



To Boldly Go: New Frontiers in Fair Lending



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Roadmap

- Fair Lending Overview
- Disparate Impact & Disparate Treatment
- Lender Innovation
- Regulator Innovation
- Developments in Fair Lending Litigation

Fair Lending Overview

- The Equal Credit Opportunity Act (ECOA) applies to all creditors and those who, in the ordinary course of business, regularly refer prospective applicants to creditors. Implemented by Regulation B.
- Illegal to discriminate against applicant regarding any aspect of a credit transaction
 - On the basis of race, color, religion, national origin, sex or marital status, or age (if applicant has capacity to contract)
 - Because all or part of the applicant's income derives from any public assistance program
 - Because the applicant has in good faith exercised any right under the Consumer Credit Protection Act
- The CFPB has ECOA rulemaking authority and supervises for and enforces compliance. FTC also has enforcement authority.

Fair Lending Overview, cont.

- Reg. B covers creditor activities before, during, and after the extension of credit.
 - Information requirements; investigation procedures; standards of creditworthiness; terms of credit; furnishing information about credit; revocation, alteration, or termination of credit; collection procedures.
- Reg. B prohibited practices (12 C.F.R. § 1002.4):
 - Discriminating against applicants on a prohibited basis regarding any aspect of a credit transaction.
 - Making oral/written statements, in advertising or otherwise, to applicants or prospective applicants that would discourage, on a prohibited basis, a reasonable person from making or pursuing an application.

Disparate Impact & Disparate Treatment

- Two theories of ECOA/Reg. B liability: disparate impact & disparate treatment.
- Disparate treatment occurs when a creditor treats an applicant differently based on a prohibited basis.
 - Can be overt/open **or** be found by comparing treatment of applicants who received different treatment for no discernable reason other than a prohibited basis.
- Disparate impact occurs when a creditor employs facially neutral policies or practices that have an adverse effect or impact on a member protected class
 - **Unless** they meet a legitimate business need that cannot reasonably be achieved by means that are less disparate in their impact.

Lender Innovation: Alternative Data in Underwriting

- Also known as “non-traditional data”
- Information not traditionally used by national consumer reporting agencies in calculating a credit score
 - On-time utility, cable, or mobile phone bill payments
 - Cash flow data from bank statements
 - Data related to consumer behavior on the Internet (e.g., time spent on social media)
- Could be even more predictive than traditional data
- Potential to expand credit access to “credit invisibles” and those with low credit scores under traditional model – disproportionately low-income, people of color, women, immigrants, and elderly.

Alternative Data in Underwriting, cont.

- How are lenders using it
 - Creating proprietary blends of alternative data points to assess creditworthiness and underwriting traditionally risky borrowers
 - Lending Club Corp.
 - Prosper Marketplace Inc.
 - Upstart Network Inc.
- “Second Chance” or “Second Look” programs – alternative data considered only when FICO score either doesn’t exist or not satisfactory to obtain credit
 - Sunrise Banks NA

Alternative Data in Underwriting, cont.

- **BUT** beware of unwitting discrimination – use of certain data points could yield disparate impacts for protected classes, even if an algorithm is facially neutral
 - Time spent on social media – younger consumers
 - Typos and grammatical mistakes – immigrants and non-native English speakers
 - Zip codes – people of color, immigrants

Lender Innovation: Artificial Intelligence in Underwriting

- Using an algorithm, rather than a human, to analyze a variety of factors to more accurately assess credit applicants
- LendingClub, Kabbage, Upstart, First National Bank of Omaha
- **BUT** beware of unwitting discrimination
 - “Black box” problem – algorithms can’t explain a result
 - What if algorithm considers a data point that correlates strongly with protected characteristic?
 - Algorithms could include information that creates biases against certain groups
 - CFPB Blog Post: “Providing adverse action notices when using AI/ML models” (July 7, 2020) – AI algorithms can be compatible with ECOA/Reg. B; “a creditor may disclose a reason for a denial even if the relationship of that disclosed factor to predicting creditworthiness may be unclear to the applicant.”

Regulator Innovation – CFPB

- Stretching limits of its fair lending enforcement authority
 - 2021 Summer Supervisory Highlights: Lender violated ECOA & Reg. B because it “conducted a number of direct mail marketing campaigns that featured models, all of whom **appeared** to be non-Hispanic white.”
- Allowing some experimentation and innovation
 - November 2020 – Revised No Action Letter (NAL) issued to Upstart Network, Inc. for its AI and alternative data underwriting model
 - Results from original 2017 NAL – machine learning + alternative data ▶ 23-29% more applicants approved compared with traditional models; < \$50k incomes 13% more likely to be approved
- Trustmark Nat’l Bank, No. 2:21-cv-02664 (W.D. Tenn. Complaint & consent order filed Oct. 22, 2021; consent order approved Oct. 27) – OCC fair lending examination revealed Trustmark structured mortgage operations to avoid providing equal access to credit to residents seeking mortgages in majority-minority areas
 - Consent Order – Create \$3.85m loan subsidy program for majority-Black and Hispanic neighborhoods in Memphis; open new lending office in such a neighborhood; \$5m civil penalty

Regulator Innovation

- Federal Reserve/CFPB/FDIC/NCUA/OCC – Request for Information and Comment on Financial Institutions’ Use of Artificial Intelligence, Including Machine Learning, 86 Fed. Reg. 16,837 (Mar. 31, 2021)
 - Agencies wanted to understand the industry’s views on AI with respect to many aspects of their business, including consumer protection.
 - RFI listed 5 fair lending questions, all of which appeared to concern how AI models would comply with ECOA/Reg. B.

Regulator Innovation

- Federal Trade Commission
 - FTC v. Liberty Chevrolet, Inc., d/b/a Bronx Honda, No. 1:20-cv-03945 (S.D.N.Y. consent order entered May 27, 2020) – Dealership charged higher financing markups and fees to Black and Hispanic consumers, but not to non-Hispanic white consumers.
 - Consent Order: \$1.5 mil in consumer redress payments; must establish fair lending program.
 - FTC Blog Post: “Using Artificial Intelligence and Algorithms” (Apr. 8, 2020) – “[Y]ou must know **what** data is used in your model and **how** that data is used to arrive at a decision. And you must be able to explain that to the consumer. . . . You can save yourself a lot of problems by rigorously testing your algorithm, both before you use it and periodically afterwards, to make sure it doesn’t create a disparate impact on a protected class.”

Regulator Innovation

- DOJ
 - New Combatting Redlining Initiative (Oct. 22, 2021)
 - AG Garland: “We will spare no resource to ensure that federal fair lending laws are vigorously enforced and that financial institutions provide equal opportunity for every American to obtain credit.”
 - Several fair lending probes already open, more to come
 - Led by Civil Rights Division’s Housing and Civil Enforcement Section, partnering with U.S. Attorney’s Offices, financial regulatory agencies, and state attorneys general
 - Trustmark National Bank settlement was the first under the new Initiative

Developments in ECOA Litigation

- *Best v. Fannie Mae*, 450 F. Supp. 3d 606 (D. Md., final judgment Mar. 30, 2020) – Plaintiff’s ECOA claim survived summary judgment. Plaintiff’s loan modification application, even though incomplete, triggered defendant’s obligation under Reg. B to respond to application within 30 days, which it did not do.
- *TeWinkle v. Capital One, N.A.*, No. 20-2049 (2d Cir., appeal withdrawn Sept. 16, 2021, possible settlement) – CFPB & FTC filed amicus brief arguing that a person does not cease to be an “applicant” under ECOA/Reg. B after he/she receives or is denied an extension of credit.
 - 12 C.F.R. § 202.2(e) – “***Applicant*** means any person who requests **or who has received an extension of credit from a creditor**”

Developments in ECOA Litigation

- *Perez v. Wells Fargo Bank, N.A.*, No. 3:17-cv-00454 (N.D. Cal., settled Jan. 8, 2021) – Settlement filed in years-long class action where lender allegedly denied applications for a variety of consumer credit products and credit cards from DACA recipients because they were not U.S. citizens or permanent residents.
 - Lender will pay up to \$16.9 mil to class and change its policies to extend unsecured credit and mortgage products to DACA recipients on the same terms as citizens, provided there is an appropriate product (e.g., no investor products if not permitted by the investor, such as FHA mortgages).
- *CFPB v. LendUp Loans, LLC*, No. 3:21-cv-06945 (N.D. Cal. Complaint filed Sept. 8, 2021, case pending) – Lawsuit alleging lender deceptively marketed incentive program for repeat small-dollar borrowers that did not provide promised benefits and failed to provide timely and accurate adverse action notices to loan applicants.

Developments in ECOA Litigation

- *United States v. Guaranteed Auto Sales*, No. 1:19-cv-02855 (D. Md., consent order entered July 2, 2020) – DOJ Civil Rights Division disparate treatment case where auto dealer allegedly provided more favorable credit terms to White prospective applicants than to equally situated Black prospective applicants for the same vehicle (e.g., lower down payments, down payment installation option, lower bi-weekly payments).
 - Consent Order: Dealer required to develop written policies to govern finance decisions; post and distribute nondiscrimination notices to potential purchasers; attend training on requirements of ECOA; and keep records and report to the government.
- *CFPB v. 1st Alliance Lending, LLC*, No. 3:21-cv-00055 (D. Conn. Complaint filed Jan. 15, 2021, pending case) – Lawsuit alleging, among other things, that mortgage lender denied credit applications from thousands of consumers but only verbally informed consumers of adverse action. Defendant alleged had a policy of not providing written adverse action notices.

Questions?



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