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MORTGAGE BANKERS ASSOCIATION

April 24, 2024

To: Denise Derosier, Connecticut Mortgage Bankers Association

Fr: Liz Facemire and Gabriel Acosta

Re: Background on Industry Use of AI and Potential Impact of Connecticut SB 2

Thank you for requesting MBA's views on the proposed legislation SB 2 on behalf of the Connecticut Mortgage Bankers Association. The bill relates to deployers and developers of artificial intelligence (AI) and applies broadly across many industries and use-cases. The general applicability of this bill has the side effect of creating compliance challenges for mortgage companies, which MBA believes will create compliance hurdles without meaningfully benefiting consumers.

In many cases, lenders rely on third-party developers for AI models that would qualify under the definition of "high-risk intelligence system" in SB 2. However, these third-party AI models are developed by government-sponsored enterprises, Fannie Mae and Freddie Mac (GSEs), or by the federal government itself. Lenders may not have the ability to change these third-party AI systems if their risk assessment finds a deficiency in the system. Although developers could make changes to how the AI system is used, they may not be able to make changes to the system itself. Concerns with AI created by the federal government should be addressed by the federal government. Examples of these "high-risk intelligence systems" lenders, or deployers, must use but do not control include the following:

- Lenders do not create the AI systems, called automated underwriting systems (AUSs), that they rely on to have a loan guaranteed or securitized. These systems are developed by the insurer or the federal government, i.e., the Federal Housing Administration (FHA), the Veterans Administration (VA), Fannie Mae, and Freddie Mac. For example, Desktop Underwriter (DU) and Loan Prospector (LP) are developed and controlled by the GSEs, while the Department of Housing and Urban Development has their own AUS for FHA and VA loan products. Even if a lender found that DU/LP does not comply with this law, they have little say in how DU/LP are developed. The Federal Housing Finance Agency (FHFA) should remain in charge of regulating DU/LP as the GSE's prudential regulator. Similarly, lenders do not create the AI systems used for FHA and VA loans. FHA and VA are not covered by this Act and thus will not need to provide developer statements to mortgage company deployers, compounding the issue. FHA and VA should internally continue to regulate their systems.

- Credit scoring models are produced using proprietary technology and do not have a comparable product. The proprietary technology could not be disclosed to the extent a lender would need under SB 2 to be able to properly assess the risk of using the score and credit scores are one of the biggest factors in lending decisions. Non-portfolio lenders like independent mortgage banks do not have a choice in the use of FICO as the GSEs, HUD, and the VA require their use.

Financial institutions are highly regulated under Federal and Connecticut state law. These institutions are subject to routine on-site examination by prudential regulators and examiners for compliance with laws and regulations, including consumer finance and anti-discrimination laws. Regulators have 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 technology. "Advancements in technology do not render existing risk management and compliance requirements or expectations inapplicable," according to the U.S. Department of Treasury's March 2024 report, *Managing Artificial Intelligence-Specific Cybersecurity Risks in the Financial Services Sector*. The applicable laws include the following:

- The Equal Credit Opportunity Act (ECOA), and its implementing regulation, Regulation B, promulgated by the Consumer Financial Protection Bureau (CFPB) prohibits lenders from using "complex credit models", such as AI, to discriminate against applicants during a credit transaction based on a protected class. ECOA is enforced by the CFPB and can be enforced by the Connecticut Attorney General. In instances where that credit is denied, a lender must provide an adverse action notice that is specific and indicates the principal reason for the denial. Further, under CFPB Circular 2022-03, creditors cannot merely rely on the output of a complex credit model 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.

- The Fair Housing Act prohibits discrimination in all aspects of residential real estate-related transactions based on protected classes. 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. 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, Connecticut has well established state laws preventing discrimination that would apply to any part of the credit transaction, e.g. Section 46a-66.

Due to the current level of oversight in the use of any technology and the requirements of developers, investors, on deployers, and lenders, MBA feels this approach will not benefit Connecticut consumers solely in the context of mortgage transactions, but it will create compliance hurdles for mortgage companies in the state.

Thank you, and please let us know if you have questions or need additional information.