins. Code Ann. § 544.002.

Because States prohibit differentiating between similar risks on the basis of protected characteristics such as race, property insurers generally do not collect data regarding those characteristics. Indeed, Maryland affirmatively prohibits the collection of such data. See Md. Code Ann. Ins. § 27-501(c)(1) (providing that "an insurer or insurance producer may not make an inquiry about race, creed, color, or national origin in an insurance form, questionnaire, or other manner of requesting general information that relates to an application for insurance," except in certain narrow instances related to health insurance).

b. By contrast, States often expressly permit insurers to classify risks based on the "differences among risks that can be demonstrated to have a probable effect upon losses or expenses." W. Va. Code § 33-20-3; see, *e.g.*, Alaska Stat. § 21.39.030; Colo. Rev. Stat. § 10-4-403(1)(c); Wis. Stat. Ann. § 626.12(2). For example, Virginia law provides that "[n]o rate shall be unfairly discriminatory if a different rate is charged for the same coverage and the rate differential (i) is based on sound actuarial principles or (ii) is related to actual or reasonably anticipated experience." Va. Code Ann. § 38.2-1904 (A)(3). Similarly, Maine law provides that a risk classification "based upon size, expense, management, individual experience, purpose of insurance, location or dispersion of hazard, or any other reasonable considerations" is not unfairly discriminatory, as long as the classification "appl[ies] to all risks under the same or substantially similar circumstances or conditions." Me. Rev. Stat. tit. 24-A, § 2303(2). These state laws not only tolerate but affirmatively sanction "fair discrimination": that is, grouping and rating practices based on shared characteristics of actuarial significance. See, *e.g.*, *Life Insurance Association* v. *Commissioner of Insurance*, 530 N.E.2d 168, 171-172 (Mass. 1988).

Under state law as under sound actuarial principles, therefore, insurers are required to classify risks and to set rates based on factors legitimately related to the risk of loss, without taking other criteria into account. Characteristics such as race not only are unsuitable for the classification and rating process; they are forbidden from being taken into consideration as a matter of state law.

3. Under The McCarran-Ferguson Act, The FHA May Not Be Construed To Impair A State Law Regulating The Business Of Insurance

a. In 1945, Congress enacted the McCarran-Ferguson Act, 15 U.S.C. 1011-1015, which preserves the primacy of state law in regulating the business of insurance. For decades, this Court had treated the regulation of insurance as outside the federal government's power, on the ground that "[i]ssuing a policy of insurance is not a transaction of commerce." *Paul* v. *Virginia*, 75 U.S. (8 Wall) 168, 183 (1869). In 1944, however, the Court changed course and held that the business of insurance was commerce—and, as such, could be regulated by the federal government. See *United States* v. *South-Eastern Underwriters Association*, 322 U.S. 533, 553 (1944). Congress swiftly responded by enacting McCarran-Ferguson.

The McCarran-Ferguson Act established a form of reverse preemption, authorizing state law to prevail over general federal law despite the ordinary operation of the Supremacy Clause. In relevant part, McCarran-Ferguson provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to the business of insurance." 15 U.S.C. 1012(b). McCarran-Ferguson further provides that "silence on the part of the Congress shall not be construed to impose any barrier to the regulation * * * of such business by the several States." 15 U.S.C. 1011.

b. The FHA is a general federal law that triggers the reverse-preemption principle of the McCarran-Ferguson Act, because it does not specifically relate to the business of insurance and therefore does not evince an intention to override the States' authority to regulate insurance within the meaning of McCarran-Ferguson. See, *e.g.*, *Ojo* v. *Farmers Group Inc.*, 600 F.3d 1205, 1209 (9th Cir. 2010) (en banc); *NAACP*, 978 F.2d at 295. As a result, the FHA may not be construed in a way that would "invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance." 15 U.S.C. 1012(b). A federal law "impair[s]" state law for purposes of McCarran-Ferguson if application of the federal law would frustrate declared state policy or interfere with a State's administrative regime. See *Humana, Inc.* v. *Forsyth*, 525 U.S. 299, 310 (1999). Under McCarran-Ferguson, therefore, the federal government may not determine that an insurer's filed rates are unlawful based on federal standards that differ from state standards under which the rates are lawful. See, *e.g.*, *Ojo*, 600 F.3d at 1209; *Saunders*, 537 F.3d at 968.

Notably, in applying the reverse-preemption principle of the McCarran-Ferguson Act to the FHA, lower courts have recognized a significant distinction between claims for intentional discrimination, with respect to which state and federal law are in accord, and claims for disparate impact, which raise the prospect of federal impairment of state insurance regulation. See *Saunders*, 537 F.3d at 967; *Nationwide Mutual Insurance Co.* v. *Cisneros*, 52 F.3d 1351, 1361 (6th Cir. 1995); *NAACP*, 978 F.2d at 290-291; see also *Dehoyos* v. *Allstate Corp.*, 345 F.3d 290, 299 (5th Cir. 2003) (Jones, J., concurring in part and dissenting in part). For example, in *Saunders*, the Eighth Circuit affirmed the dismissal of a claim alleging a disparate impact in the pricing of homeowner's insurance, holding that the claim was barred by McCarran-Ferguson because it would interfere with Missouri's comprehensive regulatory regime. 537 F.3d at 967-968. The court noted that Missouri law required insurers to establish rates based on economic factors essential to insurer solvency, such as loss experience, and further permitted insurers to classify risks based on standards that "measure any differences among risks that can be demonstrated to have a probable effect upon losses or expenses." *Id.* at 967 (quoting Mo. Rev. Stat. § 379.318 (2)). The court reasoned that allowing a federal court to "determine that the [i]nsurers' filed rates are unlawful using [the] different federal standard [of] disparate racial impact" would improperly interfere with state law and, in particular, with the ratemaking authority of the state insurance commissioner. *Id.* at 968.

4. Interpreting The FHA To Permit Disparate-Impact Liability Would Contravene Sound Actuarial Principles And The McCarran-Ferguson Act

The draconian implications of disparate-impact liability for the business of homeowner's insurance confirm that Congress did not intend the FHA to create disparate-impact liability. Interpreting the FHA to permit disparate-impact liability to be imposed on homeowner's insurers would be antithetical to sound insurance practice and would upend fundamental tenets of the insurance business, which are founded on the ability to predict the risk of loss. In addition, it would contravene the McCarran-Ferguson Act by impairing state insurance laws in numerous ways. Assessing risk and making coverage and pricing decisions based on predictive risk factors is critical to the stability of the homeowner's insurance system and is mandatory under state law. But it is in "inevitable and irreconcilable conflict" with disparate-impact liability. Miller 277.

a. Disparate-impact liability is incompatible with core insurance principles because it strikes at the heart of the concept of fair discrimination. Disparate-impact liability would force insurers to take into account factors not correlated to risk in order to avoid causing or perpetuating a disparate impact on insureds who are members of protected classes. That, in turn, would cause rates to be based on factors other than an insured's risk profile. Under established actuarial standards, the resulting rates would be unfairly discriminatory. See *Statement of Principles* 2. Disparate-impact liability would therefore place insurers in an impossible position. Any risk factor that happens to affect a protected group disproportionately could trigger a disparate-impact claim. At the same time, eliminating an otherwise appropriate risk factor because of its disparate impact on a protected group would make the insurer's rates unfairly discriminatory, thereby violating sound insurance practice and undermining the insurer's ability to cover the risks being insured. Moreover, predicting a potential disproportionate effect across time, different geographic areas, and potentially hundreds of actuarially sound risk factors could prove difficult, if not impossible, exposing insurers to significant uncertainty and litigation risk.

In response, insurers could take one of three paths, none of which is acceptable. *First*, insurers could assign insureds who could not be properly classified because of disparate-impact liability to alternative risk pools, with the result that low-risk insureds would cross-subsidize their higher-risk counterparts. That approach, however, would violate sound actuarial practices, see *Risk Classification* 6, and would be untenable because of the phenomenon of "adverse selection" discussed above, see *Insurance Law and Regulation* 144; p. 13, *supra*. *Second*, insurers could simply ignore risk characteristics that have a disparate effect, charging insureds who have those characteristics the same rate as insureds who do not. That approach, however, would either drive insurers from the market or cause serious solvency problems, thereby endangering their ability to remain in business. *Third*, insurers could raise prices for all insureds, shifting to consumers the cost of rating based on factors other than risk. That approach, however, would harm consumers and ultimately lead to the same adverse-selection problems as a cross-subsidy. Lawyers are all too fond of invoking the analogy of Scylla and Charybdis, but here it is exactly apt: insurers would have no middle path that is compatible with sound insurance practice.

b. Disparate-impact liability is also inconsistent with the McCarran-Ferguson Act. The FHA cannot be read to displace state laws that permit risk classification based on factors legitimately related to the risk of loss, state laws that prohibit the consideration of characteristics such as race, or state laws that prohibit insurers even from collecting data concerning those characteristics. See pp. 15-17, *supra*. In order to avoid disparate-impact liability, however, insurers would be compelled to collect data on protected characteristics, but see Md. Code Ann. Ins. § 27-501(c)(1); to consider that data, but see, *e.g.*, S.C. Code Ann. § 38-75-1210(B)(1); Tex. Ins. Code Ann. § 544.002, and to make classification and rating decisions that take into account membership in protected groups, but see, *e.g.*, Tenn. Code Ann. § 56-5-303 (a)(2)(d). With regard to these and other similar state laws, disparate-impact liability would plainly contravene the reverse-preemption provision of the McCarran-Ferguson Act. See, *e.g.*, *Saunders*, 537 F.3d at 967-968. And disparate-impact liability would more broadly impair both States' ability to base insurance regulation solely on risk and state insurance commissioners' authority to determine the adequacy and appropriateness of rates, also in contravention of McCarran-Ferguson. See *Dehoyos*, 345 F.3d at 300 (Jones, J., concurring in part and dissenting in part). As the association of state insurance commissioners has warned, application of disparate-impact theory "makes impossible the operation of state laws establishing insurers' right to use rationally based, neutral risk-selection techniques." National Association of Insurance Commissioners Br. at 2, *Nationwide Mutual Insurance Co.* v. *Cisneros*, 516 U.S. 1140 (1996) (No. 95-714).

The policy of the McCarran-Ferguson Act only further underscores that Congress could not have intended to create disparate-impact liability in the FHA—or to give HUD the power to do so through rulemaking in the absence of a clear statutory authorization. In light of the seismic consequences that disparate-impact liability would have on the business of homeowner's insurance, this Court should reject respondents' interpretation and conclude that disparate-impact claims are not cognizable under the FHA.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

KANNON K. SHANMUGAM
ALLISON B. JONES
A. JOSHUA PODOLL
WILLIAMS & CONNOLLY LLP
725 Twelfth Street, N.W.
Washington, DC 20005
(202) 434-5000
kshanmugam@wc.com

SEPTEMBER 2013