The Consumer Finance Podcast – Fair Lending 101 for Debt Collectors
Aired: 7/21/2022
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Guests: Stefanie Jackman and Sarah Reise

[CHRIS WILLIS]

Welcome to *The Consumer Finance Podcast*.

I'm Chris Willis, the co-practice leader of Troutman Pepper's Consumer Financial Services Regulatory Group, and we have a great episode for you today talking about the intersection of fair lending with collections. But before we get into that topic, let me remind you to visit and subscribe to our blog, ConsumerFinancialServicesLawMonitor.com, where we post multiple times a day about everything of note that happens in the consumer finance industry. And don't forget to check out our other podcast, *FCRA Focus*, which is released monthly on all popular podcast platforms. And finally, if you like our podcast, let us know. Leave us a review on your podcast platform of choice. Now, as I said today, we're going to be talking about the intersection of fair lending and collections, and I'm joined by two of my colleagues who are very well situated to talk about this issue. We have Stefanie Jackman, who's one of my partners in the Atlanta office, and Sarah Reise, who's one of our of counsel, also in the Atlanta office. So, Sarah, Stefanie, welcome to the podcast and thanks for being here.

[STEFANIE JACKMAN]

Great. Happy to be here.

[SARAH REISE]

Thanks for having me, Chris.

[CHRIS WILLIS]

So, this issue of fair lending and collections is one that we haven't spent a lot of time on recently, but I think there are a couple of recent triggers that make this a very timely topic for us. First of all, with respect to creditors, the CFPB recently released a statement reaffirming its position that the Equal Credit Opportunity Act and its prohibition on discrimination, applies to all aspects of a credit transaction. So, it would forbid discrimination, for example, in collections. And the bureau did recently issue that. And then back in March of 2022, the CFPB issued an amendment to its UDAP examination manual asserting that discrimination is unfair within the meaning of its UDAP statute. And it listed a number of areas in which it planned to apply this UDAP as discrimination theory, and collections was one of them. And that would enable the CFPB to reach even third-party collections, or the activities of debt buyers, because they're subject to UDAP, of course, even though they're not creditors who are subject to the Equal Credit Opportunity Act.

So, that's why I think this is such a great topic for the two of you to be talking about to our audience today. And so, let's just jump right into it. Stefanie, I do tons of fair lending work, but traditionally, if we look at federal regulatory enforcement, and analyses, and even supervision of fair lending issues, we see it focusing on things like underwriting decisions and pricing, not collection. So, can you share with the audience what types of processes or practices relevant

to debt collection could be subject to some kind of a fair lending review? Where do we think the regulators might go with this?

[STEFANIE JACKMAN]

It's a really great question, Chris. I think there isn't a neat fit between what we are traditionally looking at when we're doing a fair lending analysis and the way that we approach it, and we'll talk about that more as we get into the podcast, but some of the things we rely on in that context really don't translate to collections, but we have to be thinking about this. It's something that has been bubbling around for some years now. And then as you rightfully pointed out, has really been put front and center by recent announcements and other statements from the CFPB. So, where I look at it is, I think what the CFPB's really getting at here is that they want to see fair treatment, equal treatment, appropriate treatment across consumers and collections with the way that they're situated. They're pegging it to an ECOA type of analysis, and that is the lens through which we start.

And so, when I think about that, putting on my fair lending hat, areas of discretion are those that are most likely to potentially have some disparate treatment, or disparate impact, creep in. So, I think we have to look at places where we exercise discretion. And in the collections world, there are lots of places where we may exercise discretion or judgment. One is just thinking about how we're going to bucket our accounts for different collection strategies. That can be an art more than a science, although there's plenty of science to it too, especially when we're using machine learning, and different algorithms, and consumer data points that can help inform us on what's the most effective way to reach a consumer and assist them in resolving a debt. But that's one area that I think the CFPB could look at through this fair treatment lens. Also, in how we then work with consumers once we reach them in order to resolve their debts. Settlements, payment plans, how much they are, how long we put them out over time, why did we give this consumer this amount as a one-time settlement in full, but this one, a different one? And even though I know many agencies and creditors, because we have to think about this too. Banks have always had ECOA applied throughout their entire life cycle. Many have waterfalls or certain guidelines, but almost everybody has out of guideline authority, where you can exercise some discretion to give a consumer something that perhaps they otherwise didn't qualify for initially within your loss mitigation structure for some reason.

So, those are areas I think it could be looked at. And then going further into the life cycle of an accounting collections, the accounts that are put out for litigation, accounts that are sold, accounts that have credit reporting on them, to the extent that these are not things that are done universally, accounts where perhaps you remove adverse reporting, those are all areas where there can be some discretion, even if you have general guidelines, and where I think the CFPB is most likely to look to say are similarly situated people being treated in a similar manner. And if not, is there a non-discriminatory reason for why?

[CHRIS WILLIS]

Stefanie, you use the terms disparate treatment and disparate impact there, which are probably familiar to those of us who practice in this area regularly but may not be familiar to all of our audience members. Sarah, I wonder if you'd take a minute to explain what is the difference between those two? What do those two phrases mean?

[SARAH REISE]

Disparate treatment, we'll start with that one first. Disparate treatment is often referred to or thought of as intentional discrimination. I think when most people think of discrimination, what comes to mind would be disparate treatment. For example, in the collection context, Stefanie just mentioned the decision whether or not to file a collection lawsuit against a consumer. A disparate treatment or intentional discrimination would perhaps be a policy to only file a lawsuit against non-white consumers. That is a decision based directly on race and would be categorized as disparate treatment. Disparate impact, however, is often, I think, a little bit more difficult to identify. Disparate impact occurs when you have what's called a facially neutral policy. And that means you have a policy or a procedure that doesn't directly implicate any sort of protected class, does not directly consider race, or sex, or religion, or any other protected class as part of the process.

But the result of whatever that process or procedure is ends up negatively affecting or treating similarly situated people differently on the basis or across lines of protected class. So, again, sticking with that example of whether or not to file a lawsuit, an agency may have a facially neutral policy that has five or six factors to consider on an account when making a decision to file a collection lawsuit. And those factors may have nothing to do with any protected class. It could be based on age of the account, the amount of the past due balance, relatively neutral factors, but when you apply those factors and the decision is made to file the suit, at the end of the day, the agency is only filing suit against non-white borrowers. So, there's no intentional discrimination. There's no direct consideration of a protected class, but it ultimately has a disparate impact on a protected class of consumers.

[CHRIS WILLIS]

Thanks for that. And I think it's probably fair to say that for the most part, disparate treatment issues are probably easier for financial institutions, or debt collectors, or anyone to detect, because they're based on sort of policies, procedures, decisions that they made. But disparate impact is probably the place where we see more institutions get into trouble because they may not be aware of the disparate impact that some facially neutral policy that they have enacted may have on members of a protected class. So, disparate impact is where a lot of the angst is surrounding that. And speaking of angst, Stefanie, how do we think the CFPB is going to review collection related decisions, like the ones you were talking about a few minutes ago for discrimination or for disparate impact, and particularly since either a creditor or a debt collector who's engaging in collection activity isn't going to know the race or other demographic information about the consumer. It's illegal to request that as a creditor. Debt collectors definitely don't collect it. So, how are we going to see the CFPB doing analyses here?

[STEFANIE JACKMAN]

It'll be interesting. Because the first time the CFPB started making a lot of noise about this being something that people in the servicing collection context needed to think about, Chris, you'll recall, it was maybe 2014, 2015, time frame. And you and I were advising clients, listen, we need to have something here, but we're not recommending that you do a statistical regression analysis or matched pair, anything like that. Instead, it's more about training, policies, creating an awareness and culture of this, and ensuring that you document reasons for why you've made discretionary decisions within your process, to assist consumers in resolving their debt, or something that normally would've gotten this type of treatment is instead getting this one, and here's why, so that you can explain that. And that had been

enough. And I came to you and said, gosh, Chris, fast forward. I asked you this question, and how do we do this? And do we really need to start thinking about this from a statistical or matched pair? Do we need to be doing more?

And you and I both sat there and said, yeah. So, what I suspect the CFPB will do is not withstanding its public acknowledgement that this isn't perfect, in many instances, and in particular, outside of mortgage and where there's more demographic data. They're going to apply the BISG, which many people are, what does that stand for? So, I have it here. It's the Bayesian Improved Surname Geocoding proxy method, which is really combining geography and surname-based information into a single proxy probability, to assign certain racial, or ethnic, or gender, or whatever, protected class characteristics to certain populations. They'll run a regression analysis, and they'll look for things where statistically, it looks to be an anomaly. So, they'll probably then compliment it with some sort of matched pair.

And this is where one of the things that still really holds true is the advice you and I were giving six years ago is even more important than ever. Making sure you have an ability to say, there's no problem here. This was a non-discriminatory reason for why this person that you have assigned this status, which may or may not be accurate, but using the BISG analysis, and whether you've done a match pair, a regression, both, because you can't do a regression against really small populations, or at least it can be difficult for it to have any statistical significance. But having the ability to say, there is an alternative story here. This was treated this way because of this, which really, really depends on having very good, clear documentation for why that account was dispositioned that way. That's been my take, but I've been also packaging that with caution to our listeners. You and I have seen in other projects, not in this space, but when people are trying to do fair lending, they make big investments in platforms, software, that's supposed to help them do that.

But if you don't understand what you're testing for and how your software that you've invested a lot of money in and are trying to utilize to make this a consistent documented process, if you don't understand what it's testing for, how it's testing it, you won't be able to understand the significance or lack thereof of your outcome at the end. And it can create records that suggest you have problems that you don't actually have. So, I am cautious in saying we need to really be thinking about this now. Most of us in this space are not accustomed to thinking about it. Don't go it alone. Connect with an outside counsel, or consultant, or somebody who is well versed in fair lending testing generally, because it isn't going to be a one-to-one fit here, and you don't want to cause yourself even more headaches by jumping in too quickly and getting ahead of yourselves with any testing.

[CHRIS WILLIS]

Yes, Stefanie, I completely agree with you. The ill-advised test, or the poorly designed discrimination test, can really be the enemy of the entity that performs it. Because for example, let's say that you were a creditor and you wanted to do some statistical analysis on the customers who found themselves 90 plus days delinquent, and therefore had X consequence associated with them, or customers who had late fees imposed on them, or had their cars repossessed, or were referred to a collection agency, or anything like that. The reasons why somebody may have that happen may not be contained in neat data fields that you can do a regression analysis based off of. Rather, they may be based on the quality of the conversation with the consumer, and what he or she says about an ability or willingness to pay the debt, which will be contained only in free form notes on whoever's servicing system of record is collecting on the debt.

Those are important factors to determining how a consumer gets treated, but if they can't be taken into accountant in an analysis, and you then go try to do the analysis without taking it into account, you might create the impression that there's discrimination going on because there's differential outcomes that aren't explained by the analysis, but yet they're perfectly explainable if you just read the notes. That's why I want to underline what you just said, which is don't just reflexively test. Make sure the test you're doing is actually meaningful and will actually tell you if there is differential treatment being applied to people who are similarly situated. And it's that last part that's most important, making sure that they're similarly situated. Sarah, let me turn to you now. To me, our overwhelming experience with fair lending issues, underwriting and pricing type issues, is that those issues are discovered by the CFPB, or by other regulators through examinations.

They don't result from consumer complaints. It doesn't result from something that the regulator can see from outside the organization. They have to get in and look at a bunch of example transactions, look at strategies, et cetera, and figure out that the violation may be there. So, given the central role of examinations here, and we know that many creditors and all large debt collectors are subject to CFPB examination authority because debt collectors are covered by a larger participant rule, can you give the audience some flavor of what a CFPB fair lending examination would look like as a preview to what it would look like if they were examining for discrimination in the collections area?

[SARAH REISE]

The CFPB, I think, would take a couple of different steps. So, first, like an examination on many issues, the CFPB is going to be looking at policies and procedures related to specifically anti-discrimination, but also will look at policies and procedures that involve discretionary decision making, as we've talked about earlier in the podcast. They'll also look at CMS controls, your compliance management system, to see what sort of testing you do to try to monitor for and identify potential disparate treatment and disparate impact. At that point, the CFPB or the regulator, is likely going to do their own testing of your discretionary decisions. So, the first thing they would do, as Stefanie previewed, using the BISG proxy method, they would assign a race, or ethnicity, or gender, or whatever protected class they're testing for using a proxy method.

And once they have assigned protected class to each consumer in whatever population they're testing, it could be all consumers who were approved for a settlement, or all consumers against whom collection suits were filed, or all consumers put into various collection strategy buckets, any of those discretionary practices that Stefanie went through earlier in the podcast, and the CFPB would run some regression testing to try to identify whether there's any potential disparate impact among the various populations. At that point, CFPB typically would move into some match pair testing to see whether the results of the regression analysis are being carried forward and supported by that testing.

So, what is a matched pair? A matched pair would be two similarly situated consumers. One would be a member of a protected class, and one would not be a protected class. So, an example would be a white consumer and a non-white consumer, if we're looking at race. The consumers would both have applied for, or were considered for, or given the same treatment, but with a different result. For example, a white consumer and a non-white consumer with a similarly situated debt, perhaps the debt was at the same stage of delinquency, similar amounts within a range, things like that, and one of those consumers was approved for a particular settlement option, and one was denied.

The CFPB, typically, I think in our experience, we've seen them look at the hard account data, the financial statistics, if age of the consumer is available, those objective factors. And they've been pretty resistant to digging into notes. And instead, we've had our clients have to go through, review the notes on each of the transactions, to try to not only identify, but also substantiate to the CFPB that there is a non-discriminatory reason for the difference in treatment. So, therefore, the matched pair does not actually support any conclusion of disparate impact or disparate treatment.

That can be a very arduous process. And particularly given the trends of the CFPB we're seeing currently, one that may be an uphill battle with convincing the Bureau that there's no issues. We've also seen the CFPB use those matched pair analyses to support of allegation of disparate treatment - remember that intentional discrimination. I think the more highly discretionary the process or procedure is, I think there's more likelihood that the CFPB could also come in and say that that's an example of a supervisor, or a manager, or whoever the decision maker is, exercising unfettered discretion and must be making a decision based on a protected class. So, the CFPB can use that analysis to support either of those allegations of discrimination.

[CHRIS WILLIS]

So, Stefanie, I'm a practical person, and I think our clients are practical people. Let me ask you a practical question. We've gotten this very public warning from the CFPB that they're going to be applying discrimination analysis of some sort that they haven't told us about yet to collections, perhaps both first and third party. So, knowing that this is going to happen, because the Bureau has told us so, publicly, what can people with debt collection operations, again, both first and third party, start to do now with respect to their compliance management system and assessing their operations to try to identify and mitigate potential discrimination issues in those operations?

[STEFANIE JACKMAN]

It's a great question. And thinking back to where we started at first, let's identify areas where you have some discretion. And then let's identify the ways that you may control that already. There may be opportunities to have more control. And what I mean by that is just, this is the range that we have for consumers, for resolving debts. We'll approve anything in this range, and this is how to go about presenting it to a consumer, right? We see a lot of times the agents, and I understand the need, I don't want to over formalize this, I understand the need for some flexibility, but giving some guidelines to your agents and customer service representatives who are responsible for when they reach a consumer, trying to help the consumer find a plan that can work for them, steps that they go through that are outlined can be helpful, so you can say you at least try these other things and everybody gets that. And then ultimately, people end up where they are, that's in contrast to a policy, and I've seen this before, of whatever a consumer is willing to pay we'll accept. You can do that too. It's just making sure that you understand where there's the opportunity for discretion and flexibility, what controls you have, and then documenting and making sure people are understanding that if you have some more rigid guidelines, like a waterfall you go through, or this is the checklist for account that's appropriate to be referred out for consideration for litigation, or whatever. These are the types of accounts that we'll forgive if the balance is less than $25 and it's two years old, whatever it is. Or you have a policy that just says, I see this lot in medical, we'll take any amount the consumer's willing to pay. If they can do a payment plan of $10 a week from now until eternity, fine. Just know what that looks like.

And then train the people who are making those decisions to document why they agree to different things, why they make different decisions. And then I think it's important to start developing a process of not just what we used to advise, having calibration sessions with your leadership that is team leads on the collection floor, et cetera, to just learn, and educate, and continue to create a culture that focuses on making sure people are treated similarly, unless there's a reason not to. And there can be, and often are, reasons for consumers having different outcomes here. One consumer may be permanently disabled. The other anticipates perhaps having a job in a couple of months. Somebody has applications out. Somebody else has a job offer. I mean, there can be very sound reasons. Making sure those are captured, making sure you're talking about that. But then also having compliance start to come in and do some sort of testing for what Sarah was talking about with that disparate impact, notwithstanding our effort to control discretion, to make sure we have guidelines and qualifications and checklists.

Are we still impacting some class of people based on that shared protected characteristic more than others? And then looking at our notes and saying, well, okay, but here's why. That's an important piece to start building into your compliance management system that I think we don't really have right now. Identify areas of discretion, the controls you have, and build the compliance backend checking of that. Sarah, I know you've done a lot in this space as well. What are your thoughts, thinking about what you outlined for a CFPB exam?

[SARAH REISE]

I think all of that is spot on, Stefanie. The only other thing that I would touch on would be some training. When you have collection agents, managers, the people who are exercising the discretion, taking a look at what type of training they're receiving. One thing that we've been recommending since 2013, 2014, would be a calibration session with test cases, to see how your collectors are exercising discretion, and applying, hopefully, those good guidelines that they're going to build into their policies and procedures that you just touched on. So, that type of training can also dovetail very nicely with those documented policies and procedures, and to show that the organization's committed to not only on paper treating consumers fairly across the board, but that it's also giving its employees, its collectors, its managers, the tools and the training to apply those policies effectively.

[CHRIS WILLIS]

I think both of you have done a very comprehensive job of talking about how you address areas of discretion in collection. Let me just add to that one small thing on the disparate treatment side, which is if you have rules, or policies, or algorithmic models that you use in a collection operation, that might have been developed without paying attention to potential discrimination issues because you thought, "Well, Hey, this isn't covered by any discrimination law," I think now would be a great time to look at those rules or the elements in those algorithms to see if there's any use of a protected characteristic or something that's a close proxy for a protected characteristic, because now you've been told by the CFPB that, hey, it's not off limits for discrimination analysis. So, in addition to all the things you heard Stefanie and Sarah mention, I would just add that to the list.

That brings us to the end of today's episode. So, I want to first thank Stefanie and Sarah for being on the podcast and sharing their wisdom and experience with us. I want to thank our audience for tuning in for another episode of our podcast. And I'd like to remind all of you to visit our blog at ConsumerFinancialServicesLawMonitor.com. Hit that subscribe button so that you can get our daily updates about all happenings in the consumer finance industry. And

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