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May 27, 2022

To: Clients and Friends

From: David F. Dulock

Subject: CFPB Circular 2022-03— Credit Decisions Based on Complex Algorithms

On May 26, 2022, the CFPB issued Circular 2022-03 explaining a creditor's responsibility to comply with ECOA's requirement to provide a statement of specific reasons when adverse action is taken against an applicant based on complex algorithms that prevent the creditor from accurately identifying the specific reasons for denying credit or taking other adverse action.

Circular 2022-03 states, "ECOA and Regulation B do not permit creditors to use complex algorithms when doing so means they cannot provide the specific and accurate reasons for adverse actions."

As summarized in Circular 2022-03, the adverse action definition in Regulation B §1002.2(c) "include[s] 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 closing paragraph of Circular 2022-03 states:

> Creditors who use complex algorithms, including artificial intelligence or machine learning, in any aspect of their credit decisions must still provide a notice that discloses the specific principal reasons for taking an adverse action. Whether a creditor is using a sophisticated machine learning algorithm or more conventional methods to evaluate an application, the legal requirement is the same: Creditors must be able to provide applicants against whom adverse action is taken with an accurate statement of reasons. The statement of reasons "must be specific and indicate the principal reason(s) for the adverse action." A creditor cannot justify noncompliance with ECOA and Regulation B's requirements based on the mere fact that the technology it employs to evaluate applications is too complicated or opaque to understand. A creditor's lack of understanding of its own methods is therefore not a cognizable defense against liability for violating ECOA and Regulation B's requirements.

Clients should read Circular 2022-03 hyperlinked above and not rely exclusively on this memorandum.