LendingClub

October 18th, 2019

Office of the General Counsel
Rules Docket Clerk
Department of Housing and Urban Development
451 Seventh Street SW, Room 10276
Washington, DC 20410-0001

Submitted via regulations.gov

Re: Reconsideration of HUD's Implementation of the Fair Housing Act's Disparate Impact Standard, Docket No. FR-6111-P-02

Dear Sir or Madam,

Thank you for this opportunity to comment on the proposed rule addressing disparate impact in fair housing, including housing-related lending.[1] This is a topic of great importance for the country's credit markets. Although intended to support fairness for both borrowers and credit providers, we believe that the proposed revisions may have the opposite effect, bringing uncertainty to credit businesses and putting innovation at risk. We respectfully suggest the proposed rule not be advanced.

LendingClub is America's largest online credit marketplace, facilitating personal loans, auto loans, and small business loans. Borrowers access lower interest rate loans through a fast and easy online or mobile interface. Investors provide the capital to enable many of the loans in exchange for earning interest. We operate fully online with no branch infrastructure, and use technology to lower cost and deliver an amazing experience. We pass the cost savings to borrowers in the form of lower rates and investors in the form of attractive returns, helping people achieve their financial goals every day. To date, LendingClub has facilitated over $50 Billion in loans, and is the largest provider of unsecured personal loans in the country.

LendingClub shares HUD's goals of increasing access and fairness in credit allocation. While we are not engaged in the home mortgage industry governed by the Fair Housing Act ("FHA") at this time, LendingClub believes that standards established under the FHA rules may influence fair lending law generally, including under the Equal Credit Opportunity Act ("ECOA"), which governs the loans facilitated by LendingClub. For example, courts simultaneously considering FHA and ECOA claims may apply the same standards to both claims, and the Consumer Financial Protection Bureau ("CFPB") and other agencies responsible for administering and enforcing ECOA will be faced with reconciling potentially inconsistent federal fair lending regimes.

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[1] Proposed Rule, 84 FR 42854 (Aug. 19, 2019).

Today, technology innovation is producing great improvement in fair access to capital. For example, researchers at the Federal Reserve studied LendingClub's technology-forward approach to loan facilitation and found that the credit models utilized by LendingClub have "allowed some borrowers who would have been classified as subprime by traditional criteria to be slotted into 'better' loan grades, which allowed them to get lower-priced credit. In addition, for the same risk of default, consumers pay smaller spreads on loans from LendingClub than from credit card borrowing."[2] A study from UC Berkeley examined the effect of a fintech approach to fair lending in the mortgage market specifically, and found that fintech algorithms entirely eliminated discrimination in loan approvals and resulted in 40% less discriminatory pricing outcomes than traditional face-to-face lending.[3]

However, even while technology innovation is reducing discrimination in certain ways, concerns about unintentional discrimination are frequently raised. As a fintech innovator, perhaps the most frequent question LendingClub faces in a policy setting is, "How can fintechs prevent unintentional discrimination resulting from algorithms and data?" It is critical for the stability of fintech innovation that the regulatory framework sufficiently addresses these concerns about data and technology resulting in unintentional discrimination.

Fortunately, disparate impact in its current form does address those concerns about unintentional discrimination. Responsible financial services providers today have developed methodologies for complying with the existing disparate impact framework. And we can reassure policymakers, think tanks, reporters, equity analysts, and others that the existing regulatory framework, if taken seriously, addresses unintentional discrimination.

LendingClub is concerned that the proposed changes may undermine the stability of the disparate impact regime that credit providers rely on in a number of ways. First, it reduces the innovation-friendly outcomes-based approach of the existing disparate impact framework. Second, the proposal may not be considered tenable by policymakers or the courts, raising the risk of regulatory instability. Last, industry participants will not be able to benefit from the stricter requirements placed on plaintiffs because many states will continue to apply disparate impact under their state laws according to the traditional framework and will likely not adopt the pleading standards or defenses proposed by HUD.

One less-discussed, but valuable aspect of the existing disparate impact regime is its outcomes-based framework. Rather than allowing only certain types of data, or certain modeling techniques, the existing

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[2] Julapa Jagtiani and Catharine Lemieux, "The Roles of Alternative Data and Machine Learning in Fintech Lending: Evidence from the LendingClub Consumer Platform," Federal Reserve Bank of Philadelphia, Working Paper 18-15. April 2018. https://www.philadelphiafed.org/-/media/research-and-data/publications/working-papers/2018/wp18-15r.pdf

[3] Robert P. Bartlett, Adair Morse, Richard Stanton, and Nancy Wallace, "Consumer-Lending Discrimination in the Fintech Era" (June 2019). NBER Working Paper No. w25943. Available at SSRN: https://ssrn.com/abstract=3405130

framework permits innovative market participants to develop the most effective credit models, and then requires those models to be held accountable for unintended discrimination by measuring their outcomes, rather than their inputs. We see an outcomes-based approach as a pro-innovation approach to regulation, and we encourage regulatory agencies and lawmakers to explore adopting outcomes-based frameworks elsewhere when applicable.

Unfortunately, the proposed rule would turn away from this outcomes-based approach in favor of a framework focused on inputs. This shift from focusing on the outcomes of models to instead focusing entirely on the inputs to models would undermine the pro-innovation, outcomes-based approach that has existed to date. It would also open the door to further restrictions on innovation in what types of data and modeling techniques can and cannot be used, even if those techniques could produce less disparity in outcomes.

LendingClub's views on the importance of stability in the disparate impact regime, and its importance for innovation in credit markets, is further discussed in a comment letter LendingClub submitted to the CFPB on June 23, 2018 in response to the Bureau's Request for Information on Inherited Regulations. We have attached this letter for HUD's consideration.

Lastly, while we value HUD's effort in the proposed rule to promote fairness and ease for lenders, it will not be possible for lenders to prudently adopt the new framework. Any potential benefit of a new framework would be of limited value to providers operating on a national scale, because many of the largest states continue to operate under the disparate impact framework of today. Attempting to manage HUD's new rule would leave providers caught in a crossfire between state and federal agencies with different views on how discrimination is best prevented. This uneven playing field may also put lenders that must comply with all frameworks at a competitive disadvantage to those that do not.

Similarly, at the federal level, ECOA and Regulation B will remain unchanged absent action by the CFPB, which may not happen under this administration, if at all. The prudential regulators will also continue to apply existing ECOA disparate impact standards. Thus, a business that relaxes its credit-related methodologies in reliance on standards articulated in the proposed rule could face substantial risk.

We appreciate HUD's consideration of how to improve the fair lending framework, for the benefit of borrowers and lenders. Unfortunately, we believe that the well-intentioned reforms proposed would put innovation at risk. Regulatory stability, and the ability to assure stakeholders that the regulatory framework addresses the risk of unintentional discrimination, is critical for the ability of market participants to invest in innovation that is improving access to capital, and lowering the cost of credit, in all communities.

To promote improved outcomes for borrowers, and support innovation and fairness for providers of credit, we encourage HUD to consider the following principles with respect to revisions to its disparate impact rule: preserve the existing outcomes-based framework, and consult with other federal and state regulators to find consensus on how best to clarify best practices for compliance with that framework. That approach would foster harmonization and maintain regulatory stability.

Thank you for considering these views. If you wish to discuss them further, please do not hesitate to contact me at rneiman@lendingclub.com.

Sincerely,

Richard H. Neiman
Head of Public Policy
LendingClub

June 23, 2018

Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552

Submitted electronically at http://www.regulations.gov

RE: Request for Information Regarding the Bureau's Inherited Regulations and Inherited Rulemaking Authorities; Maintain Disparate Impact Policy

Dear Acting Director Mulvaney,

As one of the leading technology innovators in financial services, perhaps the most frequent question we are asked in policy settings is, "How can you ensure that innovations in alternative data, machine learning, and artificial intelligence used in credit underwriting will not result in discrimination?" The questioners are concerned that if credit decisions are made by models that are incomprehensibly complex to humans, then those models could include proxies for race or other protected classes or treat protected classes at a disadvantage. In other words, they are concerned that credit decisioning technology may discriminate without people intending or realizing it.

It is a benefit to LendingClub and other innovators to be able to explain that these concerns can be effectively addressed by the disparate impact regime. As an industry quickly innovating, regulatory stability and flexibility is crucial to financial services' growth and competitiveness. We believe the Bureau should maintain the disparate impact regime as it (a) can address a widely held policy concern while flexibly accommodating innovation in data, machine learning, and artificial intelligence (AI), (b) has not been onerous to comply with in our experience, and (c) provides the regulatory stability that supports innovation and investment.

LendingClub is America's largest online credit marketplace, facilitating personal loans, auto loans, and small business loans. Borrowers access lower interest rate loans through a fast and easy online or mobile interface. Investors provide the capital to enable many of the loans in exchange for earning interest. We operate fully online with no branch infrastructure, and use technology to lower cost and deliver an amazing experience. We pass the cost savings to borrowers in the form of lower rates and investors in the form of attractive returns, helping people achieve their financial goals every day. To date, LendingClub has facilitated over $36 Billion in loans, and is the largest provider of unsecured personal loans in the country.

Disparate impact, as described by the Bureau, describes when "a creditor employs facially neutral policies or practices that have an adverse effect or impact on a member of a protected class unless it meets a legitimate business need that cannot reasonably be achieved by means that are less disparate in their impact."[1] To address disparate impact, LendingClub's programs employ fair lending testing that assesses whether the credit decisioning process used has disparate impact on protected classes, and if so, guides the business towards credit model attributes or processes that are similarly effective at achieving the business' goals while mitigating the disparate impact.

We believe disparate impact is a constructive framework and has not inhibited LendingClub in developing innovative credit models that powerfully identify and price risk, while also expanding access to credit in underserved areas. This is evidenced in the findings of researchers at the Federal Reserve Banks of Philadelphia and Chicago in a recent paper titled, "The Roles of Alternative Data and Machine Learning in Fintech Lending: Evidence from the LendingClub Consumer Platform." The researchers found that, "the use of nontraditional information from alternative data sources has allowed consumers with fewer or inaccurate credit records (based on FICO scores) to have access to credit. Some creditworthy consumers (but with poor FICO scores) have been identified using additional information and have been rated as low-risk borrowers by LendingClub… [LendingClub's] rating grades (with only 35 percent correlation with FICO) continued to serve as a good predictor for future loan delinquency over the next two years… This has enabled some borrowers to be assigned better loan ratings and receive lower priced credit."[2]

New approaches in alternative data, machine learning, and artificial intelligence can make possible more accurate credit decisions, and thus fewer defaults and lower prices. However, investment in these innovations now faces questions about whether these newer approaches may post risks of discrimination—a concern raised frequently by regulators, policymakers, think tanks, consumer and community groups, and highlighted in analysis by the GAO, US Treasury Department, and others. Without a satisfactory response to this concern, industry will face uncertainty and opposition in its efforts to innovate in credit decisioning.

Among the ranges of potential policies that could respond to this concern, the disparate impact regime has some compelling advantages. LendingClub and other financial services companies are already following it. We find it does not severely limit what we can do and appreciate that it does not create arbitrary bureaucratic proscriptions about what types of data or techniques we can and cannot use. As a principles-based, rather than rules-based regulation, disparate impact does not put government in the position of dictating what types of AI can or cannot be used, or whether some types of data are acceptable and others are not.

The outcome requirements of disparate impact are also manageable, in our experience. The disparate impact regime does not mandate quotas of representation. It does not require financial service providers to use significantly weaker credit decisioning models if a more effective credit model is available. If a credit model produces disparate outcomes, disparate impact requires that we find the least discriminatory way we can to make a credit model that is similarly effective. This can also lead to greater value creation for the business, as the effort to reduce disparate impact leads the business to find ways of accessing profitable underserved markets it otherwise may not have reached.

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[1] https://www.cfpbmonitor.com/wp-content/uploads/sites/5/2013/06/2013-06-04-Equal-Credit-Opportunity-Act.pdf

[2] Jagitani, J. and C. Lemieux, Federal Reserve Bank of Philadelphia, Working Paper 18-15. April 2018. https://www.philadelphiafed.org/-/media/research-and-data/publications/working-papers/2018/wp18-15.pdf

As we strive to build on our results, LendingClub appreciates the disparate impact regime as a flexible policy that addresses concerns about preventing discrimination while also being able accommodate innovations in alternative data, machine learning, and artificial intelligence. In this sense, it is a pro-innovation policy. It can allow industry to harness technology innovation to create powerful credit models that deliver the lowest prices and greatest financial inclusion.

We are concerned that if the disparate impact regime were not maintained, industry would face regulatory instability. Polices to address widespread concerns about discrimination may come and go with each administration change, which would stymy innovation and create uncertainty for business. Innovators require a consistent regulatory environment to invest in these new technologies. Of greater concern, if disparate impact is removed future policymakers might apply other policy approaches that lack the pro-innovation flexibility that disparate impact provides. For example, alternative policies might permit some types of modeling techniques and prohibit others, or establish proscriptive requirements that fit the tools of today but not the tools of the future.

For these reasons, we believe the Bureau should maintain the disparate impact policy for financial services. The Bureau could also support innovation in credit analysis by publishing principles clarifying what business purposes are sufficient for consideration in disparate impact analysis.

Thank you for this opportunity to comment. We remain available to provide additional input or answer any questions regarding our letter. Please do not hesitate to reach out to me directly at 202-772-3170 or by email at rneiman@lendingclub.com.

Sincerely,

Richard H. Neiman

Richard H. Neiman
Head of Public Policy & Regulatory
LendingClub