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Artificial Intelligence and Fair Credit Decisioning: Federal Regulators Lean in

Presented by
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CFPB Consumer Protection Principals: Consumer-Authorized Financial Data Sharing and Aggregation [October 18, 2017]

"[T]he use of consumer financial account data may enable the development of innovative and improved financial products and services, increased (fair) competition, and consumer empowerment to take greater control of their financial lives…the Bureau intends for the following Consumer Protection Principals to help safeguard consumer interests as the consumer-authorized aggregation services market develops."

https://files.consumerfinance.gov/f/documents/cfpb_consumer-protection-principles_data-aggregation

CFPB Blog, Encouraging innovation in expanding credit access: 2018 Fair Lending Report to Congress (corrected September 2019), by Patrice Ficklin, Director of Fair Lending [June 28, 2019]

"On July 18, 2018, the Bureau announced the creation of its Office of Innovation…The Bureau encourages responsible innovations that could be implemented in a consumer-friendly way to help serve populations currently underserved by the mainstream credit system."

https://www.consumerfinance.gov/about-us/blog/2018-fair-lending-report-congress/

https://files.consumerfinance.gov/f/documents/201909_cfpb_corrected-2018-fair-lending_report.pdf

CFPB Press Release: CFPB and State Regulators Launch American Consumer Financial Innovation Network [September 10, 2019]

"ACFIN benefits consumers by assisting Federal and State officials coordinate efforts to facilitate innovation and further shared objectives such as competition, consumer access, and financial inclusion.
In addition to promoting regulatory certainty for innovators, the network seeks to keep pace with market innovations and help ensure they are free from fraud, discrimination, and deceptive practices.
This enhanced Federal-State collaboration also promotes consistency in the regulation of consumer financial products and services, benefiting consumers and enhancing competition."

https://www.consumerfinance.gov/about-us/newsroom/bureau-state-regulators-launch-american-consumer-financial- innovation-network/

CFPB Blog: "An update on credit access and the Bureau's first No-Action Letter," by Patrice Ficklin and Paul Watkins, Director of Office of Innovation [August 6, 2019]

"CFPB issued its first ever no-action letter in September 2017 to Upstart, a Bay Area fintech company that uses alternative sourced data and modeling techniques in automated consumer loan underwriting (unsecured, non-revolving credit) and pricing engines to help those with limited or no credit histories obtain credit or credit with better terms. The NAL expires in 3 years from issuance.

In August 2019, CFPB reported on Upstart's data, showing 27% increase in credit approvals (compared to traditional underwriting models) and 16% lower average APRs for approved loans, with no material disparities found in fair lending testing. Measured benefits to consumers with 620-660 FICO scores, applicants under 25 years of age, and applicants with incomes < $50,000."

https://www.consumerfinance.gov/about-us/blog/update-credit-access-and-no-action-letter/

https://files.consumerfinance.gov/f/documents/201709_cfpb_upstart-no-action-letter.pdf

CFPB Press Release: CFPB Issues Policies to Facilitate Compliance and Promote Innovation [September 10, 2019]

"The three policies we are announcing today…will foster innovation that ultimately benefits consumers," said [CFPB] Director Kathleen L. Kraninger.

- No-Action Letter (NAL) Policy - amends 2016 Policy to provide for more streamline review process focusing on consumer benefits and risks of the product or service in question. CFPB further announced the release of its first NAL (RESPA) under the new policy for HUD-Certified Housing Counseling Agencies for fee-for-service arrangements with lenders for pre-purchase housing counseling services.
- Trial Disclosure Program (TDP) Policy - allowing entities seeking to improve consumer disclosures, to conduct in-market testing of alternative disclosures for a limited time period.
- (3) Compliance Assistance Sandbox (CAS) Policy - provides temporary safe harbor relief from risk of liability under TILA, EFTA and ECOA for innovators testing a new financial product or service where there is regulatory uncertainty. Innovators must abide by prescriptive terms of CFPB approval.

FDIC Working Paper Series "On the Rise of the FinTechs: Credit Scoring Using Digital Footprints" [September 2018]

https://www.fdic.gov/bank/analytical/cfr/2018/wp2018/cfr-wp2018

HUD Proposes Updates to its 2013 Disparate Impact Rule [84 Federal Register 42854 (August 19, 2019)]

HUD published a proposed rule for the purpose of aligning HUD's 2013 Disparate Impact Rule with the Supreme Court's 2015 decision in Texas Department of Housing and Community Affairs v. Inclusive Communities. HUD sought comments from relevant stakeholders and the public on the proposed rule.

One controversial aspect of the proposed rule is defenses related to the use of algorithmic models.

The proposed rule provides that if a plaintiff alleges that the cause of a discriminatory effect is a model used by the defendant, such as a risk assessment algorithm, the defendant can defend the allegation by:

- Providing the material factors that make up the inputs used in the challenged model and showing that these factors do not rely in any material part on factors that are substitutes or close proxies for protected classes under the Fair Housing Act and that the model is predictive of credit risk or other similar valid objective;
- Showing that the challenged model is produced, maintained, or distributed by a recognized third party that determines industry standards, the inputs and methods within the model are not determined by the defendant, and the defendant is using the model as intended by the third party; or
- Showing that the model has been subjected to critical review and has been validated by an objective and unbiased neutral third party that has analyzed the challenged model and found that the model was empirically derived and is a demonstrably and statistically sound algorithm that accurately predicts risk or other valid objectives, and that none of the factors used in the algorithm rely in any material part on factors that are substitutes or close proxies for protected classes under the Fair Housing Act.

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Melissa Richards, CMB is a California licensed attorney with a national practice specializing in federal and multistate compliance, licensing and enterprise risk management for the financial services industry. Her clients are engaged in residential and commercial mortgage, fintech, licensed non-depository and depository institution consumer and commercial lending, either directly or in supporting vendor roles. Ms. Richards has both outside counsel experience as well as general counsel experience. From 2012-2018, Ms. Richards served as the Chief Legal & Risk Officer of a mid-size independent mortgage company ranked as one of Scotsman Guide's Top 15 Mortgage Lenders in 2018-2019.