DIGITAL MARKETING AND BIG DATA — MANAGING FAIR LENDING RISK

The advantages of digital marketing and "Big Data" have led banks and consumer finance companies, in recent years, to focus marketing efforts on internet and digital channels. While these tools are efficient, their use may create fair lending violations when model variables are correlated with prohibited factors. The authors discuss the issues and conclude with suggested best practices to mitigate fair lending risks.

By Darren M. Welch and Anand S. Raman *

As consumer banking preferences have shifted increasingly to online and mobile engagement in recent years, so too have banks and consumer finance companies focused marketing efforts on internet and digital channels. Digital marketing offers a number of advantages over more traditional approaches, including expanded data sources, social media tools to identify in-market consumers who resemble a company's most preferred customers, and cost savings that cannot be matched in print and broadcast channels. However, digital marketing and the use of so-called "Big Data" in consumer financial services presents fair lending risks as well. For example, some populations may have (or be perceived to have) differential access to, or preferences for, using online and mobile services, resulting in a so-called "digital divide" or "digital deserts." And marketing tools that leverage online data to target customer segments may result in the exclusion of customers on a prohibited basis.

As is often the case, regulatory expectations and the law have to some degree lagged innovations in technology, increasing uncertainty for the consumer financial services industry. Moreover, the prevalence of third-party providers and lack of transparency regarding how Big Data is used can complicate efforts by lenders to mitigate fair lending risk.

Digital marketing consists of communications to consumers through the internet, to consumer's mobile devices, or through other online engagement, such as social media platforms for purposes of marketing products and services. Digital marketing may take many forms, including targeted solicitations to apply for products and services delivered through social media platforms, identifying consumers for solicitations based on data about them derived from information maintained by social media platforms, banner ads on websites, and marketing to consumers through e-mails or apps. In addition, this article considers uses of sophisticated data sets and non-traditional data sources or data elements, including information about consumers derived from their online activities and use of technology — sometimes referred to as "Big Data" — for marketing and other purposes.

This article begins by discussing the primary fair lending laws and their application to marketing. Second, we survey recent trends in internet and digital access among different demographic groups. Next, we discuss specific digital marketing practices, including use of non-traditional variables, consumer matching tools, and customer segmentation, and the fair lending risks associated with each. Finally, we provide some recommendations and options for mitigating fair lending risk in this area.

OVERVIEW OF THE FAIR LENDING LAWS AND THEORIES

Equal Credit Opportunity Act

The Equal Credit Opportunity Act ("ECOA"), which is implemented by Regulation B,[1] prohibits discrimination on the basis of race, color, religion, national origin, sex, marital status, or age (provided that the applicant has the capacity to enter into a binding contract); the fact that all or part of the applicant's income derives from any public assistance program; and

[1] 15 U.S.C. §§ 1691 – 1691f; 12 C.F.R. part 1002.

* *DARREN M. WELCH is Counsel in the Consumer Financial Services practice at Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates in Washington, D.C. ANAND S. RAMAN is a Partner in Skadden's Consumer Financial Services practice in the Washington, D.C. Their e-mail addresses are darren.welch@skadden.com and anand.raman@skadden.com.*

the fact that an applicant has exercised rights under certain federal and state laws.

ECOA prohibits discrimination in all forms of credit and with respect to "any aspect of a credit transaction," including "every aspect of an applicant's dealings with a creditor regarding an application for credit or an existing extension of credit (including, but not limited to, information requirements; investigation procedures; standards of creditworthiness; terms of credit; furnishing of credit information; revocation, alteration, or termination of credit; and collection procedures)."[2] It is not settled whether ECOA applies to pre-application marketing activities, because the statute governs the treatment of "applicants."[3] However, Regulation B prohibits "discouragement" of prospective applicants on a prohibited basis, and some regulators have, at least informally, taken the position that ECOA prohibits discrimination with respect to pre-application marketing.[4]

Fair Housing Act

The other major federal fair lending law is the Fair Housing Act ("FHA"). The FHA prohibits discrimination based on race, color, national origin, religion, sex, familial status, or handicap in "residential real-estate-related transaction[s]," including the "making or purchasing of loans or providing other financial assistance" for purchasing, constructing, improving, or maintaining a dwelling.[5] The Fair Housing Act prohibition against discrimination applies more clearly to marketing, and the Act makes it unlawful to "make, print, or publish, or cause to be made, printed, or published, any notice, statement, or advertisement, with respect to the sale or rental of a dwelling that indicates any preference, limitation, or discrimination based on" a prohibited basis.[6]

In addition to these federal fair lending laws, there are a number of state fair lending and fair housing laws that apply to lending, some of which prohibit discrimination based on additional factors such as military status and sexual orientation.[7] Also, the Civil Rights Act of 1866 prohibits intentional discrimination in the formation of contracts based on race, ethnicity, and alienage, and it applies to all products and services, including credit and non-credit products.[8]

Disparate Treatment and Disparate Impact

Fair lending theories of liability recognized by the courts include (1) disparate treatment, including overt and non-overt intentional discrimination and (2) disparate impact.

Disparate treatment discrimination occurs where a lender treats members of a protected class differently than non-protected class members. Discriminatory intent is required to demonstrate disparate treatment.

Evidence of discriminatory intent can be overt, *e.g.,* policies or procedures that explicitly draw distinctions based on a prohibited factor or discriminatory statements. For example, limiting the availability of a loan program to persons under the age of 40 would be overt discrimination. Likewise, using criteria to purposefully direct advertisements to targets based on a prohibited factor, *e.g.,* race or ethnicity, or excluding such individuals from offers, could potentially be considered overt discrimination.

Intent to discriminate can also be established by more circumstantial evidence of discrimination, and some have argued that intent to discriminate for purposes of establishing disparate treatment can be inferred. Accordingly, disparate treatment cases are often premised on statistical analyses that indicate that members of a protected class are harmed in some way, such as by being denied loans at higher rates or charged higher prices, than similarly situated, non-protected class members. These results are often validated through review of individual files.

Redlining — the practice of declining to do business in an area on account of the racial or ethnic composition of that area — is also considered by some to be a form of disparate treatment. Redlining issues can be implicated by use of geography as a marketing criterion.

Disparate impact discrimination occurs where a specific, facially neutral practice has an adverse effect on a prohibited basis and is not supported by a legitimate

---

[2] 12 C.F.R. §§ 1002.2(m), 1002.4(a).

[3] 15 U.S.C. § 1691(a).

[4] 12 C.F.R. § 1002.4(b).

[5] 42 U.S.C. § 3605(a).

[6] 42 U.S.C. § 3604(c).

[7] *See, e.g.,* N.Y. Exec. Law § 296-a.

[8] 42 U.S.C. §§ 1981, 1982.

business justification. And if the practice is supported by a business justification, the practice can be found to constitute disparate impact if the plaintiff can establish that there is a lesser discriminatory alternative that serves the business justification.

Although its validity has been questioned, many recent government fair lending enforcement actions have relied on the disparate impact theory. Moreover, in 2015, the Supreme Court upheld the availability of disparate impact liability under the FHA in the case of *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*[9] While the *Inclusive Communities* decision held that disparate impact is a valid theory under the FHA, it set forth certain "cautionary standards" and "safeguards" against unwarranted claims. In particular, the Court stated that the disparate impact theory should be directed against only "artificial, arbitrary, and unnecessary barriers." In addition, the Court stated that plaintiffs must establish "robust causality" between the policy being challenged and the alleged disparate effect, in order to protect defendants "from being held liable for racial disparities they did not create."

INTERNET AND DIGITAL ACCESS — IS THERE STILL A "DIGITAL DIVIDE"?

As the internet and digital products and services have become a common part of life and commerce, variations in internet and digital access across different groups — referred to as the "digital divide" — have become less pronounced over time. And while nearly all adults in the United States use the internet to some degree, differences remain in *how* people access and use the internet and digital services. Depending on how products and services are delivered and advertised online, these differences can have fair lending implications.

The data regarding demographics and internet usage are far from precise. However, recent surveys show that nearly all adults in the United States use the internet, with only minor variation across racial and ethnic groups.[10] One study, for example, shows that only 11% of white adults, 12% of Hispanic adults, and 13% of African-American adults do not use the internet. However, differences are much greater across age groups: 34% of Americans age 65 or older do not use the internet, compared to only 2% of adults age 18-29 and 3% for those age 30-49.

While racial and ethnic groups appear to access the internet at similar rates, there appear to be differences in *how* they access it.[11] For example, according to one study, 83% of white American adults access the internet through a desktop or digital computer, compared to 60% of Hispanic adults and 66% of African-American adults. Similarly, home broadband use is more prevalent for white adults (78%) than Hispanic (58%) and African-American (65%) adults. Smartphone use is fairly similar across these groups, in the range of 72%-77%.

There also appear to be geographic differences in internet access. For example, one study indicated that approximately 22% of individuals in rural areas do not use the internet, compared to 11% of the American population as a whole.[12] In addition, regulators have expressed concern about "areas characterized by a lack of access to high-quality data that may be used to generate social and economic benefits," referred to as "data deserts."[13]

The differences described above have potential fair lending risk implications. For example, low internet use by seniors could lead to lower penetration among that group for digital marketing campaigns. Likewise, differences in how racial and ethnic groups access the internet could result in different product availability if, for example, companies make online products and services available only through certain types of internet access (such as online-only products or services that require a desktop or laptop computer to access), or if information about the type of access device used to access the internet is considered for marketing purposes (such as a marketing model variable that scores whether the customer accesses a lender's website through a home computer or broadband versus cellular service). In addition, variations in the availability of data in certain geographic areas could skew the impact of models developed using online data about consumers. For example, marketing models that use data regarding online spending practices may tend to exclude a larger

[9] 135 S. Ct. 2507.

[10] *See* Monica Anderson et al., *11% of Americans don't use the internet, Who are they?*, Pew Research Center, Mar. 5, 2018, for the data in this paragraph.

[11] *See* Andrew Perrin, *Smartphones help blacks, Hispanics bridge some – but not all – digital gaps with whites*, Pew Research Center, Aug. 31, 2017, for the data in this paragraph.

[12] Anderson, *11% of Americans don't use the internet, Who are they?*

[13] Federal Trade Commission, *Big Data: A Tool for Inclusion or Exclusion?*, p. 27, n. 149 (2016).

portion of consumers in rural areas with more limited internet access.

DIGITAL MARKETING ISSUES

In this section we describe specific fair lending issues that present elevated risk in the context of digital marketing or use of Big Data for marketing or underwriting.

Non-traditional Data Sources

The increased use of the internet and social media sites allows companies to access vast amounts of data about consumers and their preferences that were previously unavailable. Information about consumer spending and payment habits, technology use, and online "friends" and other connections between individuals and groups or businesses, for example, could allow for highly targeted and efficient advertising and thus reduced marketing costs. In addition, the use of non-traditional data sources may also open up new opportunities to extend access to credit to groups lacking traditional credit profiles. This possibility was recently recognized by the Bureau of Consumer Financial Protection (the "Bureau"), which issued a Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process, in which it stated that new data and modeling techniques could benefit "[p]otentially millions of consumers previously locked out of mainstream credit."[14]

With these new opportunities, however, come potential fair lending risks, particularly insofar as online behaviors or other data elements used for marketing or underwriting may be correlated with a consumer's race, ethnicity, sex, religion, or other prohibited basis.

While there has been limited regulatory enforcement and guidance regarding non-traditional data elements, the Bureau's first public use of its no-action letter process under Project Catalyst addressed this topic. This no-action letter was issued in September 2017 to Upstart Network, Inc. regarding its use of certain non-traditional data elements for underwriting and pricing of consumer loans. Upstart had sought the Bureau's approval for the use of non-traditional data sources, including the school attended by the consumer, the degree obtained, and current employment information in its pricing and underwriting models, which it stated was designed to improve credit access for thin file and younger applicants. As part of the no-action letter request, Upstart agreed to conduct ongoing fair lending testing of its underwriting model, maintain model-related compliance management systems, and share data with the Bureau.

Consumer Matching Tools

Some social media platforms offer tools designed to identify customers who resemble an advertiser's preferred customers for purposes of targeted marketing. In this situation, the advertiser — such as a consumer lender — can provide information on a seed population of the lender's customers to the social media platform. The social media platform would then use information about that population and modeling techniques to identify consumers who subscribe to the social media platform that resemble the seed population provided by the lender, and the advertiser's marketing would then be directed to those consumers. These consumer matching tools can be highly effective at targeting marketing to consumers that the advertiser would deem highly desirable, but they can also present fair lending risk. For example, if there is a demographic imbalance in the lender's seed population, that imbalance may be perpetuated in the matched population. Also, the variables used by the social media platform, or the demographic base of the social media users, could skew the demographics of the matched population.

Demographic Segmentation

Some third-party marketing models or services allow companies to target (or exclude from targeting) consumers falling into certain segments or clusters defined by the third party. These segments are often given a catchy and purportedly descriptive name. Examples of such names include "Urban Blues," "Remaining Diverse," "Metro Minority Families," "Country Living," "Soccer Moms," "Young Influentials," or "Lap of Luxury." An advertiser's visibility into how these segments are derived and defined may vary, and the name of the segment may not always fully describe the contents of the segment.

The use of demographic segmentation for marketing of credit products can present elevated fair lending risk insofar as the segments are defined in relation to a prohibited basis such as race, ethnicity, sex, age, or marital status.

In November 2016, for example, a putative class action was brought against Facebook alleging that the social media site allowed housing ad buyers to click a button called "Exclude People" and prevent ads from being displayed to users classified as "African American

[14] 82 Fed. Reg. 11,183, 11,184 (Feb. 21, 2017).

(US)," "Asian American (US)," "Hispanic (US – Spanish Dominant)," and "Immigrant."[15] The plaintiffs alleged that the advertising practices violated the Fair Housing Act and California state law. After Facebook announced that it had changed it advertising practices, a second lawsuit was filed against it, in March 2018, by the National Fair Housing Alliance ("NFHA") regarding advertisers' ability to "include" or "exclude" recipients of real estate advertisements based on a pre-populated list of demographics, behaviors, and interests.[16] The alleged exclusion criteria include "moms of grade school kids," and "interest" in categories such as "English as a second language," "Telemundo," Disabled American Veteran," and "Disability.gov." The lawsuit alleges that the advertising practices constitute illegal discrimination based on familial status, sex, disability, race, and national origin in violation of the Fair Housing Act and New York state law. Also, on August 17, 2018, the Department of Housing & Urban Development filed a complaint against Facebook alleging that it allowed advertisers of housing-related services to discriminate based on race, color, religion, sex, familial status, national origin, and disability, in violation of the Fair Housing Act. These matters are ongoing.

BEST PRACTICES FOR MITIGATING DIGITAL MARKETING AND BIG DATA FAIR LENDING RISK

Consumer financial regulators have provided little guidance with respect to managing fair lending risk associated with digital marketing and use of Big Data. There are, however, a number of steps consumer finance companies can take to mitigate fair lending risk. Appropriate risk mitigation strategies will vary based on the nature of the model, data, or service, and may include one or more of the following:

- **Formal fair lending review process.** Companies should consider requiring that digital marketing models, campaigns, and materials be reviewed by internal or external legal or compliance experts.

- **Model governance.** Digital marketing models — like other models — should be subject to a company's existing model risk governance processes. This may include model validation, model risk assessments, an inventory of models with risk ranking, and periodic review of existing models.

- **Demographic segment data.** It would be prudent to carefully review use of marketing inclusion or exclusion criteria or other pre-defined segments or clusters based on demographic factors that are (or that may closely correlate with) a prohibited basis.

- **Assessing and mitigating model risk.** Fair lending risk mitigation strategies for marketing models may vary, depending on the complexity and visibility of the model, as well as resource constraints. Risk mitigation strategies may include one or more of the following:

  — reviewing lists of variables in the models;

  — obtaining certification or other assurance from model vendors and marketing service providers that prohibited factors are not used in the marketing model or tool;

  — fair lending testing of models; and

  — engaging third parties with appropriate expertise to review models.

- **Reaching a broad audience.** Companies may wish to consider marketing practices that, in the aggregate, are designed to reach a balanced, broad audience, rather than being limited to a particular targeted demographic.

- **Regulatory approval.** Companies seeking greater comfort or regulatory validation of specific practices central to a company's business model could consider seeking a no-action letter from the Bureau of Consumer Financial Protection or other appropriate agency. ■

---

[15] *Onuoha, at al. v. Facebook, Inc.,* No. 5:16-cv-06440-EJD (N.D. Cal. filed Nov. 3, 2016).

[16] *National Fair Housing Alliance, et al. v. Facebook, Inc.,* No. 1:18-cv-02689-JGK (S.D.N.Y. filed Mar. 22, 2008).