NAFCU
3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org
National Association of Federally-Insured Credit Unions

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Alexander Hunt
Office of Management and Budget
Office of Information and Regulatory Affairs
725 17th Street NW
Washington, DC 20503

RE: Guidance for Regulation of Artificial Intelligence Applications
Docket No. 2020-00261

Dear Mr. Hunt:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the draft memorandum providing Guidance for Regulation of Artificial Intelligence Applications (Memo) issued by the Office of Management and Budget (OMB). NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 120 million consumers with personal and small business financial service products. Credit unions are just beginning to incorporate artificial intelligence (AI) as a tool to serve operational and business needs. Some credit unions have leveraged AI to improve access to credit, enhance risk management, or improve customer service operations. While AI holds promise for credit unions and their members, sustained innovation will depend on regulators' commitment to facilitate and encourage experimentation. Accordingly, NAFCU appreciates the Memo's description of non-regulatory approaches for encouraging the use and acceptance of AI technologies, in line with Executive Order 13859.[1]

NAFCU also recognizes that the Memo, while addressed to all federal agencies, may be received differently by independent regulatory agencies, such as the National Credit Union Administration (NCUA). The NCUA regulates all federally-insured credit unions and has recently affirmed a policy of following the spirit of OMB memoranda "[a]s long as an executive order or executive memorandum does not compromise the mission of the agency or the safety and soundness of credit unions…even when they do not apply to independent regulatory agencies."[2] NAFCU believes the Memo is one the NCUA should consider, but fully expects (and encourages) the agency to chart its own path as it seeks to accommodate credit union innovation and utilization of new technologies.

[1] Executive Order 13859, "Maintaining American Leadership in Artificial Intelligence," (February 11, 2019).
[2] Credit Union Times, NCUA Will Comply With 'Spirit' of Controversial OMB Memo (May 22, 2019), available at https://www.cutimes.com/2019/05/22/ncua-will-comply-with-spirit-of-controversial-omb-memo/.

NAFCU supports the development of consistent terminology and definitions applicable to AI and machine learning.

Although AI utilization within the credit union industry remains in its infancy, credit unions are committed to using AI safely, securely, and with the goal of helping their members meet their financial needs. Given the variety of financial applications in which AI might be employed, there is a need to harmonize definitions and terminology so that financial regulators can better understand how the technology functions before considering specific initiatives or guidance.

NAFCU appreciates the Memo's promotion of such understanding through the adoption of a working definition of "narrow" artificial intelligence in its current state.[3] NAFCU regards the Memo as first step to help federal agencies and Congress communicate using a common lexicon of AI related concepts. Agencies should also recognize that no single definition of AI can address every possible application or iteration of such technology. However, "weak" or narrow AI, which the Memo does address, is the most prevalent variety within the financial sector today.

The Memo defines narrow AI as an algorithm that learns and performs "domain-specific or specialized tasks by extracting information from data sets, or other structured or unstructured sources of information."[4] In short, narrow AI allows a machine to complete a single task, and the learned process cannot be applied to a different task. The way in which algorithms learn how to perform domain-specific or specialized tasks is generally referred to as machine learning. In short, machine learning is a method of training algorithms so they can learn how to make decisions. Machine learning can also refer to "the ability of software to learn from applicable data sets to "self-improve" without being explicitly programmed by human programmers."[5]

When consumers tend to think of AI, they often imagine something similar to strong or general AI, which endeavors to perform cross-domain activities with the same cognitive freedom as a human. While general AI is beyond the Memorandum's scope, noting the difference is important for future regulatory and legislative action, since there is often confusion about how much decision making control is vested between human and machine agents.[6] The particular degree of control has relevance insofar as some financial regulators may feel that AI driven outcomes are difficult to understand but are not sure how financial institution users should validate their use of AI to demonstrate compliance with consumer financial law. If regulators begin to demand excessive documentation or testing regarding usage of AI, perhaps under the mistaken assumption that narrow AI exhibits human-like agency, this would likely discourage continued investment in related technology, particularly for smaller entities like credit unions that already face significant compliance burdens under existing law.

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[3] *See* Section 238(g) of the John S. McCain National Defense Authorization Act for Fiscal Year 2019, Pub. L. No. 115232, 132 Stat. 1636, 1695 (Aug. 13, 2018) (codified at 10 U.S.C. § 2358, note).
[4] OMB, Guidance for Regulation of Artificial Intelligence Applications, 2.
[5] U.S. Department of the Treasury, A Financial System That Creates Opportunities: Nonbank Financials, Fintech, and Innovation, 53 (2018).
[6] See e.g., CFPB, Advisory Committee Meeting Minutes, 4, (December 6, 2018), available at https://files.consumerfinance.gov/f/documents/cfpb_advisory-committee-meeting-minutes_122018.pdf. ([CFPB staff] defined artificial intelligence (for the purpose of the discussion) as a system that exhibits humanlike intelligence and can sense, reason, act, and adapt.")

NAFCU believes that regulators should avoid developing guidance targeted at general AI behavior with the intent of applying it to narrow AI applications. Doing so could falsely suggest that users of AI lack control over algorithms, when in fact a great deal of oversight and caution is practically a prerequisite for putting virtually any type of AI software into production.

Current Uses of AI by Credit Unions.

While AI usage is not yet widespread within the credit union industry, 47 percent of NAFCU-surveyed credit unions have said they are considering investments in AI over the next two years.[7] Some credit unions are already partnering with third-parties to successfully implement AI driven tools to facilitate access to credit for members, strengthen existing risk management processes, and improve customer service.

Artificial Intelligence in Credit Underwriting

AI has the ability to quickly capture and analyze large amounts of both traditional and alternative data, which can help expand access to affordable credit at credit unions. Alternative data consists of data elements that are typically found outside of a traditional credit file, such as information related to bill payment, cash flow, spending behavior, stability of employment, and debt ratios. While conventional credit underwriting systems can incorporate alternative data through manual adjustments and reprogramming, AI driven systems can be refined more quickly. AI analysis can also produce a more robust and holistic assessment of a consumer's creditworthiness and has often been cited by regulators as a tool to expand access to low-cost mainstream credit for millions of underserved and "credit invisible" Americans.[8] However, it is important to note that AI is not necessary to make use of alternative data.

In a July 2019 survey, 46 percent of NAFCU-surveyed credit unions reported that they used alternative data for credit underwriting and the majority of NAFCU members who reported using alternative data characterized their use as "mostly manual." Among credit unions who reported using alternative data, the most common data considered includes cash flow information, stability of address, and rent payment history. The results suggest that the use of such data is not yet part of a fully automated or AI-driven underwriting process.

Risk Management and Financial Crime

AI and machine learning have the potential to significantly enhance a financial institution's risk management practices and efforts to prevent financial crime by improving detection of irregular financial behavior patterns by customers. Some credit unions are already using predictive technology to prevent fraud before it occurs through the use of neural networks. NAFCU has asked for the Department of the Treasury and Financial Crimes Enforcement Network to consider whether new technologies might be leveraged to reduce compliance burdens associated with filing

[7] NAFCU, Economic & CU Monitor Survey (June 2019).
[8] See CFPB, Advisory Committee Meeting Minutes, 4, (December 6, 2018), available at https://files.consumerfinance.gov/f/documents/cfpb_advisory-committee-meeting-minutes_122018.pdf.

of suspicious activity reports and to facilitate the use of digital identities to satisfy know-your-customer requirements.

Credit unions take risk management and developing strong compliance programs seriously – especially with the advent of AI and machine learning. In a recent survey, NAFCU found that 96 percent of surveyed credit unions made a moderate (50 percent) or significant (46 percent) investments in fraud prevention. While these investments may encompass more than just AI, the future of risk management and anti-fraud tools points towards greater incorporation of AI powered technologies.

Customer Service Improvements

One of the most publicly visible implementations of AI technology is the use of chatbots to enhance customer service. In conversations with members, NAFCU has learned that AI-driven chat tools are becoming increasingly common among credit unions and offer a cost-effective means of responding to routine member service questions. A less visible use of AI to enhance customer service involves the use of machine learning to recognize member handwriting to accurately process remotely deposited checks on smartphones.

NAFCU Supports Efforts to Reduce Barriers to Innovation

Financial sector regulators should tailor future actions related to AI in a way that recognizes the need for less prescriptive intervention and greater accommodation of innovation through pilot programs, no-action letters, waivers, and elimination of outdated rules.

The Memo's recommendation that agencies consider "using any authority under existing law or regulation to grant waivers and exemptions from regulations, or to allow pilot programs that provide safe harbors for specific AI applications" is one that is critically important to reducing barriers to innovation. Waivers and pilot programs can help alleviate regulatory uncertainty, which contributes significantly to overall compliance costs and risk aversion among small financial institutions. Compliance costs present one of the biggest obstacles to credit union adoption of new financial technology. Among NAFCU-surveyed credit unions, 82 percent noted that such costs present a moderate or significant barrier to the adoption of new financial technology. At the same time, the adoption of innovative technology—including AI—is often viewed as necessary for maintaining competitive vitality.

In an environment where non-bank fintech companies may be enjoying less rigorous supervisory oversight than traditional financial institutions, regulators should be exploring frameworks that make innovation accessible not just to the largest and most sophisticated entities, but also to smaller, community-based institutions.[9] The need to establish a fair playing field cannot be

[9] For example, fintech mortgage lenders may have structural advantages as nonbanks; in essence, benefiting from reduced regulatory burden that corresponds with a lack of federal safety and soundness standards. Research presented at the Federal Deposit Insurance Corporation's (FDIC) April 2019 Fintech Symposium suggests that 60-70 percent of "shadowbank" (i.e., nonbank lender) growth is likely due to regulatory arbitrage, and the rest due to advances in

overstated. A majority of surveyed NAFCU members have indicated that they view nonbank fintech companies as their greatest source of competition in the next 2-3 years.[10] More broadly, a majority of institutions (banks and credit unions included) surveyed in Fannie Mae's Q2 2019 Mortgage Lender Sentiment Survey said that they considered "online business-to-consumer lenders" as their biggest competitor, citing these firms' advantages in technology.[11]

While credit unions have often taken a more cautious and deliberate approach to adopting new technology for business operations, a more accommodating regulatory framework for testing AI applications could help even the playing field with larger banks and fintech companies. To develop such a framework, NAFCU supports the Memo's recommendation that agencies should "consider how best to promote retrospective analysis of rules that may be outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned."[12] More specifically, we appreciate the Memo's clarification that these retrospective reviews should consider whether "regulatory changes are necessary to remove barriers to the adoption of net beneficial AI systems." NAFCU believes that the elimination of outdated regulations is often necessary to encourage meaningful innovation, given that the guidance and waivers alone have not always produced compelling results.[13]

Conclusion

On behalf of this country's credit unions, owned by 120 million members, NAFCU appreciates the opportunity to provide comments on the proposed Memo on guidance for regulation of AI applications. NAFCU supports OMB's emphasis on non-regulatory approaches, such as pilot programs, to encourage the use and acceptance of AI. We also support OMB's recommendation that regulators pursue retrospective reviews to eliminate outdated rules that may be impairing AI-related innovation. Although the NCUA's status as an independent agency and prudential regulator means that the Memo will be received differently, NAFCU appreciates OMB's efforts to adopt consistent definitions and terminology to facilitate productive conversations between all federal agencies, Congress and the public regarding the benefits of AI.

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technology. See Piskorski, Tomasz, Fintech and Shadow Banking (April 2019), available at https://www.fdic.gov/bank/analytical/fintech/presentations/piskorski.pdf.

[10] NAFCU, Economic & CU Monitor, June 2019.

[11] Fannie Mae, Q2 2019 Mortgage Lender Sentiment Survey, 3 (June 12, 2019), available at https://www.fanniemae.com/resources/file/research/mlss/pdf/lender-business-priorities-mlss-q22019.pdf.

[12] See Executive Order 13563, "Improving Regulation and Regulatory Review."

[13] The Consumer Financial Protection Bureau (CFPB) launched an initiative called Project Catalyst in 2012 to encourage consumer-friendly innovation and entrepreneurship in markets for consumer financial products and services. In 2016, Project Catalyst was configured to serve as a gateway for financial companies to apply for No-Action Letters, which served as limited guarantees that the Bureau would not pursue supervisory action with respect to an approved product or service not already on the market; however, only a single company ever received such a letter under the first iteration of the program. Recent changes to the CFPB's innovation policies, including more definite assurances to protect applicants from potential liability, have attracted greater interest from applicants and resulted in new approvals.

Should you have any questions or require additional information, please do not hesitate to contact me at (703) 842-2266 or amorris@nafcu.org.

Sincerely,

Andrew Morris
Senior Counsel for Research and Policy