Big Data and FinTech

Implications in Fair Lending

Anne Kerttula  
Executive Director  
Ernst & Young  
Anne.Kerttula@ey.com

Ori Lev  
Partner  
Mayer Brown  
olev@mayerbrown.com

Fair & Responsible Banking
SYMPHOSIUM
Speakers

Anne Kerttula  
*Executive Director*  
Ernst & Young  
Anne.Kerttula@ey.com

Ori Lev  
*Partner*  
Mayer Brown  
olev@mayerbrown.com
In the past year, the terms “Big Data” and “FinTech” have entered into basic vocabulary in financial services and are now in almost every news digest, headline and conference agenda in financial services.

- What are they?
- What is the regulatory framework and enforcement landscape?
- What are practical compliance considerations for big data and FinTech?
What are they?

BIG DATA AND FINTECH
Increases in computing power have enabled massive increases in the amounts of data that can be stored, processed, and analyzed.

- “[L]arge, diverse, complex, longitudinal, and/or distributed datasets generated from instruments, sensors, Internet transactions, email, video, click streams, and/or all other digital sources available today.” (“Big Data: Seizing Opportunities, Preserving Values,” Executive Office of the President, May 2014)

- For example: web browsing history, social media presence, shopping patterns, data from fitness trackers, internet of things.

- Big data can be almost anything.

Increases in computing power have also led to developments in analytics.

- Instead of starting with a hypothesis and then carefully collecting data to validate it, collect all possible data and then look for any patterns that might emerge.

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Big Data and FinTech—What Are They?

• FinTech
  – Organizations combining innovative business models and technology to enable, enhance, and disrupt financial services.
  – Examples: payment processors (PayPal, Dwolla), marketplace lenders (Prosper, Lending Club), among others.

• FinTech firms leverage technology and data to provide financial services quickly and conveniently.

• Challenges
  – Managing data (volume, data quality, updates).
  – New methodologies and tools for analyzing data may have unintended consequences.
  – Regulatory framework and enforcement.
Big Data:

THE REGULATORY FRAMEWORK
Three principal regulatory regimes:

- ECOA;
- FCRA; and
- UDAAP.

Required Reading—FTC, Big Data: A Tool for Inclusion or Exclusion? (January 2016)

• Prohibits discrimination in any aspect of a credit transaction

• Disparate treatment and disparate impact

• Broad definition of creditor
  – All persons who, in the ordinary course of business, regularly participate in the credit decision, including setting the terms of the credit.
  – See CFPB auto cases

• “empirically derived, demonstrably and statistically sound, credit system.”

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FTC Report: “Concern that the use of big data analytics to make predictions may exclude certain populations from the benefits society and markets have to offer.”

- Data quality, including uncorrected biases
- Difference between correlation and causation
Concerns:

- Disparate treatment: reliance on big data to treat protected groups differently (e.g., big data shows single persons more likely to default).

- Disparate impact: targeted advertising and possible “discouragement.”

- Disparate impact: alternative underwriting—understanding the correlations between big data analytics and protected classes.
• Broad definitions:

- **Consumer report**: any information by a CRA bearing on a consumer’s credit worthiness/standing/capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used as a factor in establishing consumer’s eligibility for credit, insurance, employment purposes; or

- **CRA**: regularly engages in assembling consumer credit or other information on consumers for the purpose of furnishing consumer reports to third parties.
• Limitations on both providers and users of consumer reports

• CRA obligations:
  – Reasonable procedures to ensure maximum possible accuracy
  – Access to data and ability to correct errors
  – Permissible purpose limitations

• Are big data aggregators complying?
• Data aggregators as CRAs: *Spokeo*
  
  – *Spokeo* (2012): first case to address sale of Internet and social media data
  
  – Information gathered from social networking sites, data brokers
    • Hobbies, ethnicity, religion, social network participation, etc.
  
  – FTC Complaint: “Spokeo profiles are consumer reports because they bear on a consumer’s character, general reputation, personal characteristics, or mode of living” and were marketed for employment purposes.
  
  – Allegations: permissible purposes, maximum possible accuracy, and Notice to Users
Big Data: The Regulatory Framework—FCRA Obligations of Users

• Adverse action and risk-based pricing notices when consumer report used.

• Even if not a consumer report, must inform consumer of right to request nature of information relied upon.

• “[A] growing trend in big data, in which companies may be purchasing predictive analytics products for eligibility determinations.”
• FN85: “In 2011, FTC staff issued the 40 Years FCRA Report. In that report, staff stated that ‘[i]nformation that does not identify a specific consumer does not constitute a consumer report even if the communication is used in part to determine eligibility.’ ... The Commission does not believe that this statement is accurate. If a report is crafted for eligibility purposes with reference to a particular consumer or set of particular consumers (e.g., those that have applied for credit), the Commission will consider the report a consumer report even if the identifying information of the consumer has been stripped.”
Big Data: The Regulatory Framework—UDAAP

• Big Data UDAAP Risks:
  – Use of data
  – Information security
  – Sale of data

• Do what you say and say what you do

• Use of data: *Compucredit*

• Information security: *Dwolla*

• Sale of data: *Sequia One* (FTC) and *Lead Publisher* (CFPB)
FinTech: Other Regulatory Concerns

• Marketplace lending and the CFPB
  – Larger participant rule
  – Big data risks
  – True lender risk and CashCall

• Cybersecurity
  – *Dwolla*

• Payments
  – *Universal Debt* and substantial assistance
MANAGING COMPLIANCE
New or Old Risks?

• Big data and FinTech have not changed the basic concerns about fairness and transparency.
  – These apply to new entrants just as they apply to traditional lenders, and new entrants need to build appropriate compliance management systems.
  – Traditional lenders expanding into these areas will also need to fold the new businesses into their existing compliance management systems.

• Regulatory scrutiny likely to intensify—sample headlines.
Disparate treatment vs. disparate impact risks

- Judgmental vs. automated decisioning

Disparate treatment

- Consistency in treatment
- Need to account for relevant factors affecting decision

Disparate impact

- Increase in the types of available information presents a challenge as some data elements may be unexpectedly correlated with protected class status
- Qualitative and quantitative review
- Importance of business justification
Fairness Considerations

• Digital redlining
  – Unequal access to digital content (“haves” and “have-nots”)
  – Targeting—lead generators
  – Screening out certain groups

• Use of big data in conjunction with traditional data
  – If big data is used to extend credit to those who otherwise would not have received credit (e.g., credit invisibles, those without or with limited credit history), less likely to draw scrutiny than if big data is used as a primary decision factor.

• Representativeness, accuracy and completeness of data

• Accuracy of predictions/reliability of methodology
  – Correlation is not causation
  – Accuracy and reliability are critical for solid business justification
Transparency Considerations

• Credit reporting considerations:
  – Adverse action reasons, risk-based pricing notices
  – Need to ensure that these are appropriately captured and provided to consumers.

• Consumers’ ability to correct erroneous information.
  – Correcting erroneous information may become even more cumbersome, as large amounts of data are pulled from a variety of sources, with frequent updates.
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