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CFPB prioritizes fair lending, machine learning, privacy in digital engagement

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Members of the auto finance industry continue to have a strong appetite for developing their digital origination and servicing platforms. Much of the industry also has a desire to use data in novel and creative ways to facilitate customer access to credit.

However, the desire for growth and innovation can be tempered by regulatory oversight. Here, we discuss the resurgence in regulatory focus on disparate impact, this time applied to machine learning and agency data that reveals the vast use of digital platforms across most borrower segments, coupled with updated expectations for data security and identity verification.

Protected classes and disparate impact: A refresher

The **Consumer Financial Protection Bureau** (CFPB) has consistently stated that fair lending and credit discrimination will be a priority for the agency. Federal laws like the Equal Credit Opportunity Act (ECOA) prohibit a creditor from discriminating against any applicant based on race, color, religion, national origin, sex, marital status or age. These attributes are often referred to as a "protected status." This is referred to as "disparate treatment."

It goes without saying that denying someone an auto loan because of their sex, race or any other protected status is clearly illegal. There has been much more ambiguity as to whether an underwriting system that is facially neutral — meaning it doesn't take into consideration any of these protected statuses — also violates credit discrimination laws based on the outcome. This is often referred to as "disparate impact" policy, one that adversely impacts a certain group based on their traits.

The CFPB believes that creditors may violate fair lending laws based on this disparate impact theory. Consider the agency's 2013 bulletin that stated indirect auto finance companies are subject to ECOA and may be liable under the disparate impact theory if discriminatory pricing disparities are found — a controversial position that produced a strong reaction from many in the auto finance industry. In 2018, Congress utilized the Congressional Review Act to repeal the CFPB's 2013 bulletin. Since then, the CFPB has been prohibited from enacting a similar rule or issuing guidance without congressional authority and, as a result, there have not been any seismic developments in disparate impact in recent years.

Disparate impact, treatment and outcomes

Fast forward to 2022: the CFPB recently published a blog post that states it intends to leverage the Consumer Financial Protection Act to target discriminatory practices. Although the formal name of this law may not be familiar to everyone, most of us in the auto finance industry are familiar with what this law prohibits — unfair, deceptive or abusive acts or practices (UDAAP). The CFPB pointed out that it is concerned about both disparate treatment and disparate impact, and that both fall within its mandate to eliminate unfair practices.

Readers will recall that an act or practice is deemed unfair if:

- It causes or is likely to cause substantial injury to consumers;
- The injury is not reasonably avoidable by consumers; and
- The injury is not outweighed by countervailing benefits to consumers or to competition.

Assessing risk: Show your work

This post coincided with the Bureau's March 16 announcement that it updated the unfair portion of the UDAAP examination manual to include credit discrimination. The message from the Bureau is that examiners will require supervised companies to show their process for assessing risk and discriminatory outcomes in all consumer finance markets.

In practice, this focus on discriminatory outcomes is effectively the same as focusing on disparate impact. In industries other than auto finance, the CFPB has already taken steps to outline options for how computer models that help value collateral are accurate and fair and effectively prevent algorithmic bias. The CFPB has made it clear that it will closely examine how companies rely on automated decision-making models and any potential discriminatory outcomes.

Trends in consumer behavior

As part of its obligation to provide an annual report to Congress on the consumer credit card market, the CFPB shared its market findings on digital engagement. Many points seemingly apply to all types of credit, such as auto finance. For example, the CFPB found that 2020 data shows that more consumers than ever pay their credit card bills online or using a mobile app. In fact, approximately 60% of consumers made at least one online credit card payment during the year. Paper-based payments have declined during the same period. Although this trend was consistent across all age groups, the data revealed that older consumers' use of digital payment accelerated during this period as these consumers became more comfortable with technology during the COVID-19 pandemic.

Concurrent with the increased use of digital origination and servicing platforms is the increased risk of fraud. Finance companies that lead the market in digital services, and even those that are catching up, have invested tremendous resources in their cybersecurity protections and customer authentication practices. Financial institutions active in the digital market — likely almost every reader at this time — may want to revisit the **Federal Financial Institutions Examination Council**'s Authentication and Access to Financial Institution Services and System guidance, which was updated in 2021.

There are many valuable elements to this guidance, but companies that are expanding their digital lending programs will want to pay close attention to strategies to mitigate risk in email systems, internet access, customer call centers and other points of entry to a financial institution's information system. Single-factor authentication, for example, is often inadequate, and a layered security structure that changes based on transactional risk is recommended.

As expected, the current leadership at the CFPB has redoubled its focus on equitable access to financing, evidenced in its publications and by its actions. As digital advancements and consumer acceptance increase, lenders will want to regularly revisit their compliance platforms and marketing programs.

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