Expect CFPB Scrutiny On AI In Lending

By **Allison Schoenthal, Allison Funk and Wendy Leben** (July 17, 2023, 5:45 PM EDT)

Under the leadership of Director Rohit Chopra, the Consumer Financial Protection Bureau has shown that it will prioritize regulatory oversight of the financial services industry's use of automated systems and artificial intelligence technology.

The CFPB has expressed concern that AI algorithms produce unintended consequences such as the automation of discriminatory bias and erroneous credit decisions.

The CFPB will be looking at the use of AI in areas ranging from substantive decision making, to routine customer communications and across consumer products.

If bias can creep into AI, whether it's for a decision to lend, or something seemingly more innocuous — like marketing — you can expect the CFPB to be paying attention.

Digital Redlining And Home Mortgage Valuations

Chopra has summarized digital redlining as "redlining caused through bias present in lending or home valuation algorithms" or other AI technology.[1]

He has noted that companies use automated valuation models, or AVMs, to calculate home valuations because it is less expensive than hiring certified human appraisers, but he strongly cautioned lenders about the potential for bias in a recent blog post.[2]

Chopra highlighted his concern that, "based on the data they are fed and the algorithms they use, automated models can embed the very human bias they are meant to correct. And the design and development of the models and algorithms can reflect the biases and blind spots of the developers."[3]

On June 21, a notice of proposed rulemaking was published in the Federal Register whereby certain federal agencies, including the CFPB, would require covered financial institutions to implement quality control standards for the use of AVMs to prevent any discrimination[4]

The CFPB's focus on digital redlining arises in part from congressional mandate.

Allison Schoenthal
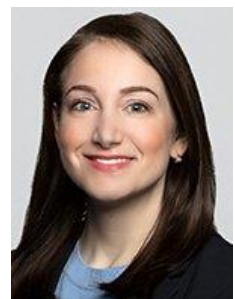
Allison Funk

Wendy Leben

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the CFPB was required to develop regulations for quality control standards for AVMs with other federal agencies — the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Federal Housing Finance Agency — to:

> (1) ensure a high level of confidence in the estimates produced by AVMs; (2) protect against manipulation of data; (3) seek to avoid conflicts of interest; (4) require random sample testing and reviews; and (5) account for any other such factor the agencies determine to be appropriate.[5]

As outlined in the notice of proposed rulemaking, the agencies determined that an appropriate fifth factor would be to ensure that AVMs "adhere to quality control standards designed to comply with applicable nondiscrimination laws."[6]

They explained that "[w]hile existing nondiscrimination law applies to an institution's use of AVMs ... a fifth quality control factor relating to nondiscrimination [will] heighten awareness among lenders of the applicability of nondiscrimination laws to AVMs."[7]

Since his appointment, Chopra has regularly underscored the CFPB's priority to counter digital redlining.

He has used enforcement actions against bank and nonbank lenders for traditional redlining as an opportunity to note that the CFPB is also monitoring "emerging digital redlining to ensure that discrimination cannot be disguised by an algorithm."[8]

In short, Chopra has made clear that the CFPB will be watching closely to ensure that AI and automation technologies do not become an "excuse for evasion of the law and consumer harm."[9]

Black Box Credit Models

Algorithms are used in other credit decisions such as applying for a credit card or increased line of credit.

Chopra often references "black box" credit models as shorthand for algorithmic decision making.[10] He has unequivocally stated that "black-box opacity" is not a legal defense if a creditor violates the law.[11]

For example, under the Equal Credit Opportunity Act, creditors must provide a statement of specific reasons that an adverse action is taken against an applicant.

The CFPB released a circular in May 2022 that stated creditors must fulfill this requirement even if the decision was made with the help of automated technologies.[12] If a creditor cannot explain the reason for the denial, then it cannot continue to use whatever algorithm informed the decision.

In the CFPB's accompanying statement, Chopra added, "[t]he law gives every applicant the right to a specific explanation if their application for credit was denied, and that right is not diminished simply because a company uses a complex algorithm that it doesn't understand."[13]

What to Expect

Given the numerous benefits of AI technology, such as accuracy, efficiency and faster decision making,

companies will continue to incorporate the technology into their business practices.

As the use of the technology increases, the CFPB's scrutiny can be expected to increase.

We can anticipate the CFPB to not only be on the lookout for direct violations of federal consumer financial law, but also to be evaluating whether the use of the technology and the resulting act or practice is unfair, deceptive or abusive.

Companies can mitigate risk by implementing an appropriate compliance management system, or updating fair lending policies, to address the following:

Auditing and Monitoring

Companies should implement robust audit and monitoring procedures, including specific testing to ensure that the technology is operating as intended and without bias. The audit and monitoring procedures should be documented and easily accessible to any regulator.

Board Management Oversight

Ensure that the board of directors — or a person or group exercising similar oversight functions — receives sufficient information about compliance and consumer protection matters related to AI technology so that they can adequately identify and manage risk.

Policies and Procedures

The policies, procedures and practices of the company should be examined and if necessary, updated to reflect how the use of AI technology or automation may affect these processes or controls.

Training

Ensure that employees are properly trained and educated about the AI technology or automation used. The CFPB will expect employees to be knowledgeable and well versed in the technology, including how the technology makes decisions or interacts with customers.

Service Provider Oversight

Companies should review their service provider agreements to ensure that they contain express provisions about the use of AI technology and clear expectations about compliance with federal consumer financial law, including engaging in discrimination and unfair, deceptive or abusive practices.

Conclusion

And, as with any new product, companies should conduct routine testing and monitor consumer complaints for insight to potential errors.

The CFPB will be closely watching the use of AI in substantive decision making, such as property valuations and lending decisions, as well as its use in routine processes like name-matching in background checks.

Bias in consumer lending decisions, especially home mortgages, remains the CFPB's most visible priority, but other areas are not far behind.

The CFPB will need to balance regulation with innovation, and financial services companies will need to be prepared for scrutiny of AI and mitigate any potential for bias or unfair, deceptive or abusive acts and practices.

Allison J. Schoenthal is a partner and co-chair of banking and consumer financial services at Goodwin Procter LLP.

Allison M. Funk is an associate at the firm.

Wendy M. Leben is a summer associate at the firm.

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[1] Director Chopra's Prepared Remarks on the Interagency Enforcement Policy Statement on "Artificial Intelligence," CFPB (Apr. 25, 2023), https://www.consumerfinance.gov/about-us/newsroom/director-chopra-prepared-remarks-on-interagency-enforcement-policy-statement-artificial-intelligence/.

[2] Algorithms, Artificial Intelligence, and Fairness in Home Appraisals, CFPB (Jun. 01, 2023), https://www.consumerfinance.gov/about-us/blog/algorithms-artificial-intelligence-fairness-in-home-appraisals/.

[3] Id.

[4] CFPB, Proposed Rule: Quality Control Standards for Automated Valuation Models, CFPB-2023-0025-0001, Regulations.gov (Jun. 21, 2023), https://www.regulations.gov/document/CFPB-2023-0025-0001.

[5] 12 U.S.C. § 3354.

[6] CFPB, Proposed Rule: Quality Control Standards for Automated Valuation Models, CFPB-2023-0025-0001, Regulations.gov (Jun. 21, 2023), https://www.regulations.gov/document/CFPB-2023-0025-0001.

[7] CFPB, Proposed Rule: Quality Control Standards for Automated Valuation Models, CFPB-2023-0025-0001, Regulations.gov (Jun. 21, 2023), https://www.regulations.gov/document/CFPB-2023-0025-0001.

[8] Director Chopra's Prepared Remarks at a Joint DOJ, CFPB Press Event on the Trident Enforcement Action, CFPB (Jul. 27, 2022), https://www.consumerfinance.gov/about-us/newsroom/director-chopras-prepared-remarks-at-a-joint-dof-cfpb-press-event-on-the-trident-enforcement-action/. Remarks of Director Rohit Chopra at a Joint DOJ, CFPB, and OCC Press Conference on the Trustmark National Bank Enforcement Action, CFPB (Oct. 22, 2021), https://www.consumerfinance.gov/about-us/newsroom/remarks-of-director-rohit-chopra-at-a-joint-doj-cfpb-and-occ-press-conference-on-the-trustmark-national-bank-enforcement-action/.

[9] Algorithms, Artificial Intelligence, and Fairness in Home Appraisals, CFPB (Jun. 01,

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[10] Remarks of Director Rohit Chopra at a Joint DOJ, CFPB, and OCC Press Conference on the Trustmark National Bank Enforcement Action, CFPB (Oct. 22, 2021), https://www.consumerfinance.gov/about-us/newsroom/remarks-of-director-rohit-chopra-at-a-joint-doj-cfpb-and-occ-press-conference-on-the-trustmark-national-bank-enforcement-action/. Director Chopra's Prepared Remarks on the Interagency Enforcement Policy Statement on "Artificial Intelligence," CFPB (Apr. 25, 2023), https://www.consumerfinance.gov/about-us/newsroom/director-chopra-prepared-remarks-on-interagency-enforcement-policy-statement-artificial-intelligence/.

[11] Director Chopra's Prepared Remarks at the Exchequer Club Fireside Chat, CFPB (Sep. 21, 2022), https://www.consumerfinance.gov/about-us/newsroom/director-chopra-prepared-remarks-exchequer-club-fireside-chat/.

[12] Consumer Financial Protection Circular 2022-03, CFPB (May 26, 2022), https://www.consumerfinance.gov/compliance/circulars/circular-2022-03-adverse-action-notification-requirements-in-connection-with-credit-decisions-based-on-complex-algorithms/.

[13] CFPB Acts to Protect the Public from Black-Box Credit Models Using Complex Algorithms, CFPB (May 26, 2022), https://www.consumerfinance.gov/about-us/newsroom/cfpb-acts-to-protect-the-public-from-black-box-credit-models-using-complex-algorithms/.