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To: Clients and Friends

From: Daniel S. Engle

Subject: CFPB Circular 2023-03 Notifies Creditors of Adverse Action Reporting Requirements on Loans Underwritten Using Artificial Intelligence or Other Predictive Decision-Making Technologies

In a circular published September 19, 2023 (Consumer Financial Protection Circular 2023-03, [link here](#)), the Bureau of Consumer Financial Protection (CFPB) notified creditors of their obligations to provide specific and accurate reasons for adverse action notices sent pursuant to the Equal Credit Opportunity Act (ECOA) and its Regulation B. These obligations arise even if the adverse actions were due to complex decision-making processes such as Artificial Intelligence (AI) algorithms.

ECOA and Regulation B require that when adverse action is taken against a credit applicant, the applicant must be provided with a statement listing the reasons for the adverse action. In this circular, the CFPB reminded creditors that the statement of reasons must be specific and must indicate the principal reasons(s) for the adverse action. While the sample forms in Regulation B for the adverse action notice provide a sample, general checklist of reasons, the CFPB explained that these sample, general reasons may not suffice to provide a credit applicant a sufficient adverse action notice if the applicant's creditworthiness was evaluated through a complex decision-making process such as an AI algorithm.

Instead, the CFPB put creditors using complex underwriting methods on notice that they have an obligation to provide specific and accurate reasons even if these reasons are not present in the sample forms. As the CFPB stated:

Rather, the sample forms merely provide an illustrative and non-exclusive list. Thus, if the principal reason(s) a creditor actually relies on is not accurately reflected in the checklist of reasons in the sample forms, it is the duty of the creditor—if it chooses to use the sample forms—to either modify the form or check “other” and include the appropriate explanation, so that the applicant against whom adverse action is taken receives a statement of reasons that is specific and indicates the principal reason(s) for the action taken. Creditors that simply select the closest, but nevertheless inaccurate, identifiable factors from the checklist of sample reasons are not in compliance with the law. (Circular 2023-03, endnote omitted)

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This obligation to provide specific and accurate reasons for an adverse action exists even if the data relied on from a complex decision-making process is not commonly found on a consumer’s credit file or on a loan application. It is even the case if the data would not be readily apparent to the consumer. The CFPB’s rationale below illustrates their position and provides sample fact-patterns:

Specificity is particularly important when creditors utilize complex algorithms. Consumers may not anticipate that certain data gathered outside of their application or credit file and fed into an algorithmic decision-making model may be a principal reason in a credit decision, particularly if the data are not intuitively related to their finances or financial capacity. As noted in the Official Commentary to Regulation B, a creditor must “disclose the actual reasons for denial . . . even if the relationship of that factor to predicting creditworthiness may not be clear to the applicant.” For instance, if a complex algorithm results in a denial of a credit application due to an applicant’s chosen profession, a statement that the applicant had “insufficient projected income” or “income insufficient for amount of credit requested” would likely fail to meet the creditor’s legal obligations. Even if the creditor believed that the reason for the adverse action was broadly related to future income or earning potential, providing such a reason likely would not satisfy its duty to provide the specific reason(s) for adverse action. Concerns regarding specificity may also arise when creditors take adverse action against consumers with existing credit lines. For example, if a creditor decides to lower the limit on, or close altogether, a consumer’s credit line based on behavioral data, such as the type of establishment at which a consumer shops or the type of goods purchased, it would likely be insufficient for the creditor to simply state “purchasing history” or “disfavored business patronage” as the principal reason for adverse action. Instead, the creditor would likely need to disclose more specific details about the consumer’s purchasing history or patronage that led to the reduction or closure, such as the type of establishment, the location of the business, the type of goods purchased, or other relevant considerations, as appropriate. (Circular 2023-03, endnotes omitted)

Therefore, creditors using complex decision-making processes such as AI algorithms have a heightened obligation to explain adverse actions that relied on data obtained via these methods. As the CFPB summarized: “[a]s data use and credit models continue to evolve, creditors have an obligation to ensure that these models comply with existing consumer protection laws.” (Circular 2023-3).

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