AI In the Mortgage Industry

CURRENT USE OF AI IN THE MORTGAGE INDUSTRY AND PRINCIPLES FOR LAWMAKERS

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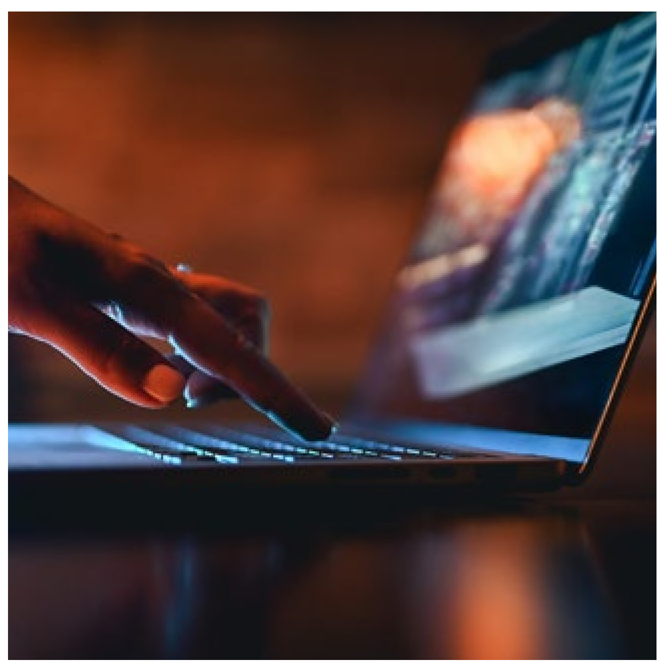
Introduction

Many of the laws and regulations concerning Artificial Intelligence (AI), including automated systems, that are being proposed have an incredibly broad definition of AI that includes technology that has been in use for decades. The broad nature of these proposals may create significant challenges and unintended consequences when applied to the mortgage industry. Their potential impact on the cybersecurity and anti-fraud efforts of financial institutions is also concerning.

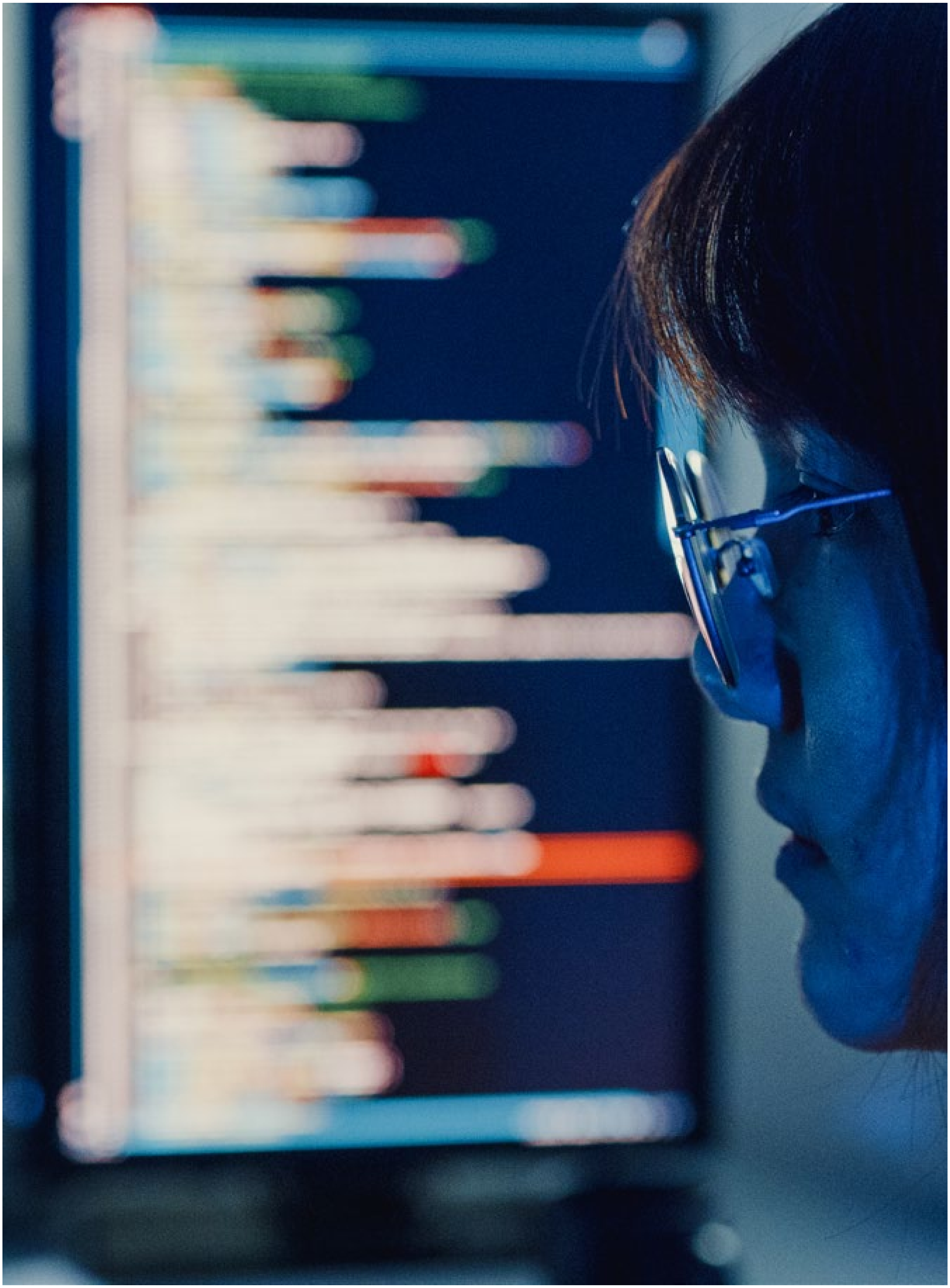
MBA member companies are already regulated by robust federal and state laws, regulations, and supervisory guidance that are applicable to the use of all technology, including AI. Additionally, many of the proposals have included the option for borrowers to opt out of automated processing or the use of ill-defined AI, which furthers the risk to financial institutions and the mortgage lending industry and could end up harming borrowers in the long run by potentially enabling fraud or limiting their access to financial institutions and lending options.

The mortgage industry has embraced many advances in technology throughout the loan lifecycle, from application to servicing, that have expanded consumer choice and lowered costs. Even with the advancements and adoption of technology, the mortgage process remains reliant on human involvement. Mortgage Loan Originators (MLOs) are required to be licensed, or federally registered, and are responsible for each mortgage application. Licensing is required for nonbank MLOs by each state in which they intend to conduct business, and they must annually renew those licenses after completing continuing education requirements. Both the Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA) also require a certified human underwriter to sign off on mortgage applications prior to closing or denial. Underwriters ensure the information used is accurate and determine if there is flexibility to qualify a borrower that may not be apparent to AI systems. When looking to understand technology in the mortgage process and the current regulatory environment, lawmakers and regulators should recognize that every mortgage application is reviewed by humans.

In this document, MBA examines the use cases of AI in the mortgage industry and the current legal regulatory landscape of AI usage. MBA then proposes several principles that lawmakers should adhere to when developing AI legislation that will preserve the benefits of AI, manage the risks, and avoid unintended consumer consequences.[1]



1 For additional resources, please see MBA's page on recent state AI activity. Mortgage Bankers Association, State Artificial Intelligence Law and the Real Estate Finance Industry (August 2024) available at mba.org/stateai.



I. Current Use Cases of AI in the Mortgage Industry

It is important to review the history, context, and deployment of the tools that are considered "AI" under many proposals.[2]

Although legislatures have proposed several different definitions of AI, most definitions fall along the lines of defining AI as a "machine-based system that can, for a given set of human-defined objectives, make predictions, recommendations or decisions influencing real or virtual environments. Artificial intelligence systems use machine and human-based inputs to (A) perceive real and virtual environments; (B) abstract such perceptions into models through analysis in an automated manner; and (C) use model inference to formulate options for information or action."[3] This inappropriately broad definition captures both newer uses of AI as well as systems that have been in use for decades, including everyday technology like calculators or spell-check. Although the technologies discussed in this paper fall under this definition of AI, there are key differences between those technologies that present different benefits and risks for consumers, and thus for policymakers.

The different types of "AI" described in this paper include:[4]

- **Algorithms:** A step-by-step procedure used to solve a problem or accomplish a specific end. Technologies that use algorithms will be referred to as "automated systems." These systems are not at risk of creating hallucinations — a response which contains false or misleading information presented as fact — like other technologies defined as AI.

- **Machine Learning:** A technique used by computers to take data as input, find patterns, and summarize the pattern in a mathematically precise way.

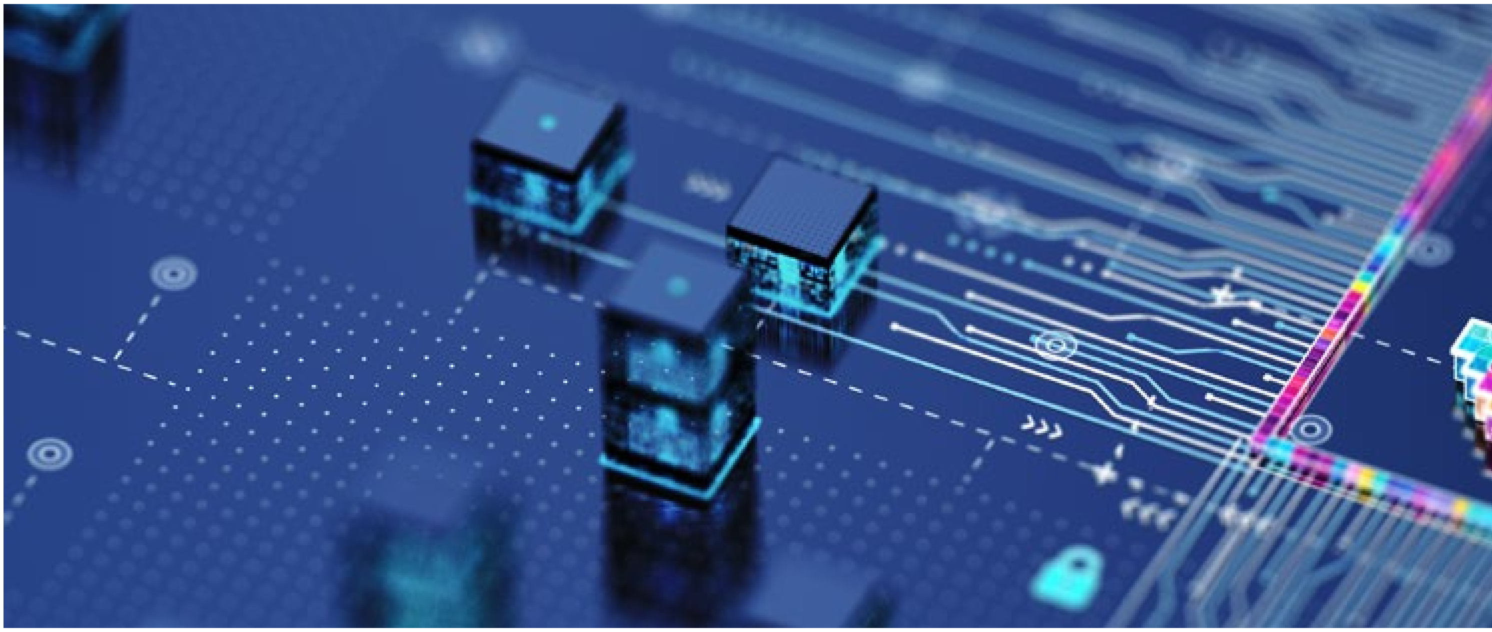
- **Generative AI:** A machine learning system that uses prompts or existing data to create new written, visual, or auditory content.

Uses of technologies that are deemed to be AI under this definition include, but are not limited to, the use of credit scoring models (CSMs), automated underwriting systems (AUS), chatbots, document classification systems, and anti-fraud or cybersecurity protections. Rules controlling the use of AUSs and CSMs — both types of automated systems — are included in guidelines for mortgage qualification from the government sponsored enterprises (GSEs, aka Fannie Mae and Freddie Mac), FHA, the VA Loan Guaranty Program, and the rural housing programs of the U.S. Department of Agriculture (USDA) and are thus required for most loans. These AUSs are specifically developed or approved by each agency or entity, while CSMs — another type of automated system — are required by agency or investor guidelines to determine eligibility or pricing. These are either prescribed by an agency of government or, in the case of the GSEs, under supervision of the Federal Housing Finance Agency (FHFA).

2 MBA has resources that address some of the myths about the use of AI in the mortgage industry. Mortgage Bankers Association, Myths and Facts About AI in the Mortgage Industry (August 2024), available at mba.org/stateai.

3 15 U.S.C. § 9401(3); *see also* Colo. Rev. Stat. § 6-1-1701(2) for a similar definition.

4 These definitions were provided by the Mortgage Industry Standards Maintenance Organization (MISMO). To learn more about MISMO, please visit https://www.mismo.org.



A. Credit Scoring Models and Automated Underwriting Systems

CSMs are required by GSE, as well as other federal guidelines, and are used to measure a consumer's credit history. The score generated by the consumer's credit history has been relied on for mortgage lending since the initial adoption of the Fair Isaac Corporation (FICO) credit score in 1995. CSMs provide risk weighting to several criteria, including payment history, public records like judgements or bankruptcies, collections or charge offs, length of credit history, and current use of credit available. Below are guidelines from the FHA Handbook requiring the use of a CSM before a lender is permitted to use a manual process:

> *Lenders must pull a credit report that draws and merges information from three national credit bureaus. Lenders are prohibited from developing non-traditional credit history to use in place of a traditional credit report. If the credit report generates a credit score, the Lender must utilize traditional credit history.*[5]
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> ...
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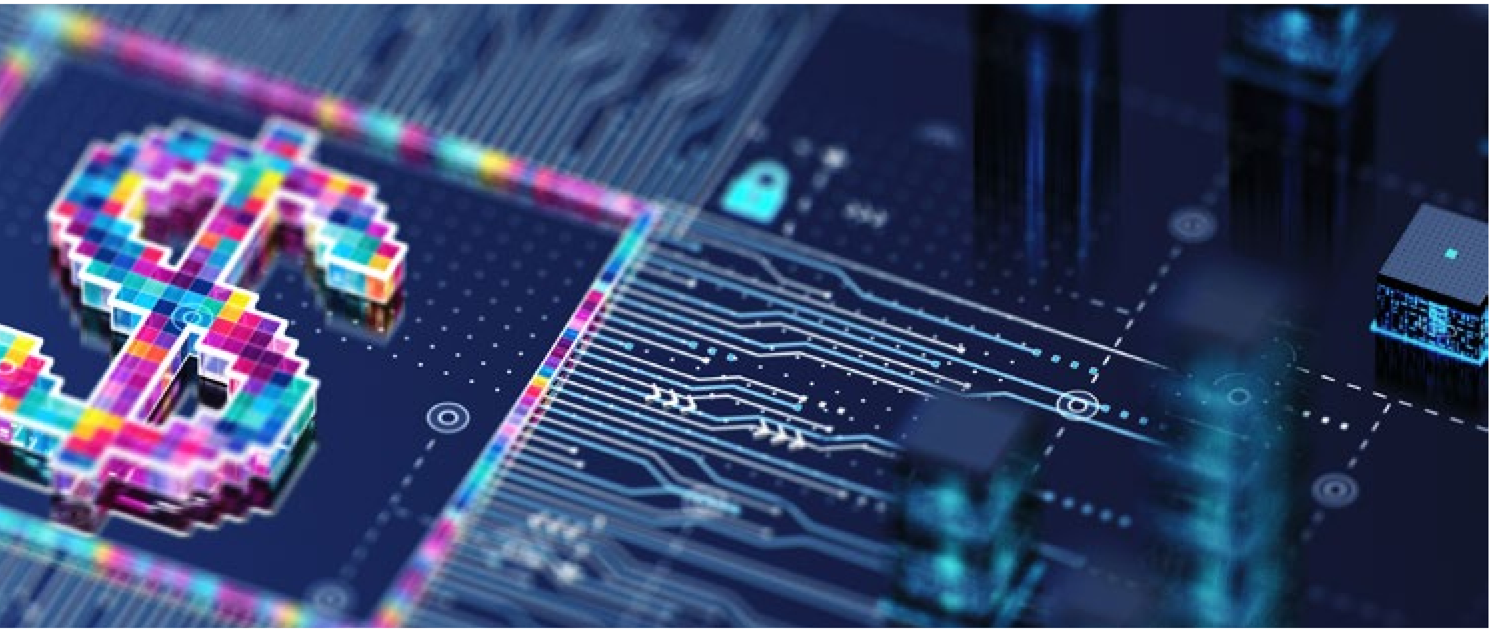
> *If a traditional credit report is available, the Mortgagee must use a traditional credit report. However, if a traditional credit report is not available, the Mortgagee must develop the Borrower's credit history using the requirements for Non-traditional and Insufficient Credit (Manual).*[6]

The introduction of AUSs in the 1990s has proven to be an extremely effective tool for expanding access to credit and driving efficiencies. AUSs are designed to standardize and streamline the mortgage application process, helping the lender to understand if each prospective loan could be insured, purchased, securitized, and/or guaranteed by a government agency or private market investor. The lender ultimately determines if it will originate a loan, but the AUS finding of eligibility is a critical factor in that decision. AUSs are designed to risk weight each applicant based on the following criteria: history and stability of income, amount of income compared to monthly debt obligations, property type and equity position, the amount of reserve assets and verification of any cash to close, and credit history and score as described previously. The finding of eligibility is vital in providing lenders with confidence in their lending decision, which allows them to guarantee or securitize an eligible loan and maintain liquidity in the market. FHA's acceptance of AUSs as seen in their July 10, 1996 mortgagee letter details the case for AUSs and industry's intentions to ensure there is no discrimination:

> *FHA must be satisfied that use of the AUS would comply with the Fair Housing Act and the Equal Credit Opportunity Act. System sponsors may be asked to provide information to help FHA ascertain that the development of the system was consistent with those Acts' requirements. FHA may establish requirements for the AUS to ensure that*

5 FHA Handbook 4000.1, at 1055, "Types of Credit History — Traditional Credit."

6 FHA Handbook 4000.1, at 282, "Types of Credit History (Manual)."



> *its use does not result in discrimination against, or have a disproportionately adverse impact on, minority or other classes of borrowers…*[7]

Evaluating borrowers for credit worthiness without using CSMs or AUSs would require a type of manual underwriting on a loan application that has not been regularly used in the mortgage industry for nearly three decades. Further, relying on a true and fully manual process introduces the potential for human error and potential bias. Aside from the potential for error or bias, greater reliance on manual underwriting would slow down access to credit and significantly increase the cost of origination by requiring lenders to spend more time and resources manually completing formerly automated tasks.

B. Anti-Fraud and Cybersecurity

Financial institutions rely on some form of machine learning-based or generative AI for anti-fraud or cybersecurity measures, including automatically processing consumer information. Machine learning used for this purpose is more effective against bad actors because of its ability to detect patterns in large amounts of data and quickly flag issues of concern for human follow up, resulting in a system that protects consumers and lenders alike. In some states, legislation aimed at regulating AI has included an opt-out provision for these technologies. Allowing consumers, or a fraudster acting as a consumer, to opt-out of anti-fraud or cybersecurity technology will make it more difficult to block fraudulent transactions, and possibly facilitate fraudulent activities or cybersecurity incidents by malicious actors using these opt-out features. State lawmakers recognized this and exempted these uses from Colorado's SB 24-205, *Consumer Protections for Artificial Intelligence,* enacted earlier this year.[8]

C. Conclusion

The introduction of automated systems and credit scoring models for loan origination has led to a fairer lending environment by making the credit standards of insurers or investors like FHA or the GSEs more efficient to work with. Each lender may be competitive through their own risk management programs or guidelines overlayed on AUS, by offering different types of products, or working with different investors. Within this competitive marketplace, all technology must adhere to the federal and state laws or regulations protecting consumers from potential discrimination.

7 Department of Housing and Urban Development, Mortgagee Letter 96-34 (July 10, 1996), available here.

8 Colo. Rev. Stat. § 6-1-1701(9)(b)(II).

II. Current Regulatory Landscape of AI Usage

The mortgage industry is highly regulated. Financial institutions are subject to routine on-site examinations by prudential regulators and examiners who ensure compliance with various consumer protection, disclosure, and anti-discrimination laws and regulations. Regulators have consistently emphasized that it is critical for financial institutions to identify, measure, monitor, and manage risks arising from the use of AI, as they would for the use of any other process or technology.

"Advancements in technology do not render existing risk management and compliance requirements or expectations inapplicable… Regardless of how AI is used in the activities of a financial institution, the institution is responsible for adherence to applicable laws and regulations," according to the U.S. Department of Treasury's March 2024 report *Managing Artificial Intelligence-Specific Cybersecurity Risks in the Financial Services Sector.* The report also notes that the financial services industry offers a model of responsible AI governance and that there are concerns about regulatory fragmentation as different financial sector regulators at both the state and federal level consider regulations around AI.

The Equal Credit Opportunity Act (ECOA), and its implementing regulation, Regulation B, enforced by the Consumer Financial Protection Bureau (CFPB), prohibits lenders from discriminating against applicants during a credit transaction based on race, color, religion, national origin, sex (including sexual orientation and gender identity), marital status, age, whether all or part of the applicant's income derives from any public assistance program, or the applicant's good faith exercise of any right under the Consumer Credit Protection Act. Additionally, as shown below, creditors must provide an adverse action notice if they deny credit to an applicant.[9] The use of AI does not relieve a lender of these legal obligations and notice requirements. ECOA is enforced by the CFPB and can be enforced by State Attorneys General. It is also important to note that these statutory requirements remain irrespective of the political control of the federal agencies and can continue to be enforced.[10]

> *12 C.F.R. § 1002.9(a)(2) Content of notification when adverse action is taken. A notification given to an applicant when adverse action is taken shall be in writing and shall contain a statement of the action taken; the name and address of the creditor; a statement of the provisions of section 701(a) of the Act; the name and address of the Federal agency that administers compliance with respect to the creditor; and either:*
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> > *(i) A statement of specific reasons for the action taken; or*
> >
> > *(ii) A disclosure of the applicant's right to a statement of specific reasons within 30 days if the statement is requested within 60 days of the creditor's notification. The disclosure shall include the name, address, and telephone*

9 Consumer Financial Protection Bureau v. 1st Alliance Lending, LLC, Case No. 3:21-cv-00055, Amended Complaint, at 8-9 (D. Conn. 2021) (Claiming that as a matter of company policy, employees only told applicants they were "ineligible" or "not qualified" for loans without providing the consumers with the written adverse action notice required under ECOA).

10 Note that the Trump Administration may have its own significant and far-reaching ideas about AI and its regulation, and the landscape may change significantly when those ideas are made known.

number of the person or office from which the statement of reasons can be obtained. If the creditor chooses to provide the reasons orally, the creditor shall also disclose the applicant's right to have them confirmed in writing within 30 days of receiving the applicant's written request for confirmation.[11]

The CFPB, federal banking agencies, and the National Credit Union Administration (NCUA) use their supervisory and enforcement authorities over banks, credit unions, and nonbank mortgage lenders to conduct regular reviews and assessments of an institution's practices to identify, monitor, and control the risk of discrimination or bias and for compliance with this adverse action notice requirement.[12] Adverse action notices provided by creditors must be specific and indicate the principal reason for the adverse action. Creditors cannot merely state that the adverse action was based on the creditor's internal standards, policies, or that the applicant failed to meet the qualifications of an internal scoring system.[13] A reason for denial can include the inability to verify income, a borrower's temporary or irregular employment, or for an incomplete credit application.[14] The CFPB and private plaintiffs have brought challenges against creditors that provide adverse action reasons that are inaccurate or insufficiently specific to identify the underlying reason for the denial.[15] This adverse action notice requirement extends to denials from AI. Under CFPB Circular 2022-03, creditors cannot merely rely on the output of AI as a reason to deny credit and must still provide an adverse action notice. As the CFPB noted in the Circular, this requirement helps prevent discrimination because a creditor must explain their decisions and cannot place blame on the technology utilized, which adds additional protection against discriminatory practices.[16] The CFPB followed up with Circular 2023-03, which further specified that creditors may not rely on the reasons provided on the sample adverse action notice when using AI or complex credit models if it does not accurately indicate the principle reason for the adverse action.[17]

Financial institutions are also subject to numerous other fair and responsible lending laws and regulations. The Fair Housing Act prohibits discrimination in all aspects of residential real estate-related transactions based on race, color, religion, sex (including sexual orientation and gender identity), national origin, disability, and familial status. The Truth in Lending Act and its implementing regulation, Regulation Z, govern the way credit terms are disclosed to consumers and include several provisions that address valuation independence in transactions when a consumer's home is securing the loan. The Fair Credit Reporting Act (FCRA), similar to ECOA, requires creditors to provide an adverse action notice if their decision is based on information contained in a consumer credit report. Additionally, FCRA allows consumers to dispute the completeness or accuracy of information in their credit report and requires that a credit reporting agency investigate this claim. Section 5 of the Federal Trade Commission Act prohibits unfair or deceptive acts or practices, all states also prohibit such acts or practices, and the Dodd-Frank Wall Street Reform and Consumer Protection Act prohibits engaging in unfair, deceptive, or abusive acts or practices.

Supervisory guidance from the Office of the Comptroller of Currency (OCC), Federal Deposit Insurance Corporation (FDIC), and Board of Governors of the Federal Reserve System (Board) on model risk management has principles applicable to managing risks from AI, including assessing conceptual soundness, confirming underlying data, considering model complexity and transparency, assessing performance, and evaluating implementation. In this context it is also worth noting that federal regulators, including the OCC, Treasury, Board, FDIC, NCUA, CFPB, and FHFA, have finalized a rule creating quality control standards for the deployment of automated valuation models (AVMs) — used by mortgage originators and secondary

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11 A borrower does not need to be a member of a protected class to be covered by this provision of ECOA. See Fischl v. General Motors Acceptance Corp., 708 F.2d 143, 146 (5th Cir. 1983) (noting that ECOA has "the twin goals of consumer protection and education").

12 Consumer Financial Protection Bureau, Mortgage Origination Examination Procedures, pg. 11 (Dec. 2021), available here.

13 12 C.F.R. § 1002.9(b)(2); see Chen v. Chase Bank USA, N.A., 393 F. Supp. 3d 850, 855-56 (N.D. Cal. 2019) (Denying defendant's motion to dismiss on the grounds that the reason given in the Adverse Action Notice, "previous unsatisfactory relationship with this bank," did not give a sufficiently specific reason for denial because it did not identify what aspect of that relationship was unsatisfactory).

14 12 C.F.R. § 1002, App. C — Sample Notification Forms (providing a non-exhaustive list of possible reasons for denial).

15 *See* In the Matter of Citibank, N.A., Administrative Proceeding File No. 2023-CFPB-0013, Consent Order, at 1, 13 (Nov. 8, 2023) (Finding that Citibank violated ECOA by failing to, "provide applicants with an accurate and adequate statement of the specific reasons for the adverse action when the applicant was denied based on Armenian national origin" when the disclosed reason was "declined due to possible credit abuse."); see also Copple v. Southern Bank of Tennessee, Case No. 3:22-cv-00692, Order Denying Motion to Dismiss, at 7 (M.D. Tenn. 2023) (Denying defendant's motion to dismiss on the grounds that the reason given in the Adverse Action Notice, "[w]e do not grant credit under terms and conditions requested," did not give the real reason for the denial — that the plaintiff had recently been the victim of fraud).

16 Consumer Financial Protection Bureau, Consumer Financial Protection Circular 2022-03 (May 26, 2022).

17 Consumer Financial Protection Bureau, Consumer Financial Protection Circular 2023-03 (Sept. 19, 2023).

market issuers to determine the collateral value of the home securing the mortgage — to ensure compliance with applicable nondiscrimination laws. Additionally, the Department of Housing and Urban Development (HUD) has released guidance which states that the anti-discrimination provisions of the Fair Housing Act apply to the use of AI for advertising.[18] Critically, financial institutions retain responsibility for the integrity of operations performed by third party systems and must ensure they have prudent risk management over all activities, including the use of AI, whether conducted in-house or through a relationship with a third party, as affirmed by the June 2023 *Board and OCC Interagency Guidance on Third-Party Relationships: Risk Management.*

Multiple regulators have asserted that financial institutions retain responsibility to comply with applicable laws and regulations for technologies used. Fair lending laws such as ECOA — which apply to the use of AI in connection with an application for credit — can be enforced on the state level by state attorneys general and private plaintiffs. Additionally, many states have their own anti-discrimination laws that apply to lending decisions and are enforced by state attorneys general or other state agencies.

Given that many recently proposed state AI bills are duplicative of the laws that our members already follow, and due to the potential negative impacts to consumers, we believe the appropriate path is for Congress to address a narrow range of relevant and evolving AI issues at the federal level with strong preemptions and for states to provide an entity-level exemption to their AI legislation. For any broad-based AI legislation, legislators should carefully consider the following principles before advancing AI legislation that will affect the mortgage industry.

18 U.S. Department of Housing and Urban Development, Guidance on Application of the Fair Housing Act to the Advertising of Housing, Credit, and Other Real Estate-Related Transactions through Digital Platforms (April 29, 2024).

III. MBA AI Principles for Lawmakers

Lawmakers should adhere to the following principles that consider the current use of AI and existing legal protections and requirements when regulating AI in the mortgage industry.

1. Congress Should Create Uniform AI Legislation

AI issues are a nationwide concern and not state specific. A patchwork of state laws and federal regulations will lead to higher compliance costs, less adoption of beneficial AI, and a disruption of lending to consumers. It can also confuse consumers as they navigate different state and federal opt-out and privacy procedures. For these reasons, concerns about AI should be addressed at the federal level with strong preemptions.

There have been several states that have at least considered legislation controlling AI across multiple industries. Given the current use of AI — as previously defined — in the mortgage space and the legal prohibitions on its use, states that are considering AI legislation should exempt the mortgage industry from coverage. Although there are multiple ways of achieving this, we believe that because of the role ECOA plays in regulating AI usage, an ECOA-based entity level exemption is appropriate.

For any federal legislation touching the use of AI in the mortgage industry, Congress should consider the following principles when addressing AI issues. States should defer to Congress. Before legislating, state legislators and regulators should consider whether their goals of regulating AI systems can be achieved with pre-existing authority. If state legislators plan to act regardless of federal action, they should also align with the following principles.

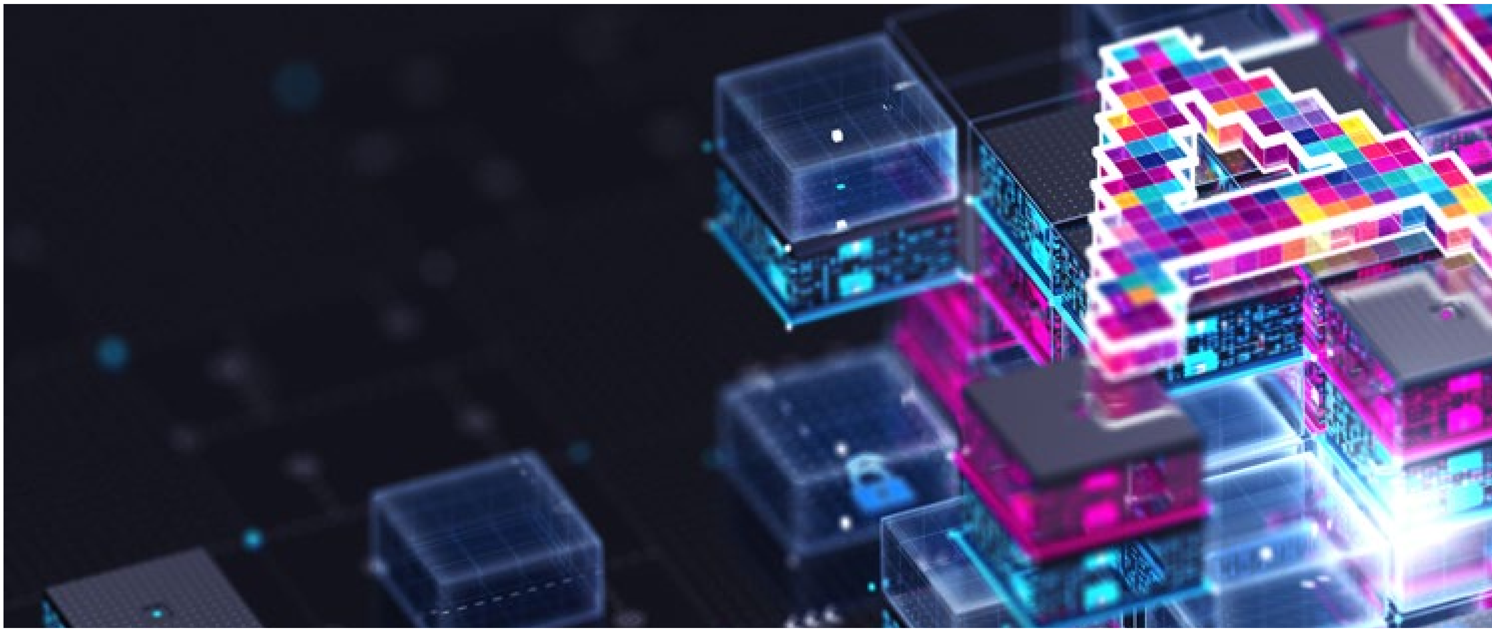
2. Congress Should Narrowly Target its AI Legislation Towards Generative AI

Congress should develop a framework for AI legislation that is targeted at emerging concerns around generative AI, such as the proliferation of misleading or harmful written, visual, and auditory content. This is the more pressing concern, rather than efforts to control model-based automated systems that are already well-regulated and have been ingrained into the financial services industry for decades. At the same time, Congress should create a permissive structure to allow developers to continue to develop their AI, which may ultimately be to the benefit of the industry and borrowers. Congress should not create an overly broad law that confuses or complicates issues for which there already are existing laws.

The proliferation of generative AI by bad actors makes it difficult for the public to discern misinformation or disinformation. For example, deepfake videos or AI-generated likeness can be used to deceive people, including financial institutions, eroding trust in authentic content and credible sources. Additionally, the ability to create realistic, AI-generated content allows malicious actors to create fraudulent documents, fake audio recordings, or videos designed to spread false information. Cybercriminals can use generative AI to produce phishing attacks or social engineering schemes, tricking people into disclosing personal information or committing financial fraud. These concerns should be addressed by Congress.

3. Any Liability for Violating Anti-Discrimination Prohibitions Should be Limited to Existing Anti-Discrimination Law

AI or algorithmic discrimination in consumer finance is punishable by numerous federal and state anti-discrimination laws. ECOA and Regulation B regulate the extension of credit by creditors, and subsequent Circulars 2022-03 and 2023-03 released by the CFPB prohibit the use of AI that would discriminate against borrowers. State Attorneys General and individual plaintiffs also



have authority to bring an action against creditors for violations of ECOA under the protections afforded by the CFPA. Lenders are also subject to the Fair Housing Act, which makes it illegal to discriminate against individuals seeking a mortgage and is enforced by the Department of Justice (DOJ), HUD, and through a private right of action from individual plaintiffs. Lenders are additionally subject to Section 1981 of the Civil Rights Act of 1866, which effectively prohibits discrimination on the basis of race or color in the making or enforcing of contracts. Section 1981 is enforced by the DOJ and has a private right of action. Lastly, many states have their own anti-discrimination laws that apply to lending decisions and are enforced by State Attorneys General or other state agencies.[19]

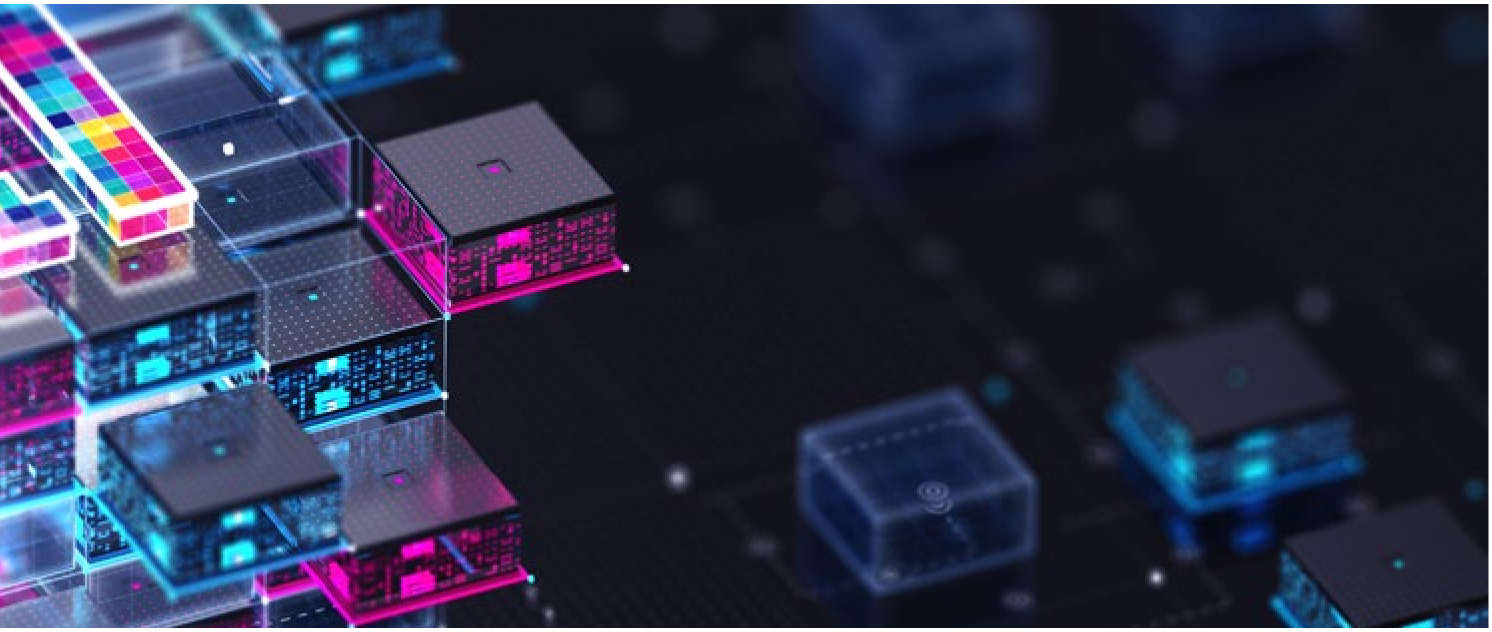
The mortgage industry is subject to many anti-discrimination laws that are just as applicable to the use of AI to help inform decisions as they are to any other input. These prohibitions are tailored towards the consumer finance industry generally and in some cases the mortgage finance industry in particular, with regulations, guidance, and caselaw that lay out rules of the road for the industry. With respect to financial services, rather than creating new anti-discrimination laws, lawmakers should tie any AI-related bias to a violation of existing anti-discrimination law.

4. Exempt Everyday Uses of AI and AI That Does Not Have a Consumer Impact

As mentioned above, the definition of AI in some AI legislation is inappropriately broad and covers many systems that have been used for decades, are already well-regulated, and predate concerns around generative AI. This overbroad definition can cover many uses of everyday technology, such as calculators and spell-checking. It also covers technology that is already highly regulated and exists for the benefit of the consumer, such as cybersecurity and anti-fraud technologies. Colorado recognized this and distinguished between everyday technology that falls under their broad definition of AI systems and "high-risk AI systems" that could have a consumer impact.[20] Colorado listed 18 systems that are not considered high-risk AI systems and are thus not covered under the law, including calculators and spell-checking. Future legislation should consider these types of use cases and exempt them from coverage of AI bills to ease compliance burdens and avoid hampering companies' ability to protect themselves and serve consumers through anti-fraud and cybersecurity measures. This can best be accomplished by narrowing the definition of AI systems to include only those they seek to regulate.

19 Cal. Gov. Code § 12900 (Fair Employment and Housing Act), NY EXEC § 290 (New York Human Rights Law), M.C.L.A. § 37.2101 (Elliot-Larsen Civil Rights Act).

20 Colo. Rev. Stat. § 6-1-1701(9).



5. **The Mortgage Industry Should Not Be Held Liable for Using Third-Party Systems Mandated, Developed, or Approved by the Federal Government or Government Sponsored Enterprises**

Lenders rely on automated systems approved or developed and maintained by the federal government and the GSEs to inform lending decisions or to determine if a loan is eligible for securitization or guarantee. For example, Desktop Underwriter (DU) and Loan Prospector Advisor (LPA) are developed and controlled by the GSEs, while the VA and FHA have their own requirements and certifications to approve vendor AUSs. Lenders also rely on, and in some cases are required to use, credit scoring models to guide lending decisions and pricing.

It would be fundamentally unfair for federal and state lawmakers to hold mortgage companies responsible for the processes of automated systems they are compelled to use but have no power to modify or have not provided input on their development. If a lender determined that a government-provided or approved lending model was discriminatory, they would be left with two choices. They would have to either continue to use these AI tools to make loans and incur liability or stop lending altogether. Concerns with these models should be addressed by the proper agencies at the federal level. The federal government and the GSEs should remain in charge of developing, validating, and monitoring these systems. If lenders are required by the government to use a tool that fails in some way because of how it was developed, there should be no liability where the mortgage company is not responsible for that failure.

6. **Recognize that Humans Have the Final Say on Lending Decisions in the Mortgage Origination Process**

Automated systems do not have the final say in mortgage lending decisions. MLOs are responsible for discussing the terms and pricing of the loan with the prospective borrower and determining whether to accept or deny an application. These MLOs must be licensed and/or registered under the SAFE Act and must provide their unique identifying number (NMLS ID) for a loan to be completed. Borrowers must be evaluated for a credit decision by a licensed or registered MLO. The MLO is also charged with ensuring the borrower understands and agrees with the terms of the loan. Although AI can assist both the borrower and MLO in finding an appropriate loan, only an MLO can accept the consumer's application after agreeing on the terms of the loan.

In addition to the MLO, the origination process also involves a human underwriter. The underwriter also has a deeper understanding of investor guidelines and can see nuances to qualifying borrowers that automated systems cannot. AUSs provide underwriters with a finding as to why a loan may not be eligible for securitization, insurance, or guarantee. Using this, underwriters ensure the integrity of the transaction and protect borrowers from erroneous denials. In both the underwriter context and on a general level, human beings can detect errors in model inputs and make observations about the outputs that a model cannot. Additionally, unlike with fully automated processes, humans are empowered to make a different decision than the one suggested by the output of a model. Lastly, in the lending context, creditors are required to provide adverse action notices under ECOA in the event of a denial, including the reason for the denial. For these reasons, the federal and state governments should treat differently decisions that do and do not involve a human with final say over a consequential decision.

7. Do Not Require Lenders to Conduct an Alternative Manual Process and Preserve Existing Underwriting Standards

While opt-outs with respect to consumer transactions are customarily viewed as empowering, a mortgage origination is different from other retail or lending transactions. Consequently, allowing consumers to opt out of well-regulated uses of AI in the delivery of mortgage products — especially those tightly supervised by the federal government or the GSEs — would be counter-productive and may unintentionally limit consumer choices and increase the cost of loan production. Establishing a consumer opt-out provision would require a type of manual underwriting that has not been regularly used in the mortgage industry for nearly three decades. As indicated above, the current mortgage origination process relies on automated systems such as AUSs and CSMs that do not have usable or scalable alternative manual processes. Additionally, a process that opts-out consumers from automated processing and instead evaluates them under a manual process introduces the potential for human error and bias. Greater reliance on manual underwriting would slow down access to credit and significantly increase the cost of origination by requiring lenders to spend more time and resources manually completing formerly automated tasks. This is further complicated by the logistics issues of running a bifurcated automation and manual process. Lastly, allowing consumers to opt out of anti-fraud or cybersecurity technology will make it more difficult to block fraudulent activity and could facilitate fraudulent activities or cybersecurity incidents by malicious actors who use these opt out features.

8. Utilize Existing Federal Disclosures Known to Consumers

In some of the AI legislation reviewed by MBA, lenders were required to send adverse action notices to consumers and in some cases must offer to correct inaccurate consumer information that formed the basis for the decision. Lenders are already required to send similar notices to consumers in the form of adverse action notices under ECOA and notices that provide consumers with the opportunity to correct inaccurate information on their credit reports under FCRA. Legislators should not require lenders to send two sets of disclosures that serve the same purpose. Sending duplicative disclosures with the same or similar informative content but with different processes will lead to consumer confusion. For this reason, any new laws regulating AI should leverage existing notification requirements rather than supplementing them.

9. Recognize Applicable Risk Management Frameworks

Government agencies and developers have published risk management frameworks that help developers and deployers identify and manage the risks of AI. For example, the National Institute of Standards and Technology published their Artificial Intelligence Risk Management Framework (NIST AI Framework), which is a resource for organizations designing, developing, deploying, or using AI systems to help them manage the risks of AI and promote trustworthy and responsible development and use of AI systems.[21] Although compliance with these frameworks is voluntary, developers and deployers that follow this or other generally accepted risk management frameworks should gain some protections for adhering to these standards.

Colorado appropriately incorporated this principle by providing developers and deployers with an affirmative defense to charges of algorithmic discrimination by showing that the entity discovered and cured the violation and is in compliance with, among other options, the NIST AI Risk Management Framework.[22] Lawmakers should follow this example.

21 NIST, Artificial Intelligence Risk Management Framework (AI RMF 1.0), at 2 (Jan. 2023), available here.

22 Colo. Rev. Stat. § 6-1-1706(3).

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