# Racial Equity Audit Proposal Q&A

*Q. What is a racial equity audit?*

A. A racial equity audit is an independent analysis of a company's business practices in an effort to identify and ferret out practices that may have a discriminatory effect. Such an audit could also evaluate a company's current efforts or efforts in response to the events in the summer of 2020.

*Q. Why should a company perform such an audit?*

A. Issues of systemic racism and racial equity are of great concern now, particularly in light of President Biden's early comments targeting systemic racism as a major focus of his Administration. A company's shareholders, employees, communities and stakeholders are increasingly likely to demand that companies demonstrate that they "get it" and that they are proactively – and effectively – taking measures to improve the situation.

*Q. Are there any examples of a racial equity audit you can cite?*

A. Yes, and with much success, notably at Facebook, Airbnb and Starbucks, and we recommend the reports involving those companies to illustrate the value of such examinations.

The 2020 **Facebook** audit report, available at here, was prepared by professionals with civil rights expertise and was released after a two-year examination and several interim reports. It sought to "help the company identify, prioritize, and implement sustained and comprehensive improvements to the way it impacts civil rights." Id. at p. 3. To that end, the audit examined not simply Facebook's employment practices, but all phases of that company's business, including Facebook's customer-facing activities.[1] The audit described in detail how Facebook was able to use the audit process "to listen, plan and deliver on various consequential changes that will help advance the civil rights of its users" in at least 12 categories (summarized at pp.6-8), while identifying several areas where the audit believed more work was needed (summarized at p. 8).

A 2016 Airbnb report, available at here, focused on potential sources for bias and discrimination in Airbnb's basic business model (summarized at p. 2), which is that:

> Hosts create profiles for themselves and their property, choose their own price and availability, and set guidelines for guests. Hosts and guests learn about each other through past reviews and personal communication through the Airbnb platform. Guests and hosts use Airbnb to confirm travel dates and expectations, and make and receive payments. After the stay, both hosts and guests leave reviews for one another, which are public for all future hosts and guests to read.

The 32-page report discusses various "lessons learned" and recommends a series of actions that can be taken, which the company agreed to take.

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1 The Facebook audit began with a focus on specific topics, including "voter suppression and voter information, building a civil rights accountability infrastructure, content moderation and enforcement (including hate speech and harassment), advertising targeting and practices, diversity and inclusion, fairness in algorithms and the civil rights implications of privacy practices," and expanded to cover a full range of civil rights issues. Id. at p. 5.

A civil rights audit at Starbucks, led by former U.S. Attorney General Eric Holder, was precipitated by the April 2018 arrest of two African-American men, who were seated in a Philadelphia Starbucks waiting for a business meeting to begin. The Holder investigation produced two reports, one for [2019] and one for [2020]. The first of these reports pointed out the importance to Starbucks' core business plan of creating an inclusive and equitable working environment, as well as a welcoming "third place" between home and work for customers. Mr. Holder noted that although the two arrests "may not have been the result of explicit racial animus, the arrests demonstrated powerfully that unaddressed implicit bias can sometimes produce outcomes that are difficult to distinguish from those motivated by conscious racism."

It is noteworthy that Starbucks initially realized that the incident called for improved sensitivity training for employees, but the company realized that such training is not by itself and that a more in-depth investigation may be warranted.

### *Q. Who would do such an audit?*

A. It is important to select auditors with the sort of civil rights background that will likely produce the most useful and valuable results. It may thus be more useful to auditors with such a background rather than, say, the "internal corporate investigations" departments of private law firms, which may have a narrow focus on legal compliance.

In working on this issue, we have consulted with individuals and organizations that have direct experience, including in some instances leadership roles, in one or more of the audits described above.

They have advised us that they are willing to work with companies in terms of scoping and executing an audit. We can provide a list based on their expertise, and we do not have any financial, business or professional relationship with any of these individuals or organizations.

### *Q. How much would such an audit cost the company and how long would it take?*

The answer varies, depending on the scope of the investigation. We heard estimates ranging from $1 million for a year-long, soup-to-nuts examinations of all aspects of a company's operation, to a five-figure audit that can be done in several months if the auditor is knowledgeable about the specific industry and can target specific aspects of the company's business. Most audits also require multiple entities to conduct it, as it is critical that individuals with civil rights expertise in a particular area cover certain topics (in the banks' case, financial products, human resources concerns, etc.). As noted above, the Facebook audit began with a specific focus on specific topics until it was realized that a more in-depth investigation would be needed. We are willing to work with companies on the timelines if a longer examination period is required, per the auditor's recommendations.

We should keep in mind that while there may be significant up front commitments to a racial equity audit, these banks are committing between millions and billions of dollars to racial justice initiatives. If banks are truly committed to making racial justice a critical element of the operations, they should treat it like they would any other operational issue and it should be audited just as a new product would be. These types of audits are inherently not cheap or a quick fix, but the benefit outweighs the cost.

### *Q. Many companies announced action plans after the events in the summer of 2020, and presumably their boards of directors and management have carefully reviewed and approved those plans. Why bring in a third party if others (board, management, outside stakeholders) have done their job properly?*

A. The real value of an audit is its independence. As we all know, the board and its audit committee oversee management on a regular basis. Even so, companies are required to hire independent auditors, which is an important way to re-assure shareholders. Independent auditors offer objective and credible assessments managements' programs.

Directors may be competent, experienced and intelligent individuals who are trying to put the best interests of the company first. However, few directors are appointed to corporate board based on their civil rights expertise. And as the Starbucks example shows, even a company that is regarded as well run with a competent board can have a situation blow up unexpectedly.

Management also may be competent and have experience in specific areas related to the company's day-to-day operations. Companies, however, are not organized in a manner that lends itself to civil rights and racial equality work. General Counsel, for example, is not an appropriate conduit to perform an audit of this type because their primary obligation is to protect the company from liabilities. Management is also inherently conflicted as they represent the company itself making its assessments of company programs potentially bias.

Many banks have also consulted outside stakeholders in developing their racial justice initiatives and financial commitments. While these stakeholders are of course experts in their field, they are not the functional equivalent of an independent outside auditor. Many of these stakeholders are in partnership with issuers, and receive funding or contributions, which could be compromised if the relationship is strained due to criticism. Further, even if they were given access to evaluate the banks internal systems and practices, they likely do not have the time and resources to dedicate to a full audit for issuers of this size unless compensated appropriately.

### *Q. Aren't regulatory requirements and inspections sufficient to ensure that financial products aren't having a disparate impact?*

A. The Community Reinvestment Act ("CRA") does not provide the correct lens with which banks should be identifying disparate impact based on race. First, the CRA focuses on the bank's lending, investments and services, not the full scope of the banks operations (like philanthropic donations, HR issues). Second, the CRA is not technically about racial equity, but simply serving all of the communities, including low and moderate income neighborhoods, or underserved communities, where the bank has branches or is in its defined geographic service area. Third, roughly 99% of banks receive "satisfactory" or "outstanding" CRA ratings. With plenty of evidence of lending discrimination still being widespread, there needs to be a much more robust auditing of racial equity at banks.

The Consumer Financial Protection Bureau also has supervisory authority over several of the banks receiving the proposal. This includes evaluations of consumer related discrimination in areas like auto financing, mortgage origination and servicing, credit card management, and marketing practices. The banks could voluntarily disclose the most recent results related to these examinations and the data collected through these examinations could be used as part of the evaluation conducted by an independent auditor. Investors should keep in mind, however, that regulatory requirements are merely the floor for performance. If issuers want to stay ahead of these risks, they need to look at higher benchmarks than just meeting minimum regulatory requirements.

### *Q. Are there key performance indicators that investors could use to judge a company's performance in this area?*

A. There are existing regulatory requirements, such as a bank's CRA reporting requirements that may provide some data, which is based on income. Such information could be used as a start to this type of racial equity audit. The idea of a racial equity audit is to dig beneath the surface reporting to examine the internal corporate models. Bias infects every element of how banks work. From a products standpoint, for example, a bank may have computer models and algorithms for marketing and selling various financial products. These models and algorithms need to be tested for bias from an independent source. Are those models producing discriminatory results? Are there are alternatives that would have a less discriminatory impact? Statistical models, for example, can skew one way or another. If a given model is producing discriminatory results in terms of the target audience or persons who would qualify for a loan, is someone at the bank looking for that situation? If so, is someone authorized to override the model, and what criteria is utilized for a discretionary authorization and how long would it take?

For example, the Community Reinvestment Act sought to outlaw redlining less affluent communities, and lenders responded with “reverse redlining,” *i.e.,* making sub-prime loans to residents of those communities, which loans were them collateralized and sold to investors; the theory was that those loans would be priced to recognize the higher risk and collateralized to reduce the risk. After the housing market and CDO/CMO market collapsed in 2007-08, there was a retreat from such practices. One question remains, notwithstanding CRA reporting: How good a job are banks doing in terms of making higher quality loans to less affluent neighborhoods of color? An audit could flesh out details of a company’s practice.

From an HR standpoint, a diversity, equity and inclusion evaluation should be conducted, using quantitative and qualitative data sourced from complaint data, meetings and focus groups, and survey responses, among other things. Inquiries should be conducted in consultation with multiple levels of management, employees, and certain stakeholders. Key practices of the bank should also be evaluated. What is the company’s culture and climate? How accessible and accountable is the company when issues are raised? How does the company address attrition attributed to people of color? What criteria is being used to promote and retain people of color to move them to upper management? Are there pay discrepancies between employees of color v. nonemployees of color?

*Q. So why would a racial equity audit be valuable to investors?*

A. Demands to eliminate systemic racism are not going to disappear. If anything, as the demographics in America continue to change in the coming decades, racial justice will be increasingly important to today’s younger investors, who will soon be tomorrow’s middle-aged and older investors. This market shift is already apparent in the financial services industry, with the surging demand from younger investors for investment products that stress environmental, social and governance (“ESG”) values.

Viewed in that context, a deep dive today into unconscious or subtle forms of discrimination can be viewed as a smart investment that will contribute to long-term shareholder value. Issues of implicit bias and discrimination are deep seeded and structural within each of these banks, and the way that these financial institutions are thinking about risk is incorrect when it comes to racial equity. A racial equity audit is fundamentally about risk management. Investors need an objective evaluation of how these issuers are measuring their progress on addressing these structural risks. And any such analysis needs to be about more than just compliance; it needs to be about increasing racial justice in the market in line with each issuer’s public statements.