

By electronic delivery to regulations.gov

May 17, 2017

Ms. Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC. 20552

Re: Docket No. CFPB-2017-0005
Notice and request for information
Regarding the use of alternative data and modeling
techniques in the credit process
[82 Federal Register 11183 \(February 21, 2017\)](#)

Dear Ms. Jackson,

The American Bankers Association¹ (ABA) is pleased to submit our comments to the Bureau of Consumer Financial Protection (Bureau) about the current and potential use of alternative data and modeling techniques in the credit process. “Alternative data” is a general term that describes a broad spectrum of data not traditionally used for credit decisions. Such data include, for example, rent, utility, telecommunications payment history, checking account transaction information, as well as information about educational or occupational attainment, use and connections on social media, and “behavioral data” defined as “data on how consumers interact with a web interface or answer specific questions, or data about how they shop, browse, use devices, or move about their daily lives.”² The Bureau states that it is seeking the information to help it monitor consumer credit markets and consider whether any market participants are or could be taking steps to mitigate risks to consumers.

Summary

As a general matter, Banks support the use of alternative data sources to evaluate credit applicants, particularly people with no or “thin” credit files who may be eligible for credit. The use of alternative data, coupled with mobile channels of access to bank products and services, may have potential to expand financial services and open the door to people who otherwise have limited or no access to mainstream credit.

However, banks have concerns about the reliability and predictability of some alternative data and about consumer protections promoting privacy and data security. In addition, it should also be emphasized that banks recognize the importance of fair lending and demonstrating that underwriting

¹ The American Bankers Association is the voice of the nation’s \$17 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$13 trillion in deposits and extend more than \$9 trillion in loans.

² Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process, 82 Fed. Reg. 11185 (Feb. 21, 2017).

models are sound. Having said that, concerns and uncertainty about regulators' fair lending compliance and underwriting expectations, and the associated costs, pose significant impediments to testing and using alternative data. The fear of unfair, deceptive, and abusive acts and practices (UDAAP) allegations also inhibits broader use of alternative data, for example, to reach those with no or low credit scores. In short, there are questions about whether the compliance risks and costs, coupled with the uncertain predictability of alternative data, justify the potential return and benefits.

To help promote use of alternative data and modeling techniques, especially for the development of products to reach underserved groups, we recommend the following:

1. Alternative data providers should be sensitive to consumer privacy and data security and ensure that data are accurate and reliable.
2. Regulators must recognize that application of disparate impact liability in supervision and enforcement causes banks to retreat from using alternative data, limiting inclusion and competition. The challenges and costs associated with analyzing and demonstrating that an alternative data variable does not cause a disproportionate impact on a prohibited basis overwhelm the capabilities of most banks and the business case for using alternative data. To promote the use of alternative data, we urge the Bureau, the Department of Justice, and prudential bank regulators to acknowledge in writing that disparate impact claims are not recognized under the Equal Credit Opportunity Act (ECOA). When considering whether to use alternative data and modeling techniques for non-mortgage consumer credit, bankers should focus on identifying – and avoiding – alternative data and models that present the risk of intentional discrimination, an obligation that can be managed by compliance programs and can be embraced by all.
3. To promote the use of alternative data in mortgage lending credit decisions, regulators should provide guidance on how banks can test and demonstrate that models comply with the Fair Housing Act's disparate impact liability, consistent with the Supreme Court's *Inclusive Communities* framework, and also meet supervisory safety and soundness expectations about model validation. Such guidance should be flexible and tailored so as to be useful and practical across the range of creditors, mortgage products and datasets, recognizing that expectations for small and mid-size banks may vary from those for large institutions.
4. Regulators must also recognize that the persistent threat of an undefined UDAAP sanction hovers like a dark cloud over financial innovation and will cause banks to retreat from using alternative data. UDAAP concerns inhibit the use of alternative data to qualify people with no or low credit scores, who may be considered "vulnerable" – and therefore attract supervisory scrutiny. We encourage the Bureau and bank regulators and their examiners to be circumspect in raising UDAAP concerns and to be sensitive to the broader message that those enforcement actions send that may discourage banks from offering innovative and valuable products.
5. A supervisory approach that reduces banks' compliance risk will encourage banks to use alternative data as a tool to develop products, especially small dollar loans, designed for people

who may not qualify under traditional underwriting standards. Use of those products, in turn, may serve as building blocks for other economic opportunities.

6. The Bureau should reconsider its Project Catalyst and No Action Letter policy to promote testing of alternative data and foster innovation without the risk of triggering fair lending and UDAAP liability.

Use and potential use of alternative data

Banks currently may use, or have expressed an interest in using, limited “alternative data,” such as rent, utilities, telecommunications payment history, stability of address and employment, and their own experience with the credit applicant. However, the review and consideration of alternative data tends to be manual and conducted on a case-by-case basis to qualify someone who might not otherwise qualify for credit based on traditional underwriting. Manual reviews are labor-intensive and slow. Our members report that they might use this information more frequently and consistently if the data were reliable, accurate, validated, and cost-effective, and they were able to build automated models.

Similarly, some banks review bank account activity on a manual basis to qualify marginally qualified credit applicants. For example, they may review the inflows and outflows of bank accounts to qualify those with no or thin files. However, developing, validating, and monitoring an automated model is expensive, especially if its application is limited, for example, to small dollar loans.

Vendors offer a variety of forms of alternative data models that go beyond the information described above to include behavioral and social media data, which have a less intuitive link to creditworthiness. This type of alternative data has promise, and some banks are cautiously investigating ways to use the information. However, use of this information is more challenging given its lack of apparent or intuitive connection to creditworthiness.

Bank concerns that inhibit the use of alternative data

Consumer protections

A primary bank concern with using alternative data, particularly non-intuitive data, is ensuring that customers and potential customers are protected. Banks need assurance that data are accurate and that the providers respect consumer privacy. Banks also need assurance that the company providing the data has appropriate controls to ensure that data are secure.

Regulatory expectations and compliance risk

In addition to those concerns, regulatory expectations and compliance risk around fair lending, UDAAP, and safety and soundness present significant impediments to testing, experimenting with, and using alternative data. Fair lending compliance risk, especially with regard to the application of disparate impact analysis, casts a long shadow. Similarly, the specter of UDAAP liability inhibits the use of alternative data to qualify people with no or low credit scores, who may be considered “vulnerable.” In addition, supervisory expectations for the validation of models also cause banks to pause. Simply put, the investment needed to meet regulatory expectations to demonstrate model predictability coupled

with the heightened UDAAP and fair lending risk may not justify the use of alternative data and models given the uncertainty of the potential return.

Fair Lending. The banking industry supports fair lending and strives to make credit available to all qualified borrowers. However, fair lending analysis and management become more challenging, risky, and complex when alternative data and new modeling techniques are involved. Unlike traditional credit history data, which have long been accepted as having a legitimate business justification notwithstanding its correlations with prohibited bases, the acceptability of alternative data has yet to be established.

While ABA believes that neither the text nor history of the ECOA support disparate impact liability,³ regulators have asserted otherwise; accordingly, to be prepared for a fair lending exam demands thorough disparate impact analysis and documentation. In the current environment banks must determine whether the data used to predict creditworthiness could also be correlated with race, ethnicity, sex, or another prohibited basis. If so, they must develop rigorous evidence to support a business justification for the use of the data, such as whether they are predictive of loan performance or fraud. If the bank can show there is a business justification, our members report that examiners also expect the bank to demonstrate that no less discriminatory option exists.

Assessing, quantifying, and weighing the fair lending risks presented by alternative data and new credit models is a complicated, lengthy, and expensive process made more so by the sheer volume of data involved. The process of identifying and evaluating all potentially questionable attributes used by the model demands the use of sophisticated statistical tools and statisticians who can assess each attribute's predictive power and weigh that against the fair lending risks involved.

In addition, vendors may not be sensitive to the need for the information or the fair lending laws and validation requirements. For these reasons, they may include, for example, prohibited bases as attributes. When building models, they may not include critical information, such as name and address, which might be used by regulators as proxies for race and gender to test for disparate impact.

Moreover, analyzing whether there is a less discriminatory option is complicated and challenging, because attributes may be bundled and cannot be separated or the vendor may be unwilling to test or validate predictability if certain variables are removed. In addition, banks that are reluctant to accept the claims of the vendor typically cannot conduct their own analysis, because the vendor may not know the source of the information or, for proprietary and competitive reasons, may be reluctant to share details about the factors used by the model.

Even assuming that the data are available, for both the banks and alternative data and model providers, the cost of developing, validating – and monitoring -- models in order to be prepared to

³ See generally Buckley Sandler LLP, *Disparate Impact Under FHA and ECOA: A Theory Without a Statutory Basis* (July 13, 2012), available at: <http://www.aba.com/Compliance/Documents/DisparateImpactWhitePaper.pdf>; Am. Bankers Ass'n, *Fair Lending: Fighting Illegal Discrimination: Promoting Growth for the Whole Community* (Apr. 2017), available at: <http://www.aba.com/Compliance/Documents/FairLendingWhitePaper2017Apr.pdf>.

respond to an allegation of potential disparate impact is significant. It is cost- and resource-prohibitive for mid-size and small institutions.

Adding to the costs of disparate impact analyses is the uncertainty about regulatory expectations for analyses, increasing the cost and also stymying analysis and the use of alternative data. For example, banks are uncertain about—

- How predictive the data must be;
- How to handle clusters of data that cannot be unbundled;
- Whether some attributes are more acceptable than others even if they are equally predictive;
- Whether a model is permissible if all attributes are not visible;
- Whether the age of the data matter;
- The options if the source of the information is unknown;
- Whether banks must re-verify that prohibited bases were not used or can rely on the vendor warranties and representations; and
- The number of variables that must be tested to determine if there is a less discriminatory option.

Compounding the challenges above is the specter of a supervisory *assertion* of a disparate impact despite a bank’s extensive and expensive disparate impact analysis. Even if the bank prevails in a challenge, it incurs substantial additional costs to prove its case and risks reputational harm. In effect, the threat of disparate impact liability threatens to choke off potential use of alternative data and credit models, limiting their use to help expand credit opportunities for underserved people with limited or no access to bank credit.

Model validation. Similar concerns about the cost of analysis, model validation, monitoring, and re-validation arise from safety and soundness requirements. Banks are uncertain about how to test and prove the reliability and predictability of the data. For example, the OCC Bulletin, “Safety and Soundness and Compliance on Credit Scoring Models, states that banks using credit scoring models must demonstrate that “the characteristics of the population used to develop the model are similar to those of a bank’s current customers.”⁴ It is not clear how banks can endeavor to reach underserved populations who may not share characteristics of its “current customers.”

UDAAP. The vague and subjective prohibitions against unfair, deceptive, or abusive acts or practices also act as a powerful deterrent to the use of alternative data. A natural use for alternative data is to qualify for credit people who might not be eligible using traditional underwriting data. However, in recent years UDAAP has been reflexively and widely invoked, often casually, subjectively, and with

⁴ OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC BULL. NO. 97-24, APPENDIX: SAFETY AND SOUNDNESS AND COMPLIANCE ISSUES ON CREDIT SCORING MODELS at 1 (May 20, 1997).

questionable legal analysis or basis.⁵ Products used by or marketed to less sophisticated people, in particular, invite UDAAP scrutiny, as this group is perceived as more vulnerable.

Our members express concern that if they qualify people in this category using alternative data, and some of those borrowers are not successful in managing the credit, the bank will be exposed to a UDAAP claim. The risk is amplified if a new, innovative product or service is involved because of the uncertainty of customer performance and the regulatory scrutiny often given to new products. Thus, the threat of a UDAAP claim inhibits the use of alternative data to expand credit to underserved groups.

Considerations to encourage use of alternative data for credit decisions

As discussed above, a number of potentially perverse regulatory effects impede the ability of banks to use alternative data, especially for purposes of developing credit products that might expand banks' ability to create economic opportunities for customers by providing a starting place to build the credit history that leads to greater economic opportunity and health. These pressures include:

- Subjective fair lending and UDAAP supervision and enforcement;
- The compliance risk due to the uncertainty of supervisory expectations with respect to those rules;
- The significant cost of validating and monitoring models for purposes of meeting regulatory expectations; and
- The uncertain potential for returns that would justify the costs and compliance risks.

It is critical that regulators recognize that current approaches to fair lending and UDAAP supervision and enforcement, especially with regard to disparate impact liability, are obstacles in the development of innovative products, especially those geared to borrowers with no or limited credit history.

To reduce the compliance risk and resistance to using alternative data, regulators should enforce ECOA under the disparate treatment standard and reject the regulatorily subjective disparate impact

⁵ See, e.g., *CFPB v. Intercept Corp.*, Case 3:16-cv-00144-RRE-ARS (March 17, 2017), available at: [https://www.morganlewis.com/documents/m/documents/\(201344131\)_1_finreg-cfpb-interceptcorp-order-mar%2022%202017.pdf](https://www.morganlewis.com/documents/m/documents/(201344131)_1_finreg-cfpb-interceptcorp-order-mar%2022%202017.pdf).

"A close review of the complaint yields a conclusion that the complaint does not contain sufficient factual allegations to back up its conclusory statements regarding Intercept's allegedly unlawful acts or omissions" (p. 9).

"The complaint lacks factual allegations that would support a finding that Intercept interfered with consumers' ability to understand the terms of their dealings with Intercept's clients or that would support a finding that Intercept took unlawful advantage of consumers. The complaint simply does not sufficiently identify particular clients whose actions provided 'red flags' to Intercept or how Intercept's failure to act upon those 'red flags,' caused harm or was likely to cause harm to any identified consumer or group of consumers . . . A complaint containing mere conclusory statements without sufficient factual allegations to support the conclusory statements cannot survive a motion to dismiss" (pp. 9-10).

analysis. Doing so will ensure fair treatment of borrowers while promoting the fair and responsible use of alternative data that will promote credit opportunity and availability. Use of alternative data also still have to be sound and predictive, as they would remain subject to supervisory requirements related to model risk management.

To promote the use of alternative data in mortgage lending credit decisions, regulators should provide guidance on how banks can test and demonstrate that models comply with disparate impact liability under the Fair Housing Act. Such guidance should be flexible and tailored so as to be useful and practical across the range of creditors, products, and datasets, recognizing that expectations for small and mid-size banks may vary from those for large institutions. Above all, it must be consistent with the framework for analyzing a disparate impact claim announced by the Supreme Court in *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*⁶

The Bureau and banking agencies should also provide guidance on how banks can test and demonstrate that models are predictive for purposes of model validation for safety and soundness.

For both fair lending and model validation purposes, the regulatory guidance should be tailored in accordance with the variety of risks and business models. In addition, the Bureau and bank regulatory agencies should consider validating models offered by third parties for purposes of fair lending compliance and safety and soundness requirements so that small and mid-size institutions, who otherwise lack the resources to do so, will have the opportunity to use alternative data and models.

As a starting point, we urge the Bureau and other regulators to raise awareness among vendors of banks' need to understand alternative data and models for fair lending and model validation purposes. Similarly, regulators should ensure that vendors are sensitive to privacy, data security and reliability, and other consumer interests.

Making it easier for all institutions to use alternative data will help advance the goal of inclusion by expanding the number of institutions able to develop and offer innovative products. This means including people living in areas where community banks are the only bank option. It will also increase competition and thus consumer choice and affordability.

We also believe that the Bureau may have opportunities to promote the use of alternative data to expand credit access through a re-examination of its Project Catalyst and No Action Letter (NAL) policy. As we have commented previously, Project Catalyst and the NAL Policy offer illusory opportunities to innovate responsibly with confidence that the experimentation will not trigger fair lending and UDAAP allegations and enforcement. As long as the intent is *to include* people who might not otherwise be eligible for credit, banks should be able to experiment with using alternative data without fear of enforcement. Regulators could monitor such programs, and if the direction or results present the risk of consumer harm, the supervisory process can ensure that adjustments are made quickly.

⁶ *Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Communities Project, Inc.*, 135 S. Ct. 2507 (2015).

Conclusion.

Banks are enthusiastic, but cautious, about using alternative data and models to innovate and improve customer access to credit and product affordability. As discussed above, a number of factors impede experimentation and use of alternative data. Fair lending, UDAAP, and model validation challenges, risks, and costs are primary obstacles. Lack of assurance about the predictability, reliability, and accuracy of the data as well as privacy and data security concerns also cause banks to hesitate. Simply put, the compliance and reputation costs and risks can overwhelm the uncertain return.

We urge the Bureau to reconsider how it enforces fair lending and UDAAP laws and to resolve uncertainties about regulatory and legal expectations. It should also investigate ways to allow banks and other lenders to experiment without the fear of subjective fair lending and UDAAP allegations. To expand the number of people served and promote competition, regulators should take steps to ensure that small and mid-size banks can take advantage of the opportunities alternative data offer. These measures will encourage innovation, particularly with regard to products designed for people with no or low credit scores, expanding access to credit that will help individuals and communities prosper.

We appreciate the opportunity to provide our comments on this request for information and are happy to provide any additional information.

Sincerely,

A handwritten signature in cursive script that reads "Nessa E. Feddis". The signature is written in black ink and is positioned to the right of the word "Sincerely,".

Nessa E. Feddis