

Payments Pros x The Consumer Finance Podcast – Point-of-Sale Finance Series:
Fair Lending Risks at the Checkout Counter

Host: Taylor Gess

Guests: Chris Willis and Lori Sommerfield

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Taylor Gess (00:05):

Welcome to this special edition of [The Consumer Finance Podcast](#) and [Payments Pros](#). I'm Taylor Gess, an associate in Troutman Pepper Locke's Consumer Financial Services Regulatory Practice, and I'll be your guest host for today's episode. Today, we're going to be giving you another installment of our special highlight series on point-of-sale finance, where we will discuss issues related to fair lending. But before we jump into that topic, let me remind you to visit and subscribe to our blogs, [TroutmanFinancialServices.com](#) and [ConsumerFinancialServicesLawMonitor.com](#). And don't forget about all of our other podcasts. We have the [FCRA Focus](#), all about credit reporting; [The Crypto Exchange](#), about crypto and digital assets. We also have [Moving the Metal](#), our auto finance podcast. All of those are available on all popular podcast platforms. Speaking of those platforms, if you like this podcast, please let us know. Leave us a review on your podcast platform of choice and tell us how we're doing. Now, as I said, today's episode is another in our special highlight series on point-of-sale finance. Here, I'm joined by my colleagues Chris Willis and Lori Sommerfield to give us some insights into fair lending. Welcome to the podcast, Chris and Lori.

Lori Sommerfield (01:12):

Thanks for having us join, Taylor. Great to be here.

Chris Willis (01:14):

Taylor, it's great to be here, and I'm really enjoying the role reversal today.

Taylor Gess (01:17):

Yes, it's quite fun, Chris. So, Chris, before we get started, can you please level set the scope of the discussion we'll be having around fair lending issues in point-of-sale transactions?

Chris Willis (01:27):

Sure. I mean, what we wanted to talk about was when we mean point-of-sale, what Lori and I are thinking about are instances where the customer is physically present with a merchant, either in the merchant's place of business at the point of sale of buying something, or perhaps even in the consumer's home if there's a home solicitation happening, like for home improvement or an alarm system or something like that, that might be the subject of financing.

It's the special issues that arise in those personal contact situations that we wanted to highlight today.

Taylor Gess (01:59):

Thanks, Chris. That's great background to have going into the rest of the conversation. Lori, what are some of the traditional fair lending risks that apply to all lenders in credit transactions? And, what do you view as the key fair lending risk in point-of-sale transactions?

Lori Sommerfield (02:12):

I'm happy to discuss those topics, Taylor. So, first of all, let me address your first question. I think we've basically seen four key fair lending risks that have been identified by the U.S. Department of Justice, federal banking agencies, and the CFPB countless times in examinations, investigations, and enforcement actions over the years. Probably since the early 1990s when the federal fair lending laws began being strictly enforced. And as a threshold matter, I should probably mention that fair lending risks can arise under either the Equal Credit Opportunity Act or the Fair Housing Act. But let me talk about four risks as they come up over the loan life cycle. So, the first one is discouraging applicants from submitting a credit application. This is clearly prohibited by Regulation B, which implements ECOA, although we've seen a proposal from the CFPB to amend Regulation B that might change that up a bit. And we expect to see the final rule coming out here in the next couple of months. So, that'll be an interesting thing to take a look at about how they might be changing that prohibition going forward. The second fair lending risk is differential treatment of consumers on a protected class basis in either marketing and sales or application processing. And this concept is where you have protected class consumers that either don't receive the same marketing and information as non-protected class groups, or they could receive targeted marketing for less desirable credit products. With regard to the application process, the concept relates to protected class consumers receiving a different level of service and/or information compared to non-protected class consumers.

Lori Sommerfield (04:00):

And as a side note, I should also probably note that UDAP risk can certainly arise in the context of sales and marketing practices. So, this points up the need for clear, conspicuous, and transparent legal disclosures that reveal the terms and any risks of the consumer credit product. The third fair lending risk is use of discretion in underwriting and pricing without appropriate controls or monitoring in place. And this is, I think, truly one of the hallmarks of fair lending risk. And we've seen these types of risks identified countless times, again, in concepts like mortgage lending and auto lending. But it also comes up in other types of credit products, too, like credit cards. The fourth risk is product steering, and this is where a creditor has a variety of similar consumer credit products, but some might be less desirable than others in terms of terms, conditions, and pricing. And the creditor uses their influence during the marketing and sales process to push a protected class group applicant toward the less desirable product. So, think of it in the context of prime versus subprime lending in either mortgage lending or credit cards when the applicant actually qualifies for the prime product. I think that's a good example and way to think about it. But getting to your second question, Taylor, the key risk in point-of-sale transactions from a fair lending perspective is how the merchant interacts with the consumer at

the point of sale. And that brings into play the human touch. So, this is where use of discretion or unconscious bias can come into play. So it's really important to have consistency in the marketing and sales process as well as intake and processing of applications to make sure that consumers are treated fairly and there's no risk of running afoul of the federal fair lending laws. So that's how I would capture the risks. Again, the key fair lending risk is really that human interaction with the consumer at the point of sale by the merchant staff.

Chris Willis (06:03):

And as an aside, Lori, I'm just gonna thank you for saying the words "the human touch," because now that Rick Springfield song from the '80s is gonna be playing in my mind for the remainder of this episode.

Lori Sommerfield (06:12):

And there's also a Bruce Springsteen song called "Human Touch" from the early 1990s. So let's give credit to both Springsteen and Springfield.

Chriss Willis (06:21):

An odd comparison, I might say.

Taylor Gess (06:24):

Definitely. Okay, great. Thank you, Lori, for those insights. That's really helpful. Chris, can you please walk us through this problem of how fair lending risks can manifest in point-of-sale transactions?

Chris Willis (06:36):

Sure. And as Lori said, it has to do with the interaction between the merchant's employees and the consumers about the credit product or products. So for example, if we just sort of take one example that Lori said about discretion. If the employee has the ability to decide who will be offered the financing product and who will not, the employee might offer it to some people and not others and might exclude people who are actually eligible for it because of some assumption or belief on the employee's part. And so you might have differential offering of the product, some consumers getting it and some not based on perceived need, desirability, or whatever, perceived odds of approval on the employee's part. And so, that differential offering of the product could be a fair lending problem. Likewise, if you have more than one product in the mix. So if a particular lender has more than one product available, more than one type of financing, or if the merchant has access to different offerors of credit from different companies, then there's a possibility for steering. And you heard Lori talk about steering a moment ago and say, the archetypical steering situation will be, "Well, I'm in kind of a lower-income neighborhood, so I'm gonna only tell customers about the subprime product," which may have a higher interest rate for it, whereas if I'm in a wealthier neighborhood, I'll offer those people the prime product that has a lower interest rate associated with it. Now, there may be people who live in the lower-income neighborhood who have 850 credit scores and could qualify for the prime product, but

they might not be offered it based on the assumption of the employees of the merchant. And that's a classic steering situation where we've seen enforcement activity happen in the past. The risk is greater for the lender if the lender itself has more than one product available to the merchant.

Chris Willis (08:28):

So if I'm a lender and I have both a subprime and a prime product and the merchant can decide which to offer, I'm at a lot of risk because my own originations and applications can be compared against one another. The practical risk is less if each lender has one product. Some are prime, some are subprime, and the merchant chooses which to offer because that's a lot more difficult for any single lender to be held responsible for the merchant's behavior in that regard. But in any event, that kind of discretionary offering or not offering and steering are the two primary risks. The other possibility, and this is a risk that we've seen play out in mortgage lending in years past and even relatively recently in a CFPB report on small business lending, is the idea of different levels of assistance or encouragement. So for decades, fair housing groups and regulators have sent sort of mystery shoppers in to mortgage lenders to apply or pretend like they're going to apply for mortgage loans. And then they've measured the difference in either encouragement or assistance that those testers received from the employees of the mortgage lender. And so you could take that same analysis and same exercise and apply it to a point-of-sale offered finance product, whether the employee says, "Oh, hey, this is a really great product and you'll really like it, it's really good for you," versus, "Oh, financing? Yeah, I guess, if you want it. But it's kinda a hassle, but we can do it if you want to, but it's kinda a hassle." So you can have this idea of the employee sort of selectively encouraging or discouraging or giving some customers more help in applying for financing than others as also a potential fair lending issue. That really only comes up with testers where, somebody can send testers in to evaluate the employee's behavior. Bank branches have gotten a lot of that in the past through the mortgage lending lens, but it could happen at a fixed location merchant's point of sale as well.

Taylor Gess (10:23):

Thank you, Chris. All these considerations sure provide our point-of-sale folks with some things to consider. Lori, what are some ways in which merchants can mitigate these fair lending risks?

Lori Sommerfield (10:32):

Well, Taylor, I think it begins with the creditor who is responsible for maintaining a fair lending risk management program and then making sure that the merchant and their staff comply with it. So, first of all, it's critical for creditors to provide appropriate fair lending training materials to merchants, who in turn should then require that their marketing and sales people take it and monitor them to make sure that they do. Second, it's also advisable for the creditor to provide merchants with standardized sales scripts and written materials, as well as clear and conspicuous legal disclosures that could reveal any potential risk of the credit product to the consumer. But it's that need for standardization so that you are treating all potential applicants equally and offering them the same information and the same level of service. And the third way creditors can mitigate this risk is to consider using mystery shopping. And Chris mentioned that in his prior answer when we were talking about ways in which fair lending risk can arise at point-of-sale transactions. And that is a way that creditors can obtain confirmation to some extent that

merchants are indeed abiding by the federal fair lending laws as well as the fair lending training and sales material that the creditor provided. But I just wanted to point out that if a creditor decides to conduct mystery shopping, then they should make sure that they're creating it in consultation with legal advice from an experienced consumer finance attorney and also ensuring that they conduct it under attorney-client privilege to protect the results.

Chris Willis (12:09):

Yeah, and I think the biggest things that a point-of-sale lender can do is first to try to achieve as much as possible uniformity in the offering and description of the product to the merchant's customers. So it would be great to have an agreement with the merchant that, like, the credit will be offered to everybody regardless, you don't make a decision about who gets offered and who doesn't, to have only one product in the market, or if you have two products, to consider all applications under both the prime and subprime product so you don't have a steering problem. That could solve that, for example. And then to the extent that the lender has the ability to communicate directly with the consumer, which probably doesn't happen until after you have an application, make sure that anything that happens after that can be as standardized and uniform as possible. And again, consider the applicant for the best product that they qualify for to alleviate any steering problems and then be mindful of any consumer complaints about the credit offering process. That's really realistically, I think, what we can do. And a lot of those preventative measures are based on point-of-sale UDAP cases that have been brought by regulators and the consent orders that followed them where the allegation was the human interaction between the merchant's employees and the customers created some deceptive practice or some other sales practice problem with respect to a credit product. The kind of measures that were required in those consent orders are very analogous to what you would want to do to prevent fair lending risks, which arise from the same human interaction aspect of the transaction.

Taylor Gess (13:44):

So Lori, given all of the federal considerations and, maybe lack of enforcement on the federal level in the fair lending space, is this something that, people in point-of-sale need to be concerned about right now?

Lori Sommerfield (13:57):

Yes, they should. Despite the pullback at the federal level in terms of enforcement of the federal fair lending laws, we know that there's always a cycle to Republican and Democratic administrations. So even though we're in a Republican administration right now that is not enforcing the fair lending laws very aggressively, there is a five-year statute of limitations on the Equal Credit Opportunity Act. So should a Democratic president take office in the next cycle, there would decidedly be a five-year look-back at activity and compliance under the federal fair lending laws. So that's something that I think merchants and creditors should take to heart, that you basically need to keep on keeping on with your fair lending risk management programs and compliance with the federal fair lending laws, despite scaling back of fair lending law enforcement by the federal government during this period of time.

Taylor Gess (14:55):

Well, Chris and Lori, thank you for being here with us today. We've done a great job highlighting some key fair lending topics for people in the point-of-sale finance space to consider. So let's leave this special series here for now, and we'll pick back up with another very interesting topic on our next special joint episode for [The Consumer Finance Podcast](#) and [Payments Pros](#) on this topic. In the meantime, thanks to our audience for listening today, and don't forget to visit and subscribe to our blogs, [TroutmanFinancialServices.com](#) and [ConsumerFinancialServicesLawMonitor.com](#). While you're at it, why not visit us on the web at [Troutman.com](#) and add yourself to our Consumer Financial Services email list? That way we can send you copies of the alerts and advisories that we send out, as well as invitations to our industry-only webinars that we put on from time to time. And of course, stay tuned for a great new episode of this podcast every Thursday afternoon, and look forward to the remainder of our special highlight series on point-of-sale finance coming soon to your podcast feed. Thank you all for listening.

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