Deloitte.

The Consumer Financial Protection Bureau (CFPB) underscores the application of anti-discrimination law throughout the credit life cycle: What lenders need to know about adverse action notification, the use of fintech solutions and credit decision modeling, and compliance with the Equal Credit Opportunity Act (ECOA)

The use of fintech solutions throughout the credit cycle—from loan application decisioning through loan servicing—has allowed for more efficient and automated processes. It has also led to reliance on increasingly complicated analytical models and engines, the basis of which may be difficult to derive. Despite the increased sophistication of models and other quantitative methods used throughout the lending process, the need to understand and provide a rationale for credit decisions remains key to demonstrating ECOA compliance.

The CFPB recently issued two pieces of regulatory guidance that emphasize the importance of the ECOA and clarify the extent of its antidiscrimination protections. Neither guidance represents a change in regulation; rather, they both communicate the agency's continuing focus on fair lending and heightened commitment to ensuring ECOA compliance. The CFPB's May 9, 2022, advisory opinion (Advisory Opinion) reminds the industry of: (1) the prohibition on discrimination throughout the servicing process and with respect to activities such as credit alteration, termination, and collection; and (2) the need to inform existing borrowers of adverse action taken on their account(s) and explain the reason behind any such action. The May 26, 2022, Consumer Financial Protection Circular (Circular) focused specifically on creditors' use and understanding of "complex" algorithmic credit decisioning models—so-called black boxes.

This publication discusses key aspects of the ECOA that are top of mind for regulators and provides insight into compliance program implications based on the recent guidance.

> **"A black-box predictor is a data-mining and machine-learning obscure model, whose internals are either unknown to the observer or they are known but uninterpretable by humans."**

Credit life cycle considerations

The ECOA requires lenders to inform applicants and borrowers, in writing within 30 days, of the detailed primary reasons for any adverse actions. The ECOA applies to both consumer and commercial loans, which distinguishes the requirements under this law from the CFPB's typical consumer focus. Adverse action includes denying an application for credit, terminating an existing credit account, making unfavorable changes to the terms of an existing account, and refusing to increase a credit limit. The Circular clearly states the CFPB's view that the use of advanced modeling or complex algorithms to make or inform credit decisions could impair a lender's ability to provide sufficient explanations in adverse action notifications, if the decision-making aspects of those tools are not well understood. The Circular clarifies the agency's stance that:

- The adverse action notice requirements of the ECOA apply equally to all credit decisions, regardless of the technology used to make them.

- The ECOA does not permit creditors to use complex algorithms when doing so means they cannot provide specific and accurate reasons for adverse actions.

The Circular recognizes that given the sophistication of black-box models, reliance on these tools can create challenges when pinpointing the reasons on which adverse actions are based.

The guidance reminds the industry that the ECOA's legal requirements are applied consistently across firms regardless of the method(s) used to conduct credit review, evaluation, and decision-making activities. The onus is on firms to understand their technology and ensure that it is operating as intended. The published guidance highlights the importance that the CFPB places on the adverse action notice requirement, given its dual purpose of deterring discriminatory lending practices while also educating consumers.

Challenges of using black-box analytics for credit decisions

The CFPB intends to hold firms accountable for understanding the inner workings of the models they rely on in the context of lending, as outlined in the Circular. Per the CFPB, some lenders have successfully incorporated various quantitative methods in credit decision-making processes, while maintaining the capability to provide the necessary rationale for credit decisions. However, as methods and tools become more and more complex, the traceability and justification of decisions can also become more difficult and, from an ECOA and adverse action perspective, problematic. Consistent with this concern, including the use of "complex algorithms," CFPB Director Rohit Chopra's recent remarks confirmed that "companies are not absolved of their legal responsibilities when they let a black-box model make lending decisions" and that "the 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."

While the Chopra's statements acknowledge the complexities associated with these complex algorithms, they provide no relief from the requirements of the ECOA. To the extent that lenders are unable to source adequately detailed reasons for adverse credit decisions due to the use of black-box analytics, they may be in violation of the ECOA's requirements to provide specific and accurate reasons for adverse actions. The examination process is the CFPB's primary way to gain insight on the use of these complex algorithms and any related inability to document adverse credit decisions. However, the CFPB may also refer to consumer complaints and information disclosed by whistleblowers to better understand how technology use is leading to consumer protection violations.

Compliance program implications

The CFPB's examination and enforcement of the ECOA remains ongoing, with violations cited at 81 institutions in 2020 and 198 institutions in 2021. The growing number of violations, coupled with the agency's recent Advisory Opinion and related Circular, suggests the need to ensure that existing compliance programs are structured to coincide with statutory requirements. In anticipation of coverage of ECOA compliance during the examination process, firms will need to focus on the following areas:

- **Policies and procedures** – Conduct a review of existing policies and procedures to ensure consistency with legal requirements, adjusting where needed.

- **Processes and documentation** – Confirm that current processes are aligned with internal policies and procedures. Ensure sufficient documentation to verify that practices are in place and working effectively to prevent discrimination.

- **Risk assessment** – Ensure that risk assessments appropriately consider ECOA obligations throughout the customer life cycle and that impacted processes are included in the audit plan. The adverse action notification process, including the required explanations, should receive coverage in audits.

- **Model risk management** – Complete periodic reviews of credit decisioning models to ensure that models are performing as intended. Understand the specific reasons supporting model-based decision-making, as this information will need to be included in adverse action notifications.

- **Third-party risk management** – To the extent that credit models are purchased from or maintained by a third party, ensure that third-party risk management protocols are being followed to analyze and mitigate compliance or other risks.

- **Control environment** – Strengthen internal controls to ensure coverage throughout the credit life cycle. Perform end-to-end reviews to make sure that when any negative credit decision is made the reason behind it is justified and communicated to the customer within a timely, written notice.

Final thoughts

With the CFPB's Advisory Opinion and Circular reflecting the prioritization of ECOA compliance, creditors have been put on notice that they are responsible for (1) understanding their credit decisioning tools, (2) ensuring that existing servicing processes do not lead to discriminatory practices, and (3) communicating adverse credit actions within the required time frame and in a way that promotes consumers' understanding of why any such action was taken. Lenders should review their end-to-end product life cycle to ensure credit-related actions are taken and communicated in line with the CFPB's published expectations and in compliance with the ECOA. This should include an inventory of existing models and black boxes, ensuring that they are aware of and can provide a detailed and accurate explanation of their output.

Contacts

James Siciliano
Managing Director | Deloitte & Touche LLP
jasiciliano@deloitte.com

Thomas Nicolosi
Principal | Deloitte & Touche LLP
tnicolosi@deloitte.com

John Graetz
Principal | Deloitte & Touche LLP
jgraetz@deloitte.com

Richard Mumford
Independent Senior Advisor to Deloitte & Touche LLP
rmumford@deloitte.com

Maria Marquez
Senior Manager | Deloitte & Touche LLP
marmarquez@deloitte.com

Monica Nguon
Senior Manager | Deloitte & Touche LLP
mnguon@deloitte.com

Samantha Robinson
Senior Consultant | Deloitte & Touche LLP
samrobinson@deloitte.com

Adrian Lucas
Senior Consultant | Deloitte & Touche LLP
adlucas@deloitte.com

Deloitte Center for Regulatory Strategy

Irena Gecas-McCarthy
Principal | Deloitte & Touche LLP
igecasmccarthy@deloitte.com

Michele Jones
Senior Manager | Deloitte & Touche LLP
michelejones@deloitte.com

Kyle Cooke
Senior Consultant | Deloitte & Touche LLP
kycooke@deloitte.com

Endnotes

1. *See* 15 USC Chapter 41, Subchapter IV: Equal Credit Opportunity.

2. Consumer Financial Protection Bureau (CFPB), "CFPB issues advisory opinion on coverage of fair lending laws," press release, May 9, 2022; CFPB, "Consumer Financial Protection Circular 2022-03: Adverse action notification requirements in connection with credit decisions based on complex algorithms," May 26, 2022.

3. CFPB, "CFPB issues advisory opinion on coverage of fair lending laws."

4. CFPB, "Consumer Financial Protection Circular 2022-03."

5. CFPB, "12 CFR Part 1002 - Equal Credit Opportunity Act (Regulation B)," accessed June 4, 2022.

6. CFPB, "Consumer Financial Protection Circular 2022-03."

7. Ibid.

8. Riccardo Guidotti et al., "A survey of methods for explaining black box models," *ACM Computing Surveys (CSUR)* 51, no. 5 (2019): pp. 1–42.

9. CFPB, "Consumer Financial Protection Circular 2022-03."

10. Ibid.

11. CFPB, "CFPB acts to protect the public from black-box credit models using complex algorithms," press release, May 26, 2022.

12. Ibid.

13. Ibid.

14. Rohit Chopra, "The CFPB's 2021 fair lending annual report to Congress," CFPB, May 6, 2022; CFPB, "Fair Lending Report 2020," April 2021.

Deloitte.

About Deloitte
Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK pri-vate company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. In the United States, Deloitte refers to one or more of the US member firms of DTTL, their related entities that operate using the "Deloitte" name in the United States and their respective affiliates. Certain services may not be available to attest clients under the rules and regulations of public accounting. Please see www.deloitte.com/about to learn more about our global network of member firms.