August 2, 2024

The Honorable Rebecca Bauer-Kahan
Member, California State Assembly
1021 O Street, Suite 5210
Sacramento, CA 95814

RE: **<u>Assembly Bill 2930 (Bauer-Kahan): Automated Decision Tools - OPPOSE UNLESS AMENDED</u>**

Dear Assembly Member Bauer-Kahan,

The above noted organizations, representing the finance industry doing business in California, write in respectful opposition to **AB 2930**, which may raise the cost of providing credit to California residents of financial institutions already abiding by robust federal and state laws, regulations, and supervisory guidance that are appliable to the use of all technologies, including automated decision tools (ADTs).

The financial services sector is a highly regulated industry and financial institutions are subject to routine on-site examination by prudential regulators and examiners who ensure compliance with laws and regulations, including those related to consumer and investor protection as well as those prohibiting discrimination and other illegal practices. Regulators have consistently emphasized that it is critical for financial institutions to identify, measure, monitor, and manage risks arising from the use of ADTs, as they would for the use of any other technology. "Advancements in technology do not render existing risk management and compliance requirements or expectations inapplicable … Regardless of how AI (artificial intelligence) 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*[1]. The report also notes that the financial services industry offers a model of responsible artificial intelligence governance and that there are concerns that subnational level regulation may result in regulatory fragmentation internationally.

Oversight includes the review and assessment of institutions' practices for identifying, monitoring, and controlling the risk of discrimination or bias. For example, the Equal Credit Opportunity Act (ECOA), and its implementing regulation, Regulation B, promulgated by the Consumer Financial Protection Bureau (CFPB) prohibits lenders from using ADTs to discriminate 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. ECOA is enforced by the CFPB and can be enforced by

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[1] https://home.treasury.gov/system/files/136/Managing-Artificial-Intelligence-Specific-Cybersecurity-Risks-In-The-Financial-Services-Sector.pdf

the California Attorney General. Under CFPB Circular 2022-03, creditors cannot merely rely on the output of an ADT as a reason to deny credit and must disclose a specific reason for the denial. 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 discourages creditors from engaging in discriminatory practices. Lenders have necessarily used algorithms and ADTs for many years to promptly complete a consumer's request for the extension of credit. In instances where that credit is denied, a lender must provide notice that is specific and indicate the principal reasons for the adverse action.

In addition to ECOA financial institutions have long been subject to numerous anti-discrimination laws and rules. 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. And, 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 appraiser independence in transactions when a consumer's home is securing the loan. Section 5 of the Federal Trade Commission Act prohibits unfair or deceptive acts or practices, and the Dodd-Frank Wall Street Reform and Consumer Protection Act prohibits covered persons (e.g., nonbank financial institutions) or service providers of covered persons from engaging in unfair, deceptive, or abusive acts or practices. Lastly, California has well established state laws preventing discrimination. The Unruh Civil Rights Act specifically outlaws discrimination in housing, including lending transactions, preventing discrimination on the basis of personal characteristics. The Fair Employment and Housing Act (FEFA) prevents discrimination in any part of a credit or real estate-related transaction, which includes mortgage brokering or mortgage lending. FEFA imposes liabilities for practices that have discriminatory effects or impacts.

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 and ADTs, 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; National Credit Union Administration (NCUA); CFPB; and the Federal Housing Finance Agency (FHFA), have finalized rules to implement the quality control standards mandated by the Dodd-Frank Act for the use of automated valuation models (AVMs) by mortgage originators and secondary market issuers in determining the collateral worth of a mortgage secured by a consumer's principal dwelling and ensure compliance with applicable nondiscrimination laws.

Critically, the Code of Federal Regulations Title 17 states that financial institutions retain responsibility for the integrity of operations performed by third parties – financial institutions must ensure they have prudent risk management over all activities, including ADTs, 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*. Financial institutions must rely on third-party ADTs that they do not create, including Automated Underwriting Systems (AUSs) to have a loan guaranteed, insured or securitized. They must also use credit scoring models required by the Government-Sponsored Enterprises (GSEs), (i.e. Fannie Mae or Freddie Mac or the GSEs), the Department of Housing and Urban Development (HUD), and the Veterans Administration (VA), but developed by FICO, as well as other ADTs such as AVMs used by third-party appraisers. ASUSs are developed by government agencies or by entities directly regulated by the agencies. These technologies are developed by the insurer or investor, including the affordable housing programs of the federal government, e.g., the Federal Housing Administration (FHA), the VA, the GSEs. For example, Desktop Underwriter (DU) and Loan Prospector (LP) are developed and controlled by the GSEs, while HUD has their own AUS for FHA and VA loan products. As the GSE's prudential regulator, the FHFA regulates DU/LP AUSs. Similarly, FHA and VA control their systems.

Finally, Section 22756.2(b) of AB 2930 requires a deployer of an ADT to offer an alternative accommodation to the use of the ADT. The use of ADT in a credit decision reduces error and can look at factors beyond credit scores, like transaction history, to determine whether a customer with limited credit history might in fact make a good credit customer. The use of ADTs in regulatory compliance is generally superior to human-based analysis. This both protects consumers and reduces cost for consumers as the cost for compliance is lessened by the aid of technology. This section of the measure is highly problematic for lenders and may result in a disruption in the extension of credit and the protection of California consumers.

While existing supervisory risk management and operational resiliency expectations may not expressly address the use of specific technologies like the use of ADTs, existing risk management principles provide a framework for financial institutions implementing ADTs to operate in a safe, sound and fair manner – as they would for the use of any other technology. As illustrated above, multiple on-site prudential regulators have asserted that financial institutions retain compliance responsibility to applicable laws and regulations for technologies used – including but not limited to ECOA, which is enforced through both the CFPB and California Attorney General, and 18 U.S. Code 1344, which protects both financial institutions and consumers from various types of fraud. Because our members are already subject to anti-discrimination laws, and due to the potential negative impacts to California consumers, we must respectfully oppose AB 2930 unless amended.

Respectfully,

California Bankers Association – Melanie Cuevas, VP of Government Relations
California Community Banking Network – Lindsay Gullahorn, Contract Lobbyist
California Credit Union League – Robert Wilson, SVP of State Government Affairs
California Financial Services Association – Scott Govenar, Contract Lobbyist
California Mortgage Bankers Association – Indira McDonald, Contract Lobbyist
Mortgage Bankers Association – William Kooper, MPA VP of State Government Affairs

cc: All Members, Senate Committee on Appropriations
Liah Burnley, Consultant, Senate Committee on Appropriations
Morgan Branch, Consultant, Senate Republican Caucus

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