AI in the Credit Department: Drafting and Implementing Responsible AI Policies and Procedures

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| AGENDA

- Key Considerations Developing AI Policies and Procedures

- What is Artificial Intelligence (AI)

- Legal and Regulatory Issues Impacting AI

- Benefits and Risks of AI

- Questions to Answer Before Using AI

- AI Policies and Procedures
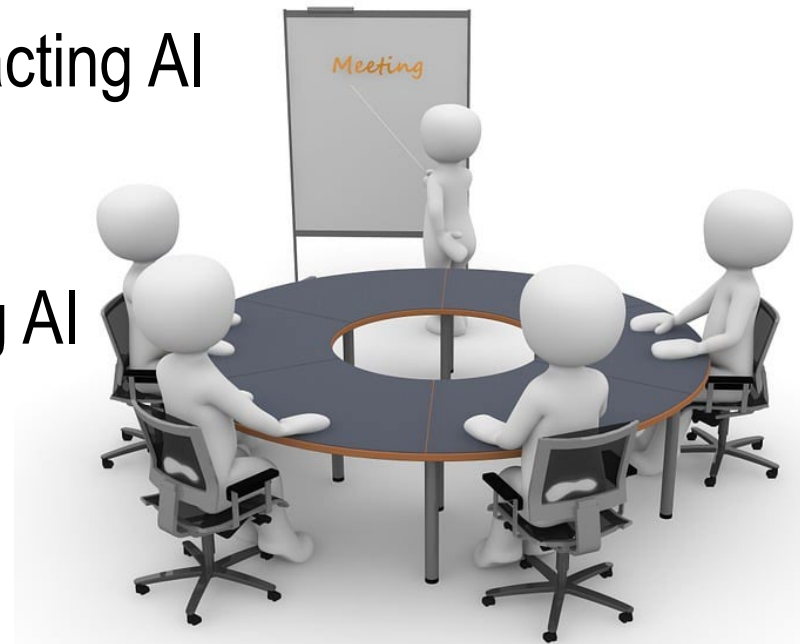
A COMPUTER

CAN NEVER BE HELD ACCOUNTABLE

THEREFORE A COMPUTER MUST NEVER

MAKE A MANAGEMENT DECISION

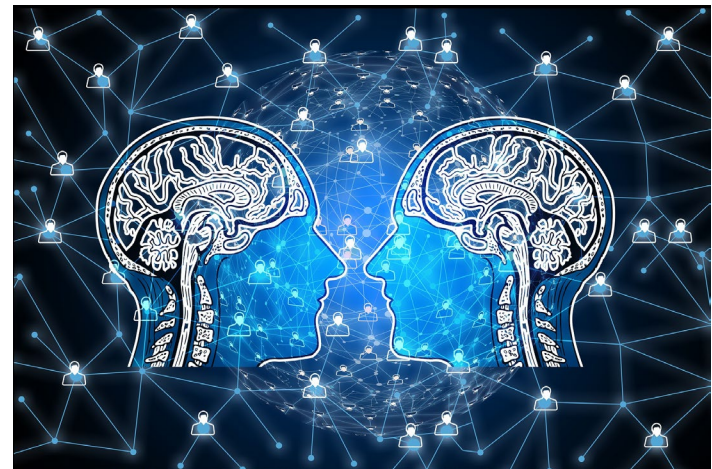# KEY CONSIDERATIONS IN DEVELOPING AI POLICIES AND PROCEDURES

- As generative AI continues to evolve and permeate various sectors, many businesses have started creating and implementing policies and procedures to govern its use

- Crafting AI policies and procedures requires considering the following
  - Types of AI
  - Governing laws and regulations
  - AI uses
  - AI risks

| BUSINESS CANNOT AVOID AI

AI is Everywhere—The Great AI Race

- What is artificial intelligence (AI)?

  - A broad field that seeks to simulate human intelligence in machines

- Generative AI

  - Focuses on creating new content using patterns and structures it learns through training

  - Examples: Microsoft Copilot, ChatGPT, DeepSeek, Meta

- Industry specific products

- Data mining with and without permission

DIFFERENCE BETWEEN TYPES OF AI MODELS

AI Models	Description	Advantages	Disadvantages
Public Open Source AI Models	• 3rd party models available for use by anyone often without any fees ❖ Example: ChatGPT	• Free	• No warranties • No ability to negotiate terms • Risk of loss of data confidentiality
Commercially Licensed AI Models	• 3rd party models licensed to other organizations for use ❖ Examples: Copilot, Harvey	• User controls state of quality by providing customized data • Data kept internally	• Large investments to make, maintain and update • Licensing fees
Private Models **Vendor-developed AI Models**	• Models developed internally, and solely used within the organization that developed it	• Complete confidentiality and data privacy • Can be highly specialized for specific tasks	• High development and maintenance costs • Expensive in-house expertise needed • All security risks borne by organization

AI LEGAL AND REGULATORY REQUIREMENTS IMPACT BUSINESS POLICY

- **Statutory/Regulatory-AI**
  - EU AI Act – in place as of Aug. 1, 2024
  - Biden Administration Executive Order on AI 2023
  - Trump Administration Rescission Order 2025
  - Federal Regulations & Rules in Place and Emerging
    - Consumer Financial Protection Bureau (CFPB)
      - Sept. 19, 2023, Guidance to credit professionals on AI and Reg. B (re: statement of reasons for adverse action reliant on AI)
    - Securities Exchange Commission (SEC)
      - Oct. 21, 2024, Announcement on agency priorities include emerging financial technologies based on artificial intelligence
    - Federal Trade Commission (FTC)
      - Aug. 1, 2024, Rule on unfair and deceptive use of AI; focused on consumer marketing but FTC has stated their authority extended beyond those industry practices
  - New Federalism means States may drive action on AI

CONSUMER FINANCIAL PROTECTION BUREAU

- Consumer Financial Protection Bureau (CFPB) has taken the laboring oar to promulgate rules governing the use of AI in credit decisions

- Advisory on AI

  – Sept. 19, 2023, Guidance issued by CFPB addressing Equal Credit Opportunity Act (ECOA) adverse action notice requirements in connection with credit decisions based on AI

- "Focus[ ] on the accuracy and specificity requirements of those notices, even when such models, driven by data gathered outside of traditional credit reports or applications, are utilized."

"In today's marketplace, creditors are increasingly using complex algorithms, marketed as artificial intelligence, and other predictive decision-making technologies in their underwriting models. Creditors often feed these complex algorithms with large datasets, sometimes including data that may be harvested from consumer surveillance. As a result, a consumer may be denied credit for reasons they may not consider particularly relevant to their finances. Despite the potentially expansive list of reasons for adverse credit actions, some creditors may inappropriately rely on a checklist of reasons provided in CFPB sample forms. However, *the Equal Credit Opportunity Act does not allow creditors to simply conduct check-the-box exercises when delivering notices of adverse action if doing so fails to accurately inform consumers why adverse actions were taken*."

CFPB Press Release, Sept. 19, 2023

CFPB'S LATEST RULE ON AI

- Consumer Financial Protection Circular 2023-03, Adverse action notification requirements and the proper use of the CFPB's sample forms provided in Regulation B, September 19, 2023.

    - If AI is used, then the pre-selected reasons for the adverse decision may not apply
    - Burden on creditor to provide the accurate basis for the adverse decision, even if not based on the list enumerated on Reg. B
    - Adverse notices should provide consumers with a "key educational tool" to either (i) improve their credit status or (ii) identify mistakes made by the creditor.

- "**Specificity is particularly important when creditors utilize complex algorithms**. Consumers may not anticipate that certain data gathered outside of their application or credit file and fed into an algorithmic decision-making model may be a principal reason in a credit decision, particularly if the data are not intuitively related to their finances or financial capacity." **Circular 2023-03**

BENEFITS OF AI

- Saving time and costs by offloading tedious or repetitive tasks from human workers

- Solving the "blank page" problem by creating first drafts of letters, e-mails, analyses, marketing materials, and other documents

- Summarizing meeting minutes and notes

- Providing greater business intelligence
  - Analyzing datasets to find new trends and patterns

- Enriching pre-existing content
  - Enhanced spellchecking, grammar, and tone
  - Brainstorming ideas on various topics

- AI greatly increases opportunities for **detecting** fraudulent activity

USES OF AI
TO CREDIT PROFESSIONALS

- **What can artificial intelligence help credit professionals do?**
  - **Research:** Enable faster, more efficient research of customers by summarizing articles, reviewing SEC filings and other available information, and digesting and analyzing large amounts of text to provide summaries, answer questions, etc.
  - **Analyze:** Analyze, summarize, synthesize, and explain credit application information, financial statements, projections, payment history, credit reports, and all sorts of other data to predict creditworthiness and make faster, better-informed decisions
  - **Score:** Implement customized, self-learning credit scoring systems
  - **Respond:** Provide conversational self-service functions to free up personnel for higher value tasks, reducing response time and increasing customer satisfaction
  - **Identify:** Assess trends in customer financials, payment history, and ordering trends and comparison to industry to mitigate risk, catch red flags regarding distressed customers and possible defaults before they happen, prevent fraud, improve supply chain efficiency
  - **Communicate:** Use generative AI systems to create and refine communications (letters, e-mails), develop scripts for collection calls
  - **Prioritize:** Evaluate historical data to identify which customers to contact, when, and how to maximize collection efficiency and effectiveness

- Deloitte, Artificial Intelligence for Credit Risk Management https://www2.deloitte.com/cn/en/pages/risk/articles/artificial-intelligence-for-credit-risk-management.html

RISKS OF AI

Drawbacks of AI:

- Intellectual property concerns

- Data privacy and security

- Regulatory concerns

- Analysis happens in a black box
  - Results can be unpredictable

- Response accuracy and hallucination risks

- Need to verify AI-generated content

- Bias and objectionable content

- Greatly increases risk of your company's exposure to fraudulent activity
  - Example: A vendor your company regularly deals with sends an invoice or voicemail with a fraudulent mailing address

- Reduced barrier to entry for novice hackers to conduct more sophisticated attacks

QUESTIONS TO ANSWER BEFORE USING AN AI TOOL

1. What Does Your Organization Want to Achieve By Using An AI Tool?

2. What Categories of Data Would Be Processed By AI Tool?

a) Any sensitive personal data?

b) Any other kings of regulated identifiable information?

c) Any organizational or third party information that is a trade secret or otherwise confidential?

3. Who Would Have Access to and Can Use That Data, And How It Would Be Used and Stored? Are They Involved in the Selection and Assessment Process?

4. What Laws, Regulations and/or Contractual Duties May Govern Your Use of The AI Tool?

QUESTIONS TO ANSWER BEFORE USING AN AI TOOL

5. What Due Diligence Is Necessary On Available AI Tools That Would Address Organizational Needs?

6. What Risk Assessment Must be Conducted To Determine Whether The AI Tool Will Put Organization At Legal Or Security Risk?

7. Are The AI Tools Properly Configured?

8. Was The AI Tool Tested On A Non-production Server?

QUESTIONS TO ANSWER BEFORE USING AN AI TOOL

9.	Is Your Company Monitoring Effectiveness of the AI Tool and Internal AI Policies?

10.	What Diligence are You Undertaking Concerning the AI Your Vendor is Using On Which You are Relying and What Contract Terms Do You Need to Add to Your Agreements with Vendors? Should You Be Diligencing Your Vendor's Insurance? Should You Require Your Vendor To Address Gaps In Compliance, Or Consider Choosing Another Vendor?

11.	**What are Your Policies and Procedures Governing the Use of AI?**

12.	Has a Training Program Been Established to Train Employees About Use of the AI Tool and Applicable AI Policies and Procedures?

WHY POLICIES & PROCEDURES MATTER

- **Policies & Procedures Matter**

- **Policies**
    - Guiding principles and statements of legal compliance
    - Transparency is key to good policy

- **Procedures**
    - Actions taken to comply with established policies

| AI POLICIES FOR CREDITORS

- Companies need to be making predictions on how the future of AI will affect the financial services industry and the world

- Companies need to create a comprehensive AI policy or update existing Acceptable Use Policies with guidance on how to safely and responsibly use AI

- Security should not get in the way of business functionality, but should act as guardrails
  - All-or-nothing policies rarely work
  - Involve relevant stakeholders
  - Have controls in place similar to other technology functions (ex: File Sharing applications)
  - Define what functions are acceptable to use AI
  - Restrict the use of AI for specific important tasks
  - Restrict the use of AI for specific employees only
  - Update employee training and awareness
  - Update customer training and awareness through disclosures and contract revisions

- **AI is a supplemental tool that enhances, *but doesn't replace*, human capabilities for critical thinking and ethical judgment**

SUGGESTED AI POLICIES & CONSIDERATIONS

- Internal-facing policies – for employee eyes only
  - **Statement of principle – standalone AI policy – important to have a position on AI that flows through all other policies**
  - Employee Handbooks – use of AI by employees
  - Company AI, Privacy & Information Security Plans / Procedures – must consider AI use and data generation
  - Procurement / Contracts Considerations – must consider AI use, data generation, and data training

- External-facing policies
  - Credit Agreements – should address whether AI is used in credit determinations
  - B2B Contracts
  - Privacy and Information Security Terms for Website
  - IT Procurement
  - Policy should also take into consideration how third-party vendors are utilizing AI tools and including appropriate terms

SUGGESTED AI POLICIES & CONSIDERATIONS (CONT'D)

- Considerations:
  - Data privacy and security
  - Verifying information generated by AI
  - Bias and discrimination
  - Transparency and explainability
  - Employee training
  - Accountability and responsibility
  - Ethical considerations
  - Continuous monitoring and improvement
- Enhances but cannot replace Credit Professional

FRAMING YOUR AI POLICIES & PROCEDURES
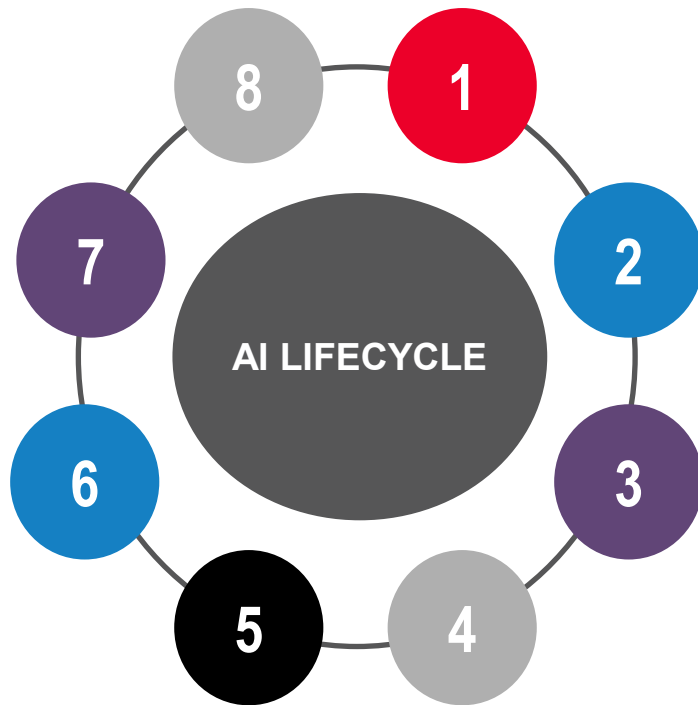
1. Business Requirements

2. Legal Requirements

3. Data Requirements

4. Vendor due diligence

5. Vendor selection

6. Implementing AI policies and procedures

7. Deployment of vendor and AI solution

8. Testing and review

AI DUE DILIGENCE RE: VENDORS

- What features/functionality is provided? What is the intended purpose/use?
  - Are there any known limitations of the product?

- What data was the model **trained on**?

- What data does the model **consider in real time?**

- What rights do customers have with respect to the output generated by the product?

| TAKEAWAYS

- AI is everywhere. Even if you don't embrace it, don't ignore it.

- Every organization should have AI policies and procedures.

- The regulatory landscape is evolving and will be for a while…

- …but still lags technological development by a few steps.

- Ongoing monitoring and quality control of AI output are critical.

- Use of vendor-provided AI technology requires due diligence (up front and ongoing) and careful contract drafting.

- **AI tools should <u>supplement</u> human judgment – *not replace it.***

A REAL-WORLD EXAMPLE:
USING A CUSTOM GPT IN B2B COLLECTIONS

Hi! I'll help you build a new GPT. You can say something like, "make a creative who helps generate visuals for new products" or "make a software engineer who helps format my code."

What would you like to make?

> Create a new GPT, which we will call CreditGPT. CreditGPT will be a GPT that assists business-to-business credit managers with certain daily tasks.
>
> Credit managers work for companies (sellers) that sell goods and services to other businesses (customers) on credit. Sellers extend credit terms to customers, permitting customers to pay sellers in the future instead of paying cash in advance or on delivery.
>
> Sellers, therefore, face credit risk when selling to customers on credit. Credit managers evaluate the creditworthiness of customers, make decisions whether to extend credit to customers (and if so, how much), and frequently are involved in collecting past-due debts from delinquent customers.

I'll set up CreditGPT with the following basic parameters. Then, we'll move on to choosing a profile picture.

QUESTIONS?

THANK YOU

NEW YORK   PALO ALTO   NEW JERSEY   UTAH   WASHINGTON, D.C.

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