
LEGAL UPDATES AND NEWS

CFPB Issues Fair Lending Law Interpretation Related to Use of AI in Credit Decisions

On September 19, 2023, the Consumer Financial Protection Bureau (the “Bureau” or the “CFPB”) issued [Circular 2023-03](#) to address whether creditors could rely on stock reasons in the Bureau’s sample adverse action notices when issuing adverse action notices after using AI or complex credit models in the credit decision. The Bureau asserted that creditors will not be in compliance with the Equal Credit Opportunity Act (the “ECOA”) and Regulation B if the reasons provided in their adverse action notices do not specifically and accurately identify the principal reason(s) for a credit denial. The CFPB further asserted that creditors cannot rely on overly broad or vague reasons in such notices, if those reasons obscure the specific and accurate reasons upon which the institution had actually relied.

The Bureau did not issue the Circular as a theoretical legal interpretation. Rather, the CFPB made clear that the Circular is intended to address real-life scenarios occurring with increasing frequency: creditors’ growing use of AI and other predictive decision-making technologies in their underwriting models and decision making. These innovative techniques may utilize data harvested from consumer surveillance, or other data not typically found in a credit file or application, which may prompt an adverse credit action for a consumer.

In the agency’s press release, Director Rohit Chopra made the connection between the Bureau’s interpretation in the Circular and the use of AI, stating that there is “no special exemption for [AI]” to the general rule that creditors must be able to “specifically explain their reasons” for a credit denial. The Circular notes that the specific reasons for a denial must be disclosed *even if* consumers “may be surprised, upset, or angered to learn their credit applications were being graded on data that may not intuitively relate to their finances”—in other words, if the consumer learns that AI was used to gather and incorporate data from external sources.

Under Director Chopra, the Bureau has shown a marked interest in exercising its authority over various sectors of the technology industry. As the CFPB’s press release acknowledges, the agency has “made the intersection of fair lending and technology a priority.” As financial institutions continue to innovate and consider ways to integrate AI into their products, services, programs, and modeling, they should expect the CFPB to be actively scrutinizing those integrations. While the CFPB may examine these institutions’ practices through a fair lending lens, it may also take a broader perspective, using its more general unfair, deceptive or abusive acts or practices (“UDAAP”) authority.

The Circular is the latest example of a notable trend under Director Chopra of the CFPB pursuing its policy goals through a variety of tools in its regulatory toolbox. While many in the financial services industry predicted that Director Chopra's appointment would lead to an explosion in enforcement cases, that has not yet materialized. However, the Bureau has sought to utilize means beyond the two most traditional regulatory avenues—formal notice and comment rulemakings and enforcement actions—to shape industry conduct.

To date, the CFPB has employed a range of mechanisms to do so. The Bureau updated its examination manual procedures to guide examiners on how to fit “discrimination” within its UDAAP authority. The agency also issued a compliance bulletin explaining its position that charging of certain fees are an unfair practice, and outlining the potential enforcement consequences for covered institutions. In addition, Director Chopra has given public speeches and testimony outlining what he considers to be illegal junk fees, and the Bureau has followed that up with reports covering the Bureau's findings from actual examinations.

For financial institutions above the \$10B asset threshold, the Circular should be viewed as a public pronouncement of the Bureau's interpretation as to how adverse action notices should be prepared. The Circular should also be viewed as the agency's notice that adverse action notices may be a subject of future examinations. Even if your institution escapes scrutiny, the Circular will apply pressure across the range of institutions the CFPB supervises to change their conduct.

The effects of the Circular may be felt beyond those institutions subject to direct CFPB supervision. According to the Bureau, its circulars are intended to promote consistency in approach across various enforcement agencies, and to provide transparency to its partners regarding the CFPB's approach when cooperating in enforcement actions. Because the CFPB has sole responsibility for issuing regulations under ECOA, the practical effect of the Circular may be to shape the views, examination priorities, and posture of the federal banking agencies, who still hold examination authority for financial institutions under the \$10B asset threshold. In addition, the Circular could inform and support positions taken by state regulators. In a 2022 interpretive rule, the CFPB encouraged state regulators to pursue violations of federal consumer financial law as a complement to its own actions.

So what should you do to ensure compliance with the Circular? First, keep in mind that the CFPB views the Circular as covering account terminations, unfavorable changes in terms, as well as new applications for credit. You should consider reviewing your adverse action procedures to make sure the reasons provided for a denial are both specific and accurate. The Circular provides a number of examples that are instructive. If your procedures allow use of broad or general reasons, or rely on checklists sourced from the CFPB or third parties, you should consider breaking those reasons down more granularly.

If you use AI, consumer surveillance, or other predictive decision-making technologies in your underwriting or decision making, you should consider whether your models' factors match the types of reasons provided in your denial notices. You may need to adopt additional, specific reasons when using AI in your models. In addition to the actual content of these notices, you should consider reviewing your policies to ensure they reflect the principles outlined in the Circular. For the reasons noted above, these are measures that should be considered even if you are not directly supervised by the CFPB.

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Luse Gorman regularly advises clients on fair lending compliance issues, and represents banks and thrifts in regulatory and enforcement matters before federal and state banking agencies and the CFPB. If you have any questions related to this Client Alert, please reach out to Brendan Clegg, Partner, at (202) 274-2034 or by email at bclegg@luselaw.com. To learn more [about our firm](#) and [services](#), [please visit our website](#).