

September 27, 2023

# Latest CFPB Circular Regarding Artificial Intelligence and Credit Decisions

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## CFPB Offers Guidance on Adverse Action Notification Requirements for Lenders Using Complex Algorithms and Artificial Intelligence

On September 19, 2023, the Consumer Financial Protection Bureau (“CFPB”) issued its latest circular regarding use of artificial intelligence in connection with offering financial services. CFPB circulars are policy statements advising parties with respect to the CFPB’s authority to enforce federal consumer financial law and generally focus on answering specific questions presented. Circular 2023-03<sup>1</sup> is relatively narrow in its specific scope: adverse notification requirements and the proper use of the CFPB’s sample forms provided in Regulation B for lenders using artificial intelligence or complex credit models (the “Circular”). The Circular provides guidance on whether creditors may rely on the CFPB sample forms codified in Regulation B<sup>2</sup> to satisfy adverse action requirements under the Equal Credit Opportunity Act (“ECOA”)<sup>3</sup> when using artificial intelligence or complex credit models in credit decisions. The CFPB advises that creditors may not rely on the checklist of reasons in the sample notification forms to satisfy obligations under ECOA if those reasons “do not specifically and accurately indicate the principal reason(s) for the adverse action” and that creditors that “simply select the closest, but nevertheless inaccurate, identifiable factors from the checklist” are not in compliance with the law. Creditors also may not rely on “overly broad or vague reasons to the extent that they obscure the specific and accurate reasons relied upon.”<sup>4</sup>

ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age, receiving income from a public assistance program or exercising any right under the Consumer Credit Protection Act in good faith. Regulation B, promulgated under ECOA, implements requirements for creditors to provide applicants with a statement of reasons for taking adverse action against the applicant, which must satisfy certain criteria. The CFPB provides sample forms for creditors to use in satisfying these adverse action requirements, which provide examples of commonly

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considered factors in adverse actions; however, the CFPB cautions that such “sample forms are illustrative and may not be appropriate for all creditors.”<sup>5</sup>

In the Circular, the CFPB expresses concern that the forms may not be appropriate for underwriting models that utilize complex algorithms involving artificial intelligence or other predictive decision-making technology as these algorithms may rely on data harvested from consumer surveillance or other information not typically found in a consumer’s credit file or credit application. The CFPB expresses concern that the use of such data, especially if it does not intuitively relate to the likelihood of loan repayments, may present additional consumer protection risks.<sup>6</sup>

The Circular highlights the importance of specificity for creditors utilizing complex algorithms and the importance of compliance with requirements to provide accurate descriptions of factors actually considered by such models.<sup>7</sup> In addition, the Circular reminds financial institutions that they remain subject to additional legal requirements with respect to their use of data and financial technologies, and that the CFPB, Department of Justice and additional enforcement agencies have pledged to use their authorities to protect individuals’ rights against potential violations arising from use of automated systems.<sup>8</sup>

The Circular follows previous guidance from the CFPB regarding compliance with ECOA when using complex models and artificial intelligence. In May 2022, the CFPB issued a circular<sup>9</sup> confirming that creditors making decisions based on complex algorithms are required to comply with ECOA and provide specific reasons to applicants if adverse action is taken based on those algorithms. “Black box” or similar algorithms are impermissible if they prevent creditors from accurately identifying specific reasons for denying credit or taking other adverse actions against applicants.

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ENDNOTES

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- <sup>1</sup> Consumer Financial Protection Bureau, *Circular 2023-03: Adverse Action Notification Requirements and the Proper Use of the CFPB's Sample Forms Provided in Regulation B* (Sept. 19, 2023), available at [https://files.consumerfinance.gov/f/documents/cfpb\\_adverse\\_action\\_notice\\_circular\\_2023-09.pdf](https://files.consumerfinance.gov/f/documents/cfpb_adverse_action_notice_circular_2023-09.pdf).
- <sup>2</sup> The CFPB sample notification forms are codified as an appendix to Regulation B, which implements the Equal Credit Opportunity Act. See 12 C.F.R. Part 1002 App. C.
- <sup>3</sup> 15 U.S.C. § 1691 *et seq.*
- <sup>4</sup> Circular at 1.
- <sup>5</sup> Circular at 3; 12 C.F.R. Part 1002 App. C.
- <sup>6</sup> Circular at 3.
- <sup>7</sup> *Id.* at 4.
- <sup>8</sup> *Id.* at 2.
- <sup>9</sup> Consumer Financial Protection Bureau, *Circular 2022-03: Adverse Action Notification Requirements in Connection with Credit Decisions Based on Complex Algorithms* (May 26, 2022), available at [https://files.consumerfinance.gov/f/documents/cfpb\\_2022-03\\_circular\\_2022-05.pdf](https://files.consumerfinance.gov/f/documents/cfpb_2022-03_circular_2022-05.pdf).

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