Community Bankers of Michigan Regulatory Dispatch

June 1, 2022

Timely news and resources community bankers can use

to better stay on top of a rapidly changing world.

CFPB Acts to Protect the Public from Black-Box Credit Models Using Complex Algorithms

Question presented:
When creditors make credit decisions based on complex algorithms that prevent creditors from accurately identifying the specific reasons for denying credit or taking other adverse actions, do these creditors need to comply with the Equal Credit Opportunity Act's requirement to provide a statement of specific reasons to applicants against whom adverse action is taken?

Response:
Yes. ECOA and Regulation B require creditors to provide statements of specific reasons to applicants against whom adverse action is taken. Some creditors may make credit decisions based on certain complex algorithms, sometimes referred to as uninterpretable or "black-box" models, that make it difficult—if not impossible—to accurately identify the specific reasons for denying credit or taking other adverse actions.1 The adverse action notice requirements of ECOA and Regulation B, however, apply equally to all credit decisions, regardless of the technology used to make them. Thus, 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.

The Circular makes clear that:

- Federal consumer financial protection laws and adverse action requirements should be enforced regardless of the technology used by creditors. For example, ECOA does not permit creditors to use technology that prevents them from providing specific and accurate reasons for adverse actions. Creditors' use of complex algorithms should not limit enforcement of ECOA or other federal consumer financial protection laws.

- Creditors cannot justify noncompliance with ECOA based on the mere fact that the technology they use to evaluate credit applications is too complicated, too opaque in its decision-making, or too new. Creditors who use complex algorithms—including artificial intelligence or machine learning technologies—to engage in credit decisions must still provide a notice that discloses the specific, principal reasons for taking adverse actions. There is no exception for violating the law because a creditor is using technology that has not been adequately designed, tested, or understood.

Comment: In general, the circular communicates a standard of explainability for these models in the context of providing adverse action notices to consumers. Bottom line—the CFPB expects these black-box systems to identify the reasons the algorithm generated the adverse score.

CBM Insights

Q: Management has suggested running all business owners (identified using beneficial ownership information) and authorized signers through Chex Systems. Would there be a permissible purpose issue in doing so?

A: Perhaps. It comes down to two issues: 1) is Chex Systems a consumer credit report? and 2) do you have a 'permissible purpose' under the Fair Credit Reporting Act (FCRA?)

Is Chex Systems a credit bureau?

Chex Systems, Inc. is a nationwide specialty consumer-reporting agency (NSCRA) governed by the Federal Fair Credit Reporting Act (FCRA) and any applicable state statutes. The term "nationwide specialty consumer reporting agency" means a consumer reporting agency that compiles and maintains files on consumers on a nationwide basis relating to -

(1) medical records or payments;
(2) residential or tenant history;
(3) check writing history;
(4) employment history; or
(5) insurance claims.

Source link.

What we do know for certain is that Chex Systems is a 'consumer reporting agency' subject to FCRA. That means that in order to pull a Chex Systems report, you need a permissible purpose.

As long as you have a request to open the account and the person making the request is going to be liable on the account, you have a permissible purpose and no written consent is required.

However, unless the owners and or authorized signers are personally obligated on the account, you don't have a permissible purpose and would need written consent to pull a Chex Systems report.

Under the often referred to Tatelbaum II letter from the Federal Trade Commission, you may pull a credit report in a commercial transaction if the individual will be personally liable on the account. Under Tatelbaum I letter you need the consumer's written consent to pull their credit report absent a permissible purpose.

Items of Interest

Bank Management

	FRB Digital Assets and the Future of Finance: Examining the Benefits and Risks of a U.S. Central Bank Digital Currency (05/26/2022) - Chairwoman Waters, Ranking Member McHenry, and other members of the Committee, I am pleased to join you. With technology driving profound change, it is important we prepare for the financial system of the future and not limit our thinking to the financial system of today. No decision has been made about whether a U.S. central bank digital currency (CBDC) will be a part of that future, but it is important to undertake the necessary work to inform any such decision and to be ready to move forward should the need arise. There has been explosive growth in an emergent digital financial system built around new digital assets and facilitated by crypto-asset platforms and stablecoins as settlement assets. In recent weeks, two widely used stablecoins have come under considerable

pressure. One widely used algorithmic stablecoin declined to a small fraction of its purported value, and the stablecoin that is the most traded crypto asset by volume temporarily dipped below its purported one-to-one valuation with the dollar.

These events underscore the need for clear regulatory guardrails to provide consumer and investor protection, protect financial stability, and ensure a level playing field for competition and innovation across the financial system. The recent turmoil in crypto financial markets makes clear that the actions we take now—whether on the regulatory framework or a digital dollar—should be robust to the future evolution of the financial system. The rapid ongoing evolution of the digital financial system at the national and international levels should lead us to frame the question not as whether there is a need for a central-bank-issued digital dollar today, but rather whether there may be conditions in the future that may give rise to such a need. We recognize there are risks of not acting, just as there are risks of acting.

Congress recognized the importance of safe, efficient, and widely accessible payments when it created the Federal Reserve and included payments as a core part of our mission. It entrusted to the Federal Reserve the issuance to the public of government, risk-free currency. The Federal Reserve has operated alongside the private sector, providing a stable currency and operating key aspects of the payments system, while also supporting private-sector innovation.

Comment: There is significant tension between the Fed's desire to have a US CBDC that will compete globally versus the very real concerns of it and community banks that it can (and will?) be used to disintermediate funding.

OCC Hosts Dallas Workshop for National Community Bank Board Directors, Bank Management (05/26/2022) - WASHINGTON — The Office of the Comptroller of the Currency (OCC) will host a workshop in Dallas for directors, senior management team members, and other key executives of national community banks and federal savings associations, June 28-29.

The Building Blocks: Keys to Success for Directors and Senior Management workshop combines lectures, discussions, and exercises to provide practical information on three key roles of directors – strategy, people and oversight. The workshop is taught by seasoned OCC supervision staff and includes discussions on board duties, responsibilities and governance; current supervisory issues; and the examination process.

The workshop fee is $99 and limited to the first 35 registrants. Participants receive course materials, supervisory materials, and lunch.

To register online, and view the schedule and locations of other workshops, visit the OCC's website. For additional questions about the workshops, please contact the OCC Bank Director Workshop Team at (202) 649-6490 or bankdirectorworkshop@occ.treas.gov.

Comment: The expectations of bank directors is ever increasing. It is critical that bank directors stay current with training to guide them through the complexities of today's banking environment. For national banks, these workshops are a valuable resource. If your director attends these kind of programs, be sure that is recorded in board minutes or a training log for directors.

CSBS State Regulators Seek Expansion of Cannabis Banking Safe Harbor (05/25/2022) - Washington, D.C. – In letters sent to both the House and Senate, Conference of State Bank Supervisors Acting President & CEO James M. Cooper urged Members of Congress to provide marijuana businesses with access to financial services by retaining the Secure and Fair Enforcement (SAFE) Banking Act in the final conference report of the America COMPETES Act.

"By granting a safe harbor for financial institutions, Congress can bring regulatory clarity to the financial services industry, address public safety concerns and ensure access to financial services for state-compliant marijuana and marijuana-related businesses.

"Safe harbor should be extended to all financial services, including money transmission, as the adverse impact of the current inconsistency in state and federal law is not limited to depository institutions."

LINKS
Senate Letter
House Letter

Comment: CBM has long lobbied for enactment of the SAFE Act under the logical premise that if it is legal to buy and sell, it should be legal to bank.

CFPB Launches New Effort to Promote Competition and Innovation in Consumer Finance (05/24/2022) - Washington, D.C. – The Consumer Financial Protection Bureau (CFPB) is opening a new office, the Office of Competition and Innovation, as part of a new approach to help spur innovation in financial services by promoting competition and identifying stumbling blocks for new market entrants. The office will replace the Office of Innovation that focused on an application-based process to confer special regulatory treatment on individual companies. The new office will support a broader initiative by the CFPB to analyze obstacles to open markets, better understand how big players are squeezing out smaller players, host incubation events, and, in general, make it easier for people to switch financial providers.

"Competition is one of the best forms of motivation. It can help companies innovate and make their products better, and their customers happier," said CFPB Director Rohit Chopra. "We will be looking at ways to clear obstacles and pave the path to help people have more options and more easily make choices that are best for their needs."

The CFPB has a statutory mandate to promote fair, transparent, and competitive markets. Families, honest businesses, and the entire economy benefit when consumer finance markets are fiercely competitive, rather than dominated by a handful of firms. Digital technology is transforming the markets, including how payments, deposits, and lending are provided and who provides them. Big banks, fintech, big tech, incumbents, and small start-ups are all jockeying to be in front. The Office of Competition and Innovation will focus on how to create market conditions where consumers have choices, the best products win, and large incumbents cannot stifle competition by exploiting their network effects or market power.

The new office will support the CFPB's general effort at increasing competition for the benefit of all consumers. Specifically, the CFPB will:

- Give consumers their walking rights to switch providers: Competition is more vibrant when people can switch to a new provider easily, creating pressure on incumbents to maintain high levels of service and giving new entrants an opportunity to win customers. The CFPB will be exploring ways to reduce the barriers to switching accounts and providers.

- Research structural problems blocking successes: The new office will be housed in the CFPB's Research, Markets, and Regulation division, giving it greater access to resources to look at market-structure problems that create obstacles to innovation. For example, this could include greater explorations of the payment networks market or the credit reporting system, both of which are essential to our financial system but have only a few dominant players.

- Understand how bigger players can gain advantage over smaller players: Sometimes start-ups simply get runover by bigger players. For example, big companies can easily pitch new products to their large customer bases and stymie outside players who may have more favorable products. Big tech companies, with their huge reaches, are also seeking new ways to join consumer finance markets and may threaten fair competition.

- Identify ways to address commonplace obstacles: Innovators may not be getting their products or services to market because of more practical problems like access to capital or talent. Or they may not launch because they don't have access to the large volumes of digital data stored by the big banks. A future rulemaking by the CFPB under Section 1033 of the Consumer Financial Protection Act will give consumers access to their own data.

- Host events to explore barriers to entry and other obstacles: The new office will convene events such as open houses, sprints, hackathons, tabletop exercises, and war games. Entrepreneurs, small business owners, and technology professionals will be able to collaborate, explore obstacles, and share frustrations with government regulators. Results will be shared publicly.

The Office of Competition and Innovation replaces the Office of Innovation, which opened in 2018, and Project Catalyst, launched in 2014. The Office of Innovation's primary purpose was to process applications for No Action Letters and Sandboxes that applied to an individual company's specific product offering. After a review of these programs, the agency concludes that the initiatives proved to be ineffective and that some firms participating in these programs made public statements indicating that the Bureau had conferred benefits upon them that the Bureau expressly did not.

The CFPB is also encouraging companies, start-ups, as well as members of the public to file rulemaking petitions to ask for greater clarity on particular rules. This will help level the playing field and foster competition by ensuring any actions the CFPB takes will apply to all companies in the market.

Comment: Reading between the lines, it appears that the CFPB is actually poised to encourage and facilitate competitors to banking through this office!

FDIC Insured Institutions Reported Net Income of $59.7 Billion in First Quarter 2022 (05/24/2022) - For Release

- Net Income Declined Year Over Year
- Net Interest Margin Remained Stable Quarter Over Quarter
- Loan Growth Was Broad-Based
- Credit Quality Continued to Improve

Community Banks Reported a Slight Decline in Net Income Compared to the Industry
"The banking industry reported a decline in net income driven by an increase in provision expense. Capital and liquidity levels remain strong. In addition, loan growth and credit quality metrics remain generally favorable. Looking forward, inflationary pressures, rising interest rates and continued pandemic and geopolitical uncertainty will likely be headwinds for bank profitability, credit quality, and loan growth." — FDIC Acting Chairman Martin J. Gruenberg

WASHINGTON— Reports from 4,796 commercial banks and savings institutions insured by the Federal Deposit Insurance Corporation (FDIC) reflect aggregate net income of $59.7 billion in first quarter 2022, a decline of $17.0 billion (22.2 percent) from a year ago. An increase in provision expense drove the annual reduction in net income. These and other financial results for first quarter 2022 are included in the FDIC's latest Quarterly Banking Profile released today.

Comment: In the latest CSBS Community Bank Sentiment Index, the profitability component was 68 - up from the fourth quarter of 2021 - but remaining below the neutral level of 100.

OCC Acting Comptroller Discusses Vulnerabilities, Volatility with Cryptocurrency (05/24/2022) - WASHINGTON — Acting Comptroller of the Currency Michael J. Hsu discussed vulnerabilities in the cryptocurrency framework and recent volatility with stablecoins in remarks at the DC Blockchain Summit 2022. In his remarks, the Acting Comptroller discussed the fragmented ecosystem of cryptocurrency, risk of contagion, and underdeveloped custody and ownership rights. He also emphasized the Office of the Comptroller of the Currency's careful and cautious approach to cryptocurrency to ensure the safety and soundness of the federal banking system.

Related Links
Remarks (PDF)

Comment: These remarks followed the crash in the TerraUSD (UST) and Terra (LUNA) stablecoins recently.

FRB Economic Well-Being of U.S. Households in 2021 Report (05/23/2022) - The Federal Reserve Board on Monday issued its Economic Well-Being of U.S. Households in 2021 report, which examines the financial lives of U.S. adults and their families. The report draws from the Board's ninth annual Survey of Household Economics and Decision making, or SHED, which was conducted in October and November of last year before the increase in COVID-19 cases from the Omicron variant and other changes to the economic landscape in recent months. The report, fact sheet, downloadable data, data visualizations, and a video summarizing the survey's findings may be found here.

The report indicates that self-reported financial well-being reached its highest level since the SHED began in 2013. In the fourth quarter of 2021, 78 percent of adults reported either doing okay or living comfortably financially. Financial well-being also increased

	among all the racial and ethnic groups measured in the survey, with a particularly large increase among Hispanic adults. Parents were one group who reported large gains in financial well-being with three-fourths saying they were doing at least okay financially, up 8 percentage points from 2020. "The SHED results provide valuable insight into Americans' financial conditions during the late fall of 2021. This important perspective helps the Federal Reserve better understand the economic challenges that existed during that phase of the pandemic recovery," said Federal Reserve Board Governor Michelle W. Bowman. The share of adults who reported that they would cover a $400 emergency expense using cash or its equivalent similarly increased to the highest level since the start of the survey—68 percent—and was up from 50 percent when the survey began in 2013. Eleven percent of adults could not pay the expense by any method. In addition, the survey presents insight into the experiences of workers through the pandemic. Fifteen percent of workers said they were in a different job than 12 months earlier. Most who changed jobs said the job change was an improvement. Remote work also continued to evolve in 2021. During the week of the survey in late 2021, 22 percent of employees worked entirely from home, down from 29 percent in late 2020, but well above the 7 percent who worked entirely from home before the pandemic. Most employees who worked from home preferred to do so, often citing work-life balance and less time commuting. Those working from home indicated that they would be about as likely to look for a new job if required to return to the office as if their employer instituted a pay freeze. In addition, the report explores families' experiences related to banking and credit, income, housing, retirement, student loans, and retirement alongside several new topics, such as the use of emerging financial products including cryptocurrencies and "Buy Now, Pay Later" services. The survey included 11,000 adult respondents.

BSA / AML

	No news to report this week.

Deposit / Retail Operations

	No news to report this week.

Human Resources

	No news to report this week.

Lending

	CFPB Credit Disputes: Getting a Clear Statement of Results From Your Furnisher (05/26/2022) - If you're trying to correct inaccurate or incomplete information on your credit report, the process can feel overwhelming. The communications you receive from

the companies involved can be confusing, and the CFPB has found some companies have not handled consumer disputes in compliance with the law.

The Fair Credit Reporting Act tells companies how credit reporting disputes should be handled. Some of the requirements apply to furnishers. Furnishers are the companies like banks, mortgage lenders, and credit card issuers that provide information that is included in credit reports.

According to federal law, if a consumer disputes directly with the furnisher the accuracy of information that's been furnished to credit reporting companies, the furnisher is required to conduct a reasonable investigation about the dispute. After completing this reasonable investigation, the furnisher is required to "report the results of the investigation to the consumer" generally within 30 days.

We recently reported that CFPB examiners had found credit card furnishers were sending unclear notices to consumers at the end of dispute investigations. In some cases, these notices did not tell the consumer the result of the dispute investigation. Some of these notices didn't even say whether the furnisher was going to correct the disputed information with the credit reporting companies. As a result, consumers were left in the dark about whether their problem was resolved.

After we conducted examinations of certain credit card furnishers and identified these problems, the credit card furnishers we examined revised their notices. The revised notices are more specific and clearly communicate whether changes were made to the consumer's disputed account as a result of the dispute investigation.

If you have submitted a dispute directly to a furnisher, the response you receive should include the following information:

- Identification of the account that you disputed;
- A statement that the dispute has been investigated;
- A statement that the dispute investigation has been completed; and
- An explanation of the results of that dispute investigation.
- If the furnisher's investigation found that the information you disputed is accurate, the notice should clearly say this.
    - If the furnisher's investigation found that the information you disputed is inaccurate or cannot be verified, the notice should say so and also state what corrections the furnisher is providing to credit reporting companies to fix the inaccuracy.
    - If you get a notice from a furnisher that doesn't meet these minimum requirements, or if you remain confused about what the furnisher is going to do about your account, you can submit a complaint with the CFPB online or by calling (855) 411-CFPB (2372).

And if you haven't already, you should submit a dispute about the account to the credit reporting companies as well. You have certain additional rights that only apply when you submit your dispute to a credit reporting company. You can get more information about how to submit a dispute generally on the CFPB website. We provide detailed instructions, addresses, and phone numbers for submitting disputes. Elsewhere on our website, we have provided some suggestions for what to do if your credit dispute is ignored or if you disagree with the results of the dispute.

Technology / Security

	No news to report this week.

Selected federal rules – proposed

Proposed rules are included only when community banks may want to comment. Date posted may not be the same as the Federal Register Date.

PROPOSED RULE WITH REQUEST FOR PUBLIC COMMENT

05.05.2022 Joint Agency Community Reinvestment Act - The Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) propose to amend their regulations implementing the Community Reinvestment Act of 1977 (CRA) to update how CRA activities qualify for consideration, where CRA activities are considered, and how CRA activities are evaluated. **DATE: Comments must be received on or before August 5, 2022.**

03.30.2022 FDIC Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions - The Federal Deposit Insurance Corporation (FDIC) is requesting comment on draft principles that would provide a high-level framework for the safe and sound management of exposures to climate- related financial risks. Although all financial institutions, regardless of size, may have material exposures to climate- related financial risks, these draft principles are targeted at the largest financial institutions, those with over $100 billion in total consolidated assets. The draft principles are intended to support efforts by large financial institutions to focus on key aspects of climate-related financial risk management. **DATES: Comments must be received no later than June 3, 2022.**

03.22.2021 Rules to Enhance and Standardize Climate-Related Disclosures for Investors - The Securities and Exchange Commission today proposed rule changes that would require registrants to include certain climate-related disclosures in their registration statements and periodic reports, including information about climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition, and certain climate-related financial statement metrics in a note to their audited financial statements. The required information about climate-related risks also would include disclosure of a registrant's greenhouse gas emissions, which have become a commonly used metric to assess a registrant's exposure to such risks. The proposing release will be published on SEC.gov and in the Federal Register. **DATES: Comments should be received on or before June 17, 2022 (the comment period was extended on Monday, May 9th.)**