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GAO REPORT ON REGULATION B: SHOULD LENDERS BE REQUIRED TO COLLECT RACE AND GENDER DATA OF BORROWERS FOR ALL LOANS?

HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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GAO REPORT ON REGULATION B: SHOULD LENDERS BE REQUIRED TO COLLECT RACE AND GENDER DATA OF BORROWERS FOR ALL LOANS?

Thursday, July 17, 2008

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Melvin L. Watt [chairman of the subcommittee] presiding.

Members present: Representatives Watt, Lynch, Cleaver, Green; and McHenry.

Ex officio: Representative Frank.

Chairman WATT. Good morning, everybody.

This hearing of the Financial Services Subcommittee on Oversight and Investigations will come to order.

We will start with opening statements by the members. Without objection, all members' opening statements will be made a part of the record, and we will proceed with allowing whomever wants to, to make an opening statement since we have so few people here to do so today. I will recognize myself for 5 minutes to kind of frame the issue for us.

Today's hearing is entitled, "GAO Report on Regulation B: Should Lenders Be Required To Collect Race and Gender Data of Borrowers for all Loans?" The Financial Services Committee has a special interest in ensuring fair and equal access to credit, and our committee was instrumental in the passage of the Equal Credit Opportunity Act.

The Federal Reserve issued Regulation B to implement the Act. Regulation B currently forbids the collection of racial, gender, and other personal characteristics data for loans other than mortgage loans, loans such as small business loans or automobile loans, for example.

By contrast, the Federal Reserve's Regulation C, which implements the Home Mortgage Disclosure Act, commonly known as HMDA, requires the collection and public reporting of racial, gender, and personal characteristics data on applicants for home mortgages, and that data is regularly used by Congress, Federal banking regulators, researchers, and the public to discern patterns of lending and alert for public possible discrimination.

Last year Chairman Frank, Congresswoman Maloney, and I requested the GAO to study Regulation B, with particular attention to the Federal Reserve's factual and analytical basis for concluding that removing Regulation B's prohibition on the collection of racial and gender data of applicants and borrowers could increase discrimination. Without objection, I will submit a copy of our request to the GAO and we will make that a part of today's hearing record.

We are pleased that the GAO is here today to release the results of the study we requested, and today's hearing will focus on the GAO's findings and whether lenders should be required to collect race and gender data on applicants and borrowers of all loans. The GAO report reflects that serious data gaps now exist that impede the efforts of Federal banking regulators to enforce fair lending laws, especially on loans other than mortgage loans.

The primary source of data for tracking patterns of non-mortgage lending is the Federal Reserve's survey of small business finances, the so-called SSBF. SSBF data is collected from borrowers of small business loans rather than from lenders. The data is voluntary, self-reported, and not verified by the Federal Reserve. This limits the analytical value of the SSBF data.

By contrast, the likelihood, or at least the possibility, that discrimination is occurring in mortgage lending can be detected from data collected under the Home Mortgage Disclosure Act. This data is required to be provided annually by a large population of lenders and can be used by Federal bank regulators to help facilitate fair lending examinations.

Another limitation of SSBF data has been that the surveys of small business finances were conducted only about every 5 years, instead of annually, between 1987 and 2003. Additionally, the Fed has been habitually slow in reporting the results of the surveys. The survey results have therefore often been stale. In fact, much of the information reviewed by the GAO for the report we are receiving at today's hearing is based on SSBF surveys conducted in 1993 and 1998, more than 10 years ago in some cases.

Some of the other information in today's GAO report is based on the 2003 survey that was not publicly released until 2006. Perhaps recognizing these problems, the Federal Reserve discontinued the SSBF in 2007. The Fed now says that elements of the SSBF will be incorporated into the Federal Reserve survey of consumer finances, but this is not due to be released until 2010.

It is hard to believe, as we convene this hearing today, that no one in the Federal Government has access to reliable data about important lending patterns and the real prospect of disparities and discrimination in the provision of credit other than mortgage credit. Indeed, the GAO report indicates that one Federal Reserve bank has been unable to conduct thorough fair lending examinations and unable to review consumer complaints alleging discrimination by non-mortgage lenders, due to lack of available data. This is alarming, and, given the recent documented disproportionality of subprime mortgage loans to racial and ethnic minorities, I personally think it is unacceptable.

The Federal Reserve has periodically reviewed Regulation B, most recently in 2003, and concluded that amending Regulation B to permit the collection of racial, gender, and personal characteristics data could increase discrimination. If that is still the Fed's contention, I certainly hope that it will offer specific evidence for that hypothesis at today's hearing.

I am anxious to know whether the Fed thinks that the collection of racial and ethnic data under HMDA is contributing to, causing, or increasing discrimination by mortgage lenders. The Financial Services Committee needs to carefully consider the potential cost that would result from amending Regulation B to require the collection and public reporting of personal characteristics data on loans other than mortgage loans.

For that reason, the subcommittee invited several lenders to testify at today's hearing about some of the potential costs that we have heard about, but they declined. Perhaps this subcommittee will attempt to get details about these costs at a subsequent hearing.

We all should be attentive to holding down the cost of lending, but we also have a public policy obligation to ensure equal and fair lending to all Americans, whether they are shopping for mortgage loans or non-mortgage loans.

The GAO report and today's hearing allow us to start the process of evaluating both the cost as well as the benefits of more comprehensive reporting. I encourage our subcommittee members to approach this hearing in that spirit, and I thank all of our witnesses for appearing today to assist us as we start this effort.

I am now happy to recognize my colleague from North Carolina, who is substituting for the ranking member. Well, he says he is not substituting for Mr. Miller; he says he is standing in for Mr. Miller, for our ranking member, Gary Miller, who had another commitment this morning.

My colleague, Mr. McHenry from North Carolina, is recognized for 5 minutes.

Mr. MCHENRY. Chairman Watt, thank you, and thank you for hosting this hearing today.

And I do think it is important that we follow up on the GAO report on the Equal Credit Opportunity Act, which is a law that is intended to enforce our Nation's fair lending laws. I look forward to hearing from the witnesses today, both this first panel and the second panel, regarding the efforts to eliminate discrimination in the credit industry.

You know, access to credit has provided enormous opportunities and benefits to consumers. I think we have to ensure that credit is available to all, regardless of any race, ethnic background, or general considerations. And I think it is obvious and clear to all that is what we should be doing.

We have to ensure that families have access and opportunities to purchase a home or an automobile, to finance an education, to deal with emergencies, and to purchase everyday goods and services. For this reason, and ensuring that there's non-discrimination within lending practices, the Equal Credit Opportunity Act, as implemented by the Federal Reserve by Regulation B, it prohibits lenders from collecting racial, ethnic, and gender information in order to make a credit decision.

So we have to look at the unintended consequences of that, and I think it is important that we have this hearing to follow up on my colleague's request for this GAO report. I look forward to hearing the details of it, and I think it is important that we ensure that the detection and enforcement tools are there and available to us to protect consumers in this country and ensure that our laws our working appropriately.

So with that, I thank you, Chairman Watt, for your leadership, and I look forward to this hearing.

Chairman WATT. I thank the gentleman for his statement and for standing in for the ranking member.

Without objection, all members' opening statements will be made a part of the record in their entirety, and I would be happy to recognize Representative Cleaver for an opening statement if he cares to make one.

Mr. CLEAVER. I will wait, Mr. Chairman, until a question-and-answer period.

Chairman WATT. Okay. Mr. Green from Texas.

Mr. GREEN. Thank you, Mr. Chairman.

I would like to make a statement, and I want to thank your ranking member today, Mr. McHenry. You seem to wear that seat quite well.

Mr. Chairman, I thank you for hosting this hearing, because it is important for us to make meaningful decisions as to how we can eliminate discrimination, not only in lending, but discrimination in the main. And the most effective way to do it is to have empirical evidence of what is happening.

The acquisition of empirical evidence necessitates collecting certain evidence, certain information. Unfortunately, we have not devised a system that will allow us to properly collect this information. My belief is that if we have the will, the way is readily available to us. We have to adopt the will to eliminate invidious discrimination. So I am hopeful that at this hearing this morning we can hear more about how we can get this done, how we can acquire the intelligence necessary to not only prove that the discrimination exists but have the intelligence such that it can be used in an efficacious way to deal with the actual problem itself. It is the will that we need. The way is available to us.

And, Mr. Chairman, I thank you very much for hosting the hearing, and yield back the balance of my time.

Chairman WATT. I thank the gentleman for his opening statement and for his presence today for this important hearing.

I am now going to proceed with an abbreviated introduction of the witnesses. Without objection, therefore, your bios will be made a part of the record; and, in the interest of time, I won't go into an elaborate introduction, although both of them deserve and warrant elaborate introductions.

I think our first panel is extremely important for two reasons, because one of the witnesses is testifying about the actual report that was requested some time ago, and by and large the essence of the report is about the Federal Reserve. So the other witness is here in fairness to hear and respond if the Federal Reserve desires to do so.

Our first witness is Ms. Orice Williams. She is the Director of Financial Markets and Community Investment, United States Government Accountability Office. And our second witness on this panel will be Ms. Sandra Braunstein, the Director of the Division of Consumer and Community Affairs at the Federal Reserve Board.

Without objection, your entire written statements will be made a part of the record, and each of you will be recognized for a 5-minute summary of your testimony. We tend to be very liberal in our assessment of 5 minutes, especially on this panel, where we are getting the basic information. So don't feel like you are under the gun, but try to be as cognizant as you can of the lighting system.

The green light will be on for 4 minutes and then the yellow light will be on for 1 minute. And then the red light will come on, so be cognizant of that, but don't stop when the red light comes on if you are trying to finish your statement.

Thank you all for being here.

Ms. Williams, you are recognized for 5 minutes.

STATEMENT OF ORICE WILLIAMS, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

Ms. WILLIAMS. Thank you.

Chairman Watt and members of the subcommittee, I am pleased to be here this morning to discuss our report on the Federal Reserve Board's Regulation B, which is being publicly released today.

As you know, Regulation B implements the Equal Credit Opportunity Act of 1974. Reg B, as it is known, generally prohibits lenders from collecting certain data from loan applicants such as race or gender for non-mortgage loans, including small business or auto loans. Whether or not to repeal or amend this regulation has been the subject of debate and review for years, including a review in 1998.

Effective in 2003, while retaining the broad prohibition, the Board authorized lenders to collect such data for the purposes of a limited self-test to evaluate their compliance with ECOA. This morning, I will highlight the findings from our report. Specifically, I will touch on three areas: One, available research on possible discrimination in non-mortgage lending and the data used; two, the Board's 2003 decision to retain the prohibition of voluntary collection of personal characteristics data; and, three, the benefits and costs of a data collection and reporting requirement.

First, what the research shows: We found that most research suggests that while discrimination may play a role in certain types of non-mortgage lending, data limitations complicate efforts by researchers and regulators to better understand the role that discrimination may actually play. For example, the research indicates that minority-owned and African-American-owned small businesses, in particular, are denied loans more often or pay higher interest rates than white-owned businesses, with similar risk characteristics.

However, the primary data source for these studies, a periodic Board survey of small businesses, while providing important insights into possible discrimination, lacks the rigor of the Home Mortgage Disclosure Act data, commonly known as HMDA data.

For example, survey data are collected from borrowers, rather than lenders, which limit their usefulness as a means to assess lending practices across institutions and the industry. We also found that in the absence of personal characteristics data for non-mortgage loans, Federal bank regulators that enforce fair lending laws may rely on time-consuming and less reliable approaches to identify possible discrimination, such as assuming a loan applicant is Hispanic based on his or her last name.

Next, I would like to discuss the Board's rationale for retaining the general prohibition of voluntary data collection and reactions to it. We found that while views varied about the decision to retain the prohibition of voluntary data collection, there was general agreement that such voluntary data would have limited benefits.

We found that the Board's final decision to retain the prohibition of voluntary data collection was two-fold. First, it said the proposal would have created an opportunity for lenders to use the data for discriminatory purposes; and, second, voluntary data would not be useful because lenders may use different collection approaches. While some researchers and others agreed with the Board's first rationale, others said that data collection alone would not necessarily create the risk for discrimination, because in some cases, such as small business lending, lenders may already be aware of an applicant's personal characteristics, given that such lending is often done face-to-face.

On the other hand, a range of researchers, regulatory staff, and others generally agreed that voluntary data collection would not likely materially benefit efforts to better understand possible discrimination, because the data would be collected on an inconsistent basis. Moreover, few lenders, if any, would participate out of concern for additional regulatory scrutiny of their non-mortgage lending practices and the potential for litigation.

The last issue I will address involves our analysis of the implications of a data collection and reporting requirement. We found that while requiring lenders to collect and publicly report data on personal characteristics for non-mortgage loan applicants could help address many of the current data limitations, it could impose additional costs on lenders that could be passed on to borrowers.

While limiting a requirement to certain types of loans, such as small business loans, could help mitigate such costs, such a requirement may also involve complexities that would need to be carefully considered. For example, to the extent that small business lending is more complicated than other types of lending, lenders may need to collect and report additional information on a range of underwriting standards in addition to data on personal characteristics, so that informed judgments can be made about their lending practices.

In closing, I would like to note that despite limitations with existing data, one key data source, the Survey of Small Business Finances, is being discontinued. While the Board plans to fold it into the Survey of Consumer Finances, how this change will impact researchers who rely on the data remains unclear.

Given the limitations of voluntary data collection, now is the time to fully evaluate the implications of a mandatory reporting requirement, and this hearing is an important step.

Thank you, and this concludes my oral comments.

I would be happy to answer any questions that you may have.

[The prepared statement of Ms. Williams can be found on page 80 of the appendix.]

Chairman WATT. Thank you very much for the summary of your report.

Ms. Braunstein, you are recognized for 5 minutes, or thereabouts.

STATEMENT OF SANDRA F. BRAUNSTEIN, DIRECTOR, DIVISION OF CONSUMER AND COMMUNITY AFFAIRS, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Ms. BRAUNSTEIN. Thank you.

Chairman Watt, Congressman McHenry, and members of the subcommittee, I want to thank you for this opportunity to discuss whether personal characteristics data collection for non-mortgage loans is appropriate and, if so, the best way to collect it.

There are four possible approaches to the collection of applicant data: A general prohibition on data collection; voluntary data collection; mandatory data collection without public disclosure; and mandatory collection with public disclosure. It is important to note that the Equal Credit Opportunity Act is silent on the question of data collection.

The first approach, a general prohibition on collecting an applicant's personal data, is the approach currently followed for non-mortgage loans in Regulation B which implements the Equal Credit Opportunity Act, or ECOA. For credit that typically is granted using automated underwriting systems without face-to-face contact between the creditor and the consumer, this approach seems appropriate.

The second option, voluntary collection of applicant data, was considered but rejected by the Board in 2003. Voluntary data collection does not appear to be a useful approach. A voluntary collection regime would not produce either reliable or useful market-wide data.

Under a voluntary regime, the data would be incomplete, because some creditors would elect not to collect. In addition, the reliability of the data could not be assured, because the data that is collected would be done with different standards criteria and methods. Thus, the data would not be comparable from creditor to creditor.

The third regime, mandatory collection of personal data without public disclosure, is the approach that the Board adopted in 1977 for mortgage loans to obtain information for monitoring purposes. This approach can provide supervisory agencies with additional data that can be useful in identifying possible discriminatory practices, however, many creditors such as non-bank finance companies and auto dealers are not subject to regular examinations for fair lending compliance. Thus, data collection without public disclosure may not enhance fair lending enforcement against creditors that are not subject to routine oversight.

Mandatory collection of personal characteristics data with public disclosure is the approach used for the Home Mortgage Disclosure Act or HMDA. Public disclosure can provide heightened scrutiny of lender practices by entities other than enforcement agencies. We believe that the availability of the HMDA data has led mortgage lenders to review their loan decisions more carefully to ensure compliance with their lending laws.

Although an approach which includes public disclosure would provide greater transparency than mandatory collection alone, it also raises significant public policy choices and cost benefit considerations. One fundamental question is the proper scope of any mandatory collection, reporting, and public disclosure requirement for non-mortgage loans. Should such a requirement apply to all non-mortgage loans or some subset of those loans such as small business loans? A requirement to collect, report, and publicly disclose race, ethnicity, and gender data for lending other than mortgages, such as small business, may promote fair lending enforcement.

However, such a requirement would be challenging to implement and could impose significant costs on lenders. Small business lending is quite complex and variable. For example, there are many different types of small business lending, including credit lines, business credit cards, vehicle and equipment loans, mortgages, capital leases, and trade credit. There are also many different types of small business lenders, including banks, credit card companies, finance companies, and trade creditors. Many different types of data about business attributes and underwriting standards would have to be collected for the data to be useful as a screen for fair lending enforcement purposes.

The Board is committed to addressing racial and ethnic gaps in the availability and affordability of credit. However, just as Congress required the collection, reporting, and disclosure of personal data in HMDA for mortgage loans, we believe that Congress is in the best position to make these important public policy and cost-benefit determinations for non-mortgage loans.

Thank you, and I will be happy to answer any questions from the subcommittee.

[The prepared statement of Ms. Braunstein can be found on page 44 of the appendix.]

Chairman WATT. Thank you very much, both of you, for your comprehensive statements.

Let me do a little housekeeping here for the purpose of making sure that all the members have a full appreciation of what we are trying to develop here. This has actually been going on for a while and I don't want the members to miss what has led up to today's hearing. So let me ask unanimous consent to submit the following documents for the record:

A letter dated February 12, 2004, from Representative Frank and 22 Members of Congress to Federal Reserve Chairman Greenspan; a letter dated March 8, 2004, which is the response of Chairman Greenspan to Representative Frank's letter;

A letter dated February 14, 2007, from Representatives Frank, Watt, Waters, Gutierrez, and Lee to Chairman Bernanke; a letter dated March 13, 2007, which is the response of Chairman Bernanke to the February 14th letter;

A letter in preparation for today's hearing from Chairman Watt to the FDIC, the OTS, the OCC, the NCUA, the SBA, the Department of Justice, and the FTC asking for their response to a series of questions about the desirability of collecting this kind of data and the contents of that letter will speak for itself;

Responses to the July 10th letter from the FDIC, the OTS, the OCC, NCUA, the SBA, and the FTC—we have not yet received the response from the Department of Justice and we are still trying to get that;

And a letter dated July 16th to Chairman Watt from the National Consumer Law Center stating its views.

Without objection, all of those items will be submitted for the record.

I have previously asked for unanimous consent to submit the letter dated July 16, 2007, from Representatives Frank, Watt, and Maloney to the GAO which requested today's report. So I am just trying to make sure that everybody is aware that this hearing today is another step in a sequence of things that has occurred on this issue, as Ms. Williams has indicated. This issue has been around for a while and we need to try to address it. Now let me proceed with the questioning of these witnesses, and I will recognize myself for 5 minutes for the first questions.

Ms. Williams, I take it that just about everybody has concluded, based on your report, that voluntary reporting and collection of collection and/or reporting of race, gender, and personal characteristics data is probably not worthwhile, because of various issues that you identified in your statement.

You would get all kinds of different responses if it were voluntary as opposed to setting up a set series of things that people will be expected to respond to. Is that correct?

Ms. WILLIAMS. That is correct.

Chairman WATT. So the options we are looking at, it seems to me, are mandatory: either no collection, or mandatory collection, with us or somebody, perhaps the Fed, giving guidance about how that information would be structured.

That is a fair summary of where you got to?

Ms. WILLIAMS. Yes.

Chairman WATT. And, Ms. Braunstein, I take it that you reached kind of the same conclusion. The Fed has reached the same conclusion, and you basically said that there would be costs associated with collecting the data, but that there would be benefits flowing from the collection of data, and it is the Congress' prerogative to determine whether to collect it or not.

It is not the Fed's prerogative to make that determination?

Ms. BRAUNSTEIN. Correct.

Chairman WATT. So you have basically thrown the ball back to us. Okay. That frames our hearing today, because it seems to me that Congress, at the end of whatever series of hearings we have on this, has to be evaluating the benefits of collecting the data, the detriments of collecting the data, and the cost of collecting the data.

Would that be a fair assessment of what you would think would be the appropriate inquiries that we would be making, Ms. Williams?

Ms. WILLIAMS. Yes, I think that is right.

Chairman WATT. Okay. Both of you made some reference to cost, so let me get you to elaborate, if you can. You described some general problems associated with collecting data, but has anybody done any specific looks at what the actual cost would be, Ms. Braunstein?

Ms. BRAUNSTEIN. Yes. The best frame of reference that we have, of course, is the HMDA system; and one of the benefits of HMDA is that the Congress did set out in a statute a very specific framework for the collection, the public reporting of that data, and it involves a lot of entities. It involves costs on the part of the lenders, certainly, who are doing the collection and the reporting. It involves a lot of costs on the part of the supervisory agencies who collect that information from the lenders and then analyze it and report it back out in public.

So that is our best frame of reference. I don't have numbers on that, but certainly, we would be willing to come up and talk to you and your staff, or whomever, about what costs are associated with HMDA. I would say they are pretty significant and we have a lot of resources ourselves dedicated to this process. Additionally, we think that collection of something like small business data would be even more complex than mortgage data, because of the nature of the loans.

The products in small business lending are not nearly as homogenous or standardized as mortgage lending, so you are talking about a lot of different variables. So I think it would be the HMDA cost, probably plus an additional factor to put into place a robust system that would be valuable for people.

Chairman WATT. Okay, before my time runs out, let's compare the cost of collecting HMDA data to the benefits of collecting HMDA data.

Does the Fed have a position on that?

Ms. BRAUNSTEIN. Yes, as I have said in my testimony, we do think that HMDA data has been beneficial in terms of fair lending enforcement and in terms of providing information in the public that give people an understanding of mortgage lending. It is certainly not determinative of discrimination, but it is a very useful screening tool for us in our fair lending examinations.

Chairman WATT. I ask unanimous consent for one additional minute. Would it be correct to say that the collection and public reporting of this data also has been a deterrent to or has deterred people, lenders, from engaging in discriminatory practices?

Ms. BRAUNSTEIN. I think that is fair to say.

Chairman WATT. Okay. How do you square that with the notion, then, that you all have had that somehow collecting this data in non-mortgage loans would or could run the risk of encouraging people to discriminate?

Ms. BRAUNSTEIN. That statement was made in the context of voluntary collection not publicly reported. That context was made regarding just lifting the prohibition, which would have led lenders to ask people for this data without anybody checking it. Many of the lenders involved do not get regular examinations from supervisory authorities, so we would have no way of knowing if they were using it for bad purposes. That was in that context, not in the context of a public system.

Chairman WATT. Okay. And, Ms. Williams, finally, to what extent did you all do any analysis of what the actual cost might be of collecting this kind of data in non-mortgage situations?

Ms. WILLIAMS. Given that there's no current structure in place, the approach we took to collect what the cost would be was largely through conversations with regulators, HMDA experience, and also talking to lenders and focusing where the cost would be impacted.

Chairman WATT. And is that fully reported in your report?

Ms. WILLIAMS. It is.

Chairman WATT. All right. I thank you.

My time has expired, and I will recognize Mr. McHenry for 5 minutes for his questions.

Mr. MCHENRY. Thank you, Mr. Chairman. And thank you all for your testimony.

You know, I would like to know from you, Ms. Braunstein, the Federal Reserve had a prohibition for a few decades, roughly, on collection of race, gender, and ethnicity, and then you went to this voluntary method.

What was the thought process to move to the voluntary method of collection?

Ms. BRAUNSTEIN. Actually, let me clarify that. We did not move to voluntary collection. We proposed it and then we withdrew that application.

Mr. MCHENRY. What was the thought process behind the proposal?

Ms. BRAUNSTEIN. The proposal, what we ended up with, was we have a little window there where lenders can collect it but only for purposes for doing their own self-testing for fair lending. But otherwise, there still is a prohibition in place on collecting this data.

Mr. MCHENRY. It seems sort of bizarre, because in your testimony you said, and in answering Chairman Watt's question as well, that you have some concerns about ensuring that this data is not used for other purposes if that data is requested, if that is the intent of Congress and the Federal Reserve.

So how do you allow people to voluntarily do this as a self-check? I mean, it seems bizarre to me that you would say if you collect this data you could use it for ill intent, but at the same time, we are going to let you voluntarily do that so you can self-check. It just seems sort of odd.

Ms. BRAUNSTEIN. Well, there are self-testing provisions in the ECOA, so that is a normal state of affairs where banks do their own mystery shopping and testing to make sure that their policies are being carried out. And so we did say that if this was a useful tool for them, they could do that. I will add that our understanding in talking to lenders is that hardly anybody is doing it. For many reasons they are not collecting this data, so I don't think anybody has taken us up on that. But we did allow that window.

Mr. MCHENRY. Could you collect an analysis of the cost of collecting HMDA data, and could you submit that to us?

Ms. BRAUNSTEIN. We could put together figures, probably, on HMDA data. Yes, I would think that we could follow up with you.

Mr. MCHENRY. Okay, just for the subcommittee to have that information, both the regulatory, the governmental portion of the cost and the private sector as well.

Ms. BRAUNSTEIN. Right. Obviously, we would have to estimate the private sector but we will do that.

Mr. MCHENRY. Ms. Williams, you spoke generally of the cost. Can you go into some more detail about the cost of possibly implementing this?

Ms. WILLIAMS. Our approach on this particular issue, we weren't able to collect specific costs for institutions, because there is no rule in place. So the cost would be dictated by the specifics of a rule if it were in place in terms of what information had to be kept, what was collected, how it was maintained, and if it was publicly reported.

We focused our conversations with lenders and regulators in terms of what are the broad categories that the cost would be incurred in, information systems, training employees, expanding their technological capabilities. And views varied about how much it would actually cost. Would it be extremely expensive because all of these systems would have to be created? Would they be able to build on existing systems as well as, for example, small business lending may not occur?

Mr. MCHENRY. What was your conclusion?

Ms. WILLIAMS. Our conclusion was that there is a potential for increased cost. No specific dollar figure was provided.

Mr. MCHENRY. Okay. Just more?

Ms. WILLIAMS. More.

Mr. MCHENRY. So perhaps we need to have another study with some parameters on what it would actually cost, but we would have to give you some specifics. Is that what you are saying?

Ms. WILLIAMS. Yes. And historically, when we have attempted to quantify costs of a particular change, it is extremely difficult because the specifics aren't there. And also it is difficult to confine how the lenders go about attributing cost to a specific activity. Sometimes, they will lump in all the cost of information systems to a change without backing out the fact that there are certain things that they have to collect regardless of the change in the regulation or not.

Mr. MCHENRY. Okay. Ms. Braunstein, sampling: Is there a possibility the Federal Reserve could do sampling in order to determine in this broad market of lending, you know, the racial breakdown, race, ethnicity, and gender breakdown in lending?

Ms. BRAUNSTEIN. The problem is that we don't have the contact with the borrowers. So right now there is a prohibition in effect for the lenders to collect that information.

Mr. MCHENRY. But it is a Federal Reserve prohibition.

Ms. BRAUNSTEIN. So there were wouldn't be the implication that it is a sample. Do you see what I mean? The information would come to us. Normally, like in HMDA, the information is collected by the lenders, and then it comes to us by the lenders. Right now, the lenders can't collect this information.

Mr. MCHENRY. Yes, because of your prohibition. So you are saying the Federal Reserve can't do it because the Federal Reserve prevents it from being done. So my question is, is there the possibility that you could through the lenders do sampling that is statistically sound?

Ms. BRAUNSTEIN. We would have to remove the prohibition in order to do that.

Mr. MCHENRY. Actually, if you removed the prohibition, could you do that in a statistically sound way?

Ms. BRAUNSTEIN. Yes, but the concern would be that without putting into place a framework for collection sampling, you would have similar problems to voluntary collection in that lenders would do it differently in different cases, and you would have apples and oranges. So, once again, we are talking about the need for a framework or system so that there is consistent data collected. Otherwise, it is not useful.

Chairman WATT. Thank you. The gentleman from Missouri is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

Ms. Williams, on page 9 in your report, you mention in the first paragraph that the four Federal bank regulatory agencies said that the availability of HMDA data has facilitated the fair lending law examination process. How? Can you explain that?

Ms. WILLIAMS. Yes, the existence of that data allows regulators to have information on a specific lender as well as industry-wide so they can look at the HMDA data as a baseline and determine if they need to look at a particular lending institution or certain aspect of the industry while enforcing their fair lending laws so they have demographic data.

Mr. CLEAVER. Okay, that brings about Ms. Braunstein, does the Fed share the HMDA data with any other Federal agencies?

Ms. BRAUNSTEIN. Yes, all the agencies. Well, it is publicly available to everybody, to the—

Mr. CLEAVER. Public.

Ms. BRAUNSTEIN. Public, yes. So, yes, it is publicly available. And the other agencies, the regulatory agencies, all use it in their fair lending examinations.

Mr. CLEAVER. This data is available, but not necessarily sent to State banking?

Ms. BRAUNSTEIN. Actually, we do send HMDA data every year to the State banking agencies.

Mr. CLEAVER. How long has that been a practice? Forever?

Ms. BRAUNSTEIN. Well, I don't know about forever, but it is been quite a while.

Mr. CLEAVER. In your testimony, you discuss how many institutions have been referred to the Department of Justice. Do you have any data on how those cases were disposed with the Department of Justice? What happened?

I mean, can you say 12 institutions were taken to Federal court?

Ms. BRAUNSTEIN. I do not have that information. Certainly, we receive information on how those cases are handled, and, there are a number of ways that they are. Sometimes, there are settlements between Justice and the lenders. Sometimes, the cases are sent back to us for disposition. I don't have those statistics today, but we could certainly get you that information.

Mr. CLEAVER. Yes, I am very much interested in it, because you know if there are violations, I think it would help the committee to know what the Department of Justice is doing. I mean, you know, and are we getting a letter from DOJ, saying you have been a bad person or are there penalties that would discourage others. So I think that information would be very helpful.

That is all, Mr. Chairman.

Chairman WATT. I thank the gentleman, and the gentleman from Texas, Mr. Green, is recognized.

Mr. GREEN. Thank you, Mr. Chairman, and I thank the witnesses for your testimony. It has been very enlightening.

Sometimes, we can make things a little bit more complicated than they actually are. Dr. King spoke of the paralysis of analysis, that you can take the simplest thing and analyze it to the point that you do absolutely nothing. So let me move quickly to what I say is a bottom line, notwithstanding the cost to collect and, by the way, that cost cannot only be the dollar amount to collect, but it could also be the cost on society for failure to collect the empirical evidence necessary.

You can have a cost that is associated with actually the physical process of collecting information. But then, if you don't collect, society has a cost. It is the cost of dreams not being fulfilled, the cost of homes not being purchased, the cost of wealth building not taking place.

So there are various and sundry costs and we ought not just look at the dollar amount associated with the actual collection of data.

Next point, notwithstanding the complications associated with data collection, I understand that it can be difficult. But I also understand that we collect an enormous amount of intelligence on things, and we do it most effectively and we do it consistently. And we do it in such a way that the information can be used for whatever the stated purpose is.

So I ask you this: Do you agree that we can construct an effective data collection system if we have the will to do so? Can it be done? I would like to start with Ms. Williams.

Ms. WILLIAMS. I think based on the experience with HMDA, HMDA is an important precedent to consider. So I think it is within the realm of possibility.

Mr. GREEN. Okay. Ms. Braunstein?

Ms. BRAUNSTEIN. Yes, certainly, it could be done. Again, it is a cost benefit analysis.

Mr. GREEN. I understand. Well, cost benefit analysis, let's just take that off the table just for the purpose of our discussion now. Assuming that we conclude that the benefits outweigh whatever the costs are, can a system be devised so that we can acquire empirical evidence indicating whether or not discrimination has taken place?

Ms. BRAUNSTEIN. I don't believe as with HMDA that we would ever be able to construct a system for small business or other data where it was definitive. On discrimination, I think that the HMDA system is an excellent screening tool and we use it that way. And, we could also build a system, like you say, if there was the will and people felt that the benefits were worth it.

We could build a system for small business lending or other kinds of lending that would also be a screening tool, but it would not be definitive on discrimination.

Mr. GREEN. Let me ask you this. If we have a system that allows us to ascertain who is involved in the process, whom it is that is involved in the process; and, if we can determine what the outcome is of the persons involved in the process, are you indicating that we don't have the intellect to put a system in place that will give us an opportunity to analyze data and come to conclusions?

Ms. BRAUNSTEIN. No. I'm not saying we don't have the intellect. I'm saying that the lending process as with HMDA is so complex that you need to go beyond what is reported on a data sheet that there would be almost an impossibility to collect every single factor that would go into a credit decision.

That is what I am saying. I am not saying we don't have the intellect. I am saying that you still would need to do investigations into files and other policies of the institution and a lot of other things in order to definitively—

Mr. GREEN. Would we be in a position, Ms. Braunstein, to collect enough information such that we can do the follow-up investigations that would say to the person making the inquiry, you need to do this follow-up investigation?

Ms. BRAUNSTEIN. Absolutely.

Mr. GREEN. Could we do that?

Ms. BRAUNSTEIN. Yes, that is what I was saying. It is a screening tool, yes.

Mr. GREEN. All right. And upon moving forward with the follow-up investigation, then couple that intelligence with the intelligence acquired initially. Then can we start to draw the conclusions?

Ms. BRAUNSTEIN. Yes.

Mr. GREEN. Here is a point, friends. Really now, here we are in 2008, and we are debating whether or not it is appropriate to ascertain, to put in place a proper system to ascertain whether discrimination is taking place.

Now, there are so many people who can tell you that it is taking place and you can always dispute it, but the point is that at some point in America, we ought to just get on with it and stop making excuses for what we know to be something that can be done. We can put this system in place if we so choose. It is a question of will, not way.

Do you differ with me, Ms. Williams?

Could you say yes or no please?

Ms. WILLIAMS. No.

Mr. GREEN. Do you differ with me, Ms. Braunstein?

Ms. BRAUNSTEIN. No.

Mr. GREEN. All right. Mr. Chairman, I yield back, and I just beg that we get on with the business of eliminating invidious discrimination. It really is time.

Thank you.

Chairman WATT. I thank the gentleman for his questions. I ask unanimous consent to ask a few more questions, just to be clear on a couple of things. So let me ask unanimous consent for 3 additional minutes.

Ms. Braunstein, it is not clear to me whether I understand that you think as a matter of policy it would be better for Congress to make the decision whether to construct a system to collect this data in non-mortgage situations.

Is it also the Federal Reserve's position that you don't have the authority to do it now without congressional legislation?

Ms. BRAUNSTEIN. We are still looking at that issue. We think that it may be unclear as to whether we would have the authority to put into place the kind of framework that exists with HMDA, which would involve the other regulatory agencies. It involves more than just telling banks to collect data.

Chairman WATT. So, clearly, you would prefer us to do it than you all assume that responsibility?

Ms. BRAUNSTEIN. Yes, that is a decision for Congress. Yes.

Chairman WATT. Okay.

Just in follow-up to Mr. Green's questions, I would like to submit for the record the Federal Reserve Bank of Boston's report on credit card redlining in which it is fairly unequivocal in its assessment. Credit cards and the availability of credit cards is one form of credit that we are talking about. It is pretty specific in its observations.

I will just read one or two sentences that says the paper's principal observation is that remarkably in spite of identical scores and identical community characteristics, an individual in the black neighborhood receives less consumer credit than the individual than the white area.

That is in spite of the fact that both have been assessed to have been similar risk of non-payment as determined by the credit score, the person living in the black area has less ability to access credit.

That is the Federal Reserve Bank of Boston. That is part of your operation, isn't it?

Ms. BRAUNSTEIN. Yes, it is.

Chairman WATT. Okay. And the Federal Reserve Bank of Chicago, that is your operation, too?

Ms. BRAUNSTEIN. Correct.

Chairman WATT. Going all the way back to 1999, and I am going to ask unanimous consent to put in a letter dated November 17, 1999, from the Federal Reserve Bank of Chicago and the attachments to that letter where it is pretty aggressive, and its position about whether we ought to be mandatorily setting up the system, too.

So just to complete the record, I am just trying to make sure we have a full record on this. I noticed that our illustrious chairman of the full committee has come in and I would be honored to yield to him as much time as he may consume.

The CHAIRMAN. I thank the chairman.

If I can make a statement, it was fortuitous that I came here. We are talking about the good work that was done by the Federal Reserve Bank of Boston and there is also the University of Massachusetts, Boston Center, that studies this. And, of course, my colleague Mr. Lynch is also here. We have learned a lot about this in Boston.

I would just say with regard to collecting this data, I have seen this movie before, and it has a happy ending. In the late 1980's or early 1990's, my then-colleague or former Member of the House, Joe Kennedy, led the fight for the Home Mortgage Disclosure Act data, and it was very controversial. And in fact, it lost in this committee and was then overturned on the Floor. And a former close ally of Newt Gingrich, a former Member from Pennsylvania, Bob Walker, took the Floor on a very forceful speech and helped us overturn the negative vote; he supported it and said, "No."

If this country isn't going to confront racial discrimination, which we all know continues to be a factor, then we are failing ourselves; and, there was a good deal of negative argument there and there were predictions that collecting the HMDA data on race and gender would be terribly disruptive.

Today, I think there are very few people who aren't very glad that we have it. It has become the common currency, the data that has been very important for a lot of discussions; and I have been to presentations in the real estate industry and others who are so glad to have this data. I just wish people would look at that example, because we had many of the same concerns when we decided to do this with regard to HMDA.

Joe Kennedy took the lead and was under the chairmanship, of course, of Henry B. Gonzalez, a great fighter for fairness, and it worked very well. I believe it would work very well here, too. So I apologize for coming in and out of the hearing, but we are dealing with the housing bill and that is taking some of my time. But this is a very important hearing. I appreciate the chairman of the subcommittee devoting time to it, and I just want to say again, I hope people will look to the example that we had before and how helpful it has been. I think that this hearing will be helpful to us in going forward as well.

I thank you, Mr. Chairman.

Chairman WATT. I thank the chairman for being here, and I would just say to the chairman that I think there will not be put together a more comprehensive record than we are trying to put together in this subcommittee to support whatever public policy the Congress decides to take on this.

We want to try to be fair. We hope to have a follow-up hearing on the cost aspects of it, but I think we have this issue framed pretty well.

The CHAIRMAN. If the gentleman would yield further, when you say I appreciate it, it is reinforcing that, because obviously we are getting late in this year. But this particular issue will be, unless things develop in November very differently than I think most of us now expect, I can guarantee people that this will be very high on this committee's agenda in 2009.

Chairman WATT. I am delighted to yield to the other gentleman from Massachusetts, Mr. Lynch, a member of the subcommittee, for as much time as he may consume.

Mr. LYNCH. Thank you, Mr. Chairman.

I appreciate that and I associate myself with the remarks of the full committee chairman, as well.

Ms. Braunstein, I don't want to put you on the spot here. I know that as far as the GAO report that is central to our discussion this morning, the FRB, the Federal Reserve Board, did not take an official position regarding the GAO report. However, I would like to really get down to the essence of this in a couple of sentences. And I just want to ask you about this partially, if you would be so kind.

The report states in the third paragraph. It says that, "Requiring lenders to collect and publicly report data on personal characteristics for non-mortgage loan applicants could help address current data limitations that complicate efforts to better assess possible discrimination." It does go on to raise concerns consistent with the chairman's remarks about costs and how to do this. But just on that basic assessment, and I think it is pretty powerful, I want to know your own thoughts on this and your own observations from your position.

Is that something that could be done here fairly accurately and with a minimal cost being generated?

Ms. BRAUNSTEIN. First of all, we agree with the position that if there was a good data collection, it could be helpful. As to whether it could be done with minimal costs, we are not sure. I mean, as I have said before, our best frame of reference is the HMDA data, and the HMDA data is an excellent system, and everybody benefits from it. We believe that wholeheartedly, but it is not without significant costs. So I think again it is a cost-benefit decision that needs to be made here.

Mr. LYNCH. Yes. Ms. Williams?

Ms. WILLIAMS. Our position is that it could address many of the limitations that exist in terms of fully enforcing all aspects of the fair lending laws and the costs have to be weighed against that. But we do raise the fact that the survey of small business finances that is currently used as the data source by researchers that do research in this area and have identified issues will be going away.

So now really is the time to evaluate given that important data source will be going away and how it is going to be replaced is unclear in terms of deciding whether additional information will be helpful. And I think in terms of enforcing fair lending laws, it is critical that information be available to, at a minimum, the regulators.

Mr. LYNCH. Yes, I agree; and, maybe I am just providing my own testimony, but based on what I have read here and some of the reports provided by the additional witnesses, it would appear, just as you say, Ms. Williams, the timing here is very, very critical. And, also, the likely benefit in my opinion of getting this additional data so that we can more accurately measure and address the discrimination that remains I think outweighs.

We will have to do this carefully, precisely, and accurately, working with the lending community. But I definitely think this is something that is tremendously worthwhile and beneficial to all of us, and I think the challenge will be just that—how to do it in a cost-effective way.

But again, I want to thank you both for your testimony and I yield back the balance of my time.

Chairman WATT. I also want to express my thanks to these two witnesses for framing this issue and giving us the context for evaluating it; and, particularly, I thank Ms. Williams of the Government Accountability Office for the excellent report that your Office has generated in response to our request.

So with that, this panel is excused, and we will ask the next panel of witnesses to come forward.

While everybody is getting seated, and in hopes that they won't realize how much I butchered their names—I think my staff has made it difficult by giving me a bunch of witnesses with complicated names to pronounce. So let me just say that without objection, your full bios will be made a part of the record. We will not engage in long introductions in the interest of time.

Our first witness will be Dr. Ken Cavalluzzo, Wisconsin Capital Management LLC. Our second witness will be Mr. Robert F. Gnaizda, general counsel, The Greenlining Institute. Our third witness will be Mr. Bill Himpler, executive vice president, Federal Affairs, American Financial Services Association. Our fourth witness will be Mr. Jorge Corralejo, chairman of the Latino Chamber of Commerce of Greater Los Angeles. And our final witness will be Ms. Ann Sullivan, the president of Madison Services Group, on behalf of Women Impacting Public Policy.

Without objection, your entire written statements will be made a part of the record, and each of you will be recognized for a 5-minute summary of your testimony.

Dr. Cavalluzzo, we now recognize you for 5 minutes.

STATEMENT OF KEN CAVALLUZZO, RESEARCH ANALYST, WISCONSIN CAPITAL MANAGEMENT LLC

Mr. CAVALLUZZO. Thank you.

Mr. Chairman and other distinguished members of the subcommittee, my name is Ken Cavalluzzo. I am a research analyst at Wisconsin Capital Management, an investment firm located in Madison, Wisconsin.

Thank you for the opportunity to speak today about whether lenders should be required to collect race and gender data of borrowers for all loans. My testimony today is based on work I started as a graduate student at the Wharton School of the University of Pennsylvania where I received my doctorate, and continued while on the faculty of Georgetown University's McDonough School of Business.

My research was conducted in collaboration with Dr. Linda Cavalluzzo, a senior economist at CNA, and Dr. John Wolken, a senior economist at the Board of Governors of the Federal Reserve. Our research on this topic has been published in leading, peer-reviewed, academic journals sponsored by the University of Chicago and Ohio State University.

The common finding across all our research is that black-owned firms were denied credit at higher rates than white-owned firms. Even after controlling for relevant risk characteristics, black-owned firms were denied credit at almost twice the rate of white-owned firms. The differences are economically meaningful and statistically significant.

We found that black and Hispanic firms were significantly more likely not to have applied for credit for fear of being turned down; and, we found that blacks, Hispanics, and Asians were significantly more likely to have unmet credit needs than were firms owned by white males. Our work is based on data obtained from the borrower, that have strengths and limitations relative to lender data. These limitations together with the differences we document on credit access among demographic groups strongly point to the need to collect both borrower and lender data.

I believe that data should be collected from the lender on the personal characteristics of borrowers of non-mortgage credit. I do not believe that collecting such data would be particularly onerous or costly to lending institutions. Such collection would not materially heighten the likelihood of discrimination.

According to our data, 78 percent of small business loans are on a face-to-face basis, and small business lending tends to be relationship-based. So the opportunity to discriminate on personal characteristics already exists, even in the absence of collection of such data.

Collecting personal characteristics data would likely benefit regulators, lenders that do not discriminate, and borrowers. Data collection is an important step towards ensuring equal treatment in lending to minority-owned small businesses.

I recommend that collection of personal characteristics data from lenders be mandatory. Data provided by volunteers are unlikely to be representative of behavior across the industry. The data should be collected and at a minimum reported to the appropriate Federal banking regulator. Data reporting is a more expensive activity than data collection, yet such costs may be limited to the degree that banks already codify their data. But I have an important caveat.

Reporting personal characteristics data without reporting corresponding information on risk characteristics is a fairly meaningless and potentially dangerous exercise, as such disclosure could unfairly characterize some banks as engaging in discrimination. Given the importance of financial institutions to the funding of small businesses, to the important roles small businesses play in the U.S. economy, and the wide differences in acceptance rates found between black- and white-owned small businesses, I encourage Congress to consider mandating that all key information to the application and pricing decision be made public.

In this spirit, Congress should revisit the Federal Reserve Board's decision to discontinue the small business data series, which provided data from the borrower. The Federal Reserve no longer collects small business data from the borrower, nor does the Federal Reserve collect such data from the lender. Plain and simple, it is difficult to learn anything without data.

Markets would function better if applicants knew the information that went into the underwriting decision. Regulators could regulate better. Borrowers could become better borrowers. Lenders would probably become better lenders. Obviously, reporting data is more costly than simply collecting it; yet, given the advancements and technological developments for data gathering, reporting, and analyzing, historically, it has never been cheaper.

I appreciate the opportunity to testify and I look forward to any additional questions you may have.

[The prepared statement of Dr. Cavalluzzo can be found on page 55 of the appendix.]

Chairman WATT. Thank you very much for your testimony.

Mr. "Gnaizda?"

Mr. GNAIZDA. "Gnaizda."

Chairman WATT. I have captured your name already, so Mr. Gnaizda, you are recognized for 5 minutes.

STATEMENT OF ROBERT F. GNAIZDA, GENERAL COUNSEL, THE GREENLINING INSTITUTE

Mr. GNAIZDA. Good morning, Mr. Chairman, and members of the subcommittee.

Greenlining believes that this is a unique opportunity, the recommendations of the GAO study. It is a unique opportunity for a major economic stimulus far beyond any stimulus so far approved by this Congress, and it is a great potential for job creation.

Two-thirds of all new jobs in this country come from small businesses. Forty-five percent of small businesses are women or minority-owned. There are approximately 13 million in total. Greenlining members include the U.S. Hispanic Chamber, the California Hispanic Chamber, the California Black Chambers, and the Asian Business Associations. All believe that the GAO study was long overdue.

We have a 15-year history of addressing this matter. Congresswoman Maxine Waters was a leader in 1993 in supporting a revision for mandatory reporting. Greenlining members visited with Chairman Greenspan on at least 10 occasions over the last 15 years on this matter, and with Chairman Bernanke on three occasions since he became chairman. We fully support the GAO study.

We believe that Congressman Green's analysis is exactly correct. We can paralyze ourselves with over-analysis. We have three recommendations. The first is that the Federal Reserve develop a task force and all those lenders who failed to respond to this committee be part of that task force to develop common metrics and discuss costs if they wish.

That should be done by September. The minority business associations will join in if requested. We believe the Federal Reserve should immediately eliminate its prohibitions and allow any financial institution that wishes to gather the data on a voluntary basis; and, we believe by no later than 2011 and hopefully by 2010 there will be mandatory reporting, and the reporting of course should be public. This is no different than HMDA and no different than SBA lending.

These are the benefits: Number one, transparency; number two, this is fully consistent with Chairman Bernanke's view that the Federal Reserve is often operating with inadequate data and needs more data—he has reiterated this on many occasions; third, we believe this is a multi-billion-dollar economic stimulus and will create hundreds of thousands if not millions of new jobs over the next few years; fourth, we think it will discourage discrimination; fifth, we have the Wells Fargo model, and I am sorry that they declined to testify. They have side-stepped the Federal Reserve's rule and courageously with the assistance of the Latino business community, the black business and the Asian business community developed multi-billion-dollar goals for small business lending for women- and minority-owned businesses and have achieved all of their goals, in many cases exceeded them.

Lastly, something that has not been discussed is the effective marketing opportunities for financial institutions. There is no way to effectively market to the 13 million minority- and women-owned businesses unless you can get data on it and determine how successful you are. So banks are losing multi-billions in opportunities.

We will be meeting with the Federal Reserve on Friday to discuss this task force. We would welcome any financial institutions joining us, and we will be meeting with Sheila Bair on Friday. And this afternoon we will be meeting with Mr. Ryan, the Undersecretary on this matter, as well as with OCC and OTS; and we have scheduled a meeting for November 18th with Chairman Bernanke and the minority business associations.

We are open, and I am particularly open, to any questions regarding the Federal Reserve and discrimination or their contentions of it, and are open to any questions on costs, because we don't agree on the cost analysis by the Federal Reserve. And we agree with you, Congressman McHenry. There are many unintended consequences of not gathering this data; and, we agree of course with Congressman Green's position that this is long overdue.

So thank you, Mr. Chairman, and members of this committee.

[The prepared statement of Mr. Gnaizda can be found on page 67 of the appendix.]

Chairman WATT. Thank you very much.

Mr. Himpler, you are recognized for your opening statement.

STATEMENT OF BILL HIMPLER, EXECUTIVE VICE PRESIDENT OF FEDERAL AFFAIRS, AMERICAN FINANCIAL SERVICES ASSOCIATION (AFSA)

Mr. HIMPLER. Thank you, Mr. Chairman, and, by the way, you pronounced my name exactly correct.

[Laughter]

Chairman WATT. You and Ms. Sullivan get rewards for having simpler-to-pronounce names.

Mr. HIMPLER. It is a pleasure to be here this morning with you, acting Ranking Member McHenry, and the other members of this subcommittee.

I am the executive vice president for the American Financial Services Association, AFSA. AFSA's 350 members include finance companies that lend to consumers and small businesses.

Mr. Chairman, I commend you and your colleagues for holding this hearing. We recognize the importance of ensuring that all persons have equal access to credit and are committed to eliminating discrimination in lending.

We believe that ECOA and Regulation B contain the necessary restrictions and enforcement tools to end discrimination and we do not believe that access to affordable credit will be enhanced by requiring non-mortgage creditors to collect race and gender data. On the contrary, imposing data collection obligations may decrease credit options available and will increase the cost of credit for consumers and creditors alike.

While both government and industry strive to make credit application processes as color blind as possible, we believe that the proposed requirement being discussed today goes against this goal. Reg B currently prohibits creditors from collecting information about the applicant's personal characteristics including race and gender information in connection with non-mortgage credit. This prohibition ensures that decisions in non-face-to-face transactions are race neutral.

For example, in the indirect finance situation, an auto finance company makes a decision about whether or not to purchase a retail installment sales contract based on the applicant's credit worthiness, not his or her race. The decision is race neutral, because the finance company does not typically have contact with the applicant and therefore does not have race information. There is scant statistical evidence to demonstrate that race or gender plays a role in access to or cost of non-mortgage credit.

Rather, studies suggest that credit scores and related risk factors determine access to credit and the cost of credit. The Federal Reserve Board conducted a study to determine the relationship between credit scores and the actual credit losses and how those relationships vary for groups protected under ECOA. The Board concluded that credit scores accurately predict credit risk for the population as a whole and for all major demographic groups.

The study revealed that on average, blacks and Hispanics have lower credit scores than non-Hispanic whites and Asians. This study suggests that if creditors were to collect data on race, the results would demonstrate a disparity in access to the pricing of credit that would be consistent with credit risk factors and not necessarily any discriminatory conduct by creditors.

The Federal Reserve Board has already concluded the benefits of voluntary collection and reporting of race and gender data would not outweigh the potential harm. In 2003, the Board decided to retain the prohibition for two primary reasons: First, the collection of data not available before could create a risk of discrimination if it was made available; and, second, at least the voluntarily-provided data would be of questionable reliability.

If voluntary data is unreliable, then the alternative would be mandatory data collection. From experience with HMDA reporting requirements we know that collection and reporting requirements require tremendous time and resources. We also know that a mere correlation between race and pricing without consideration of detailed creditworthiness factors cannot tell us whether or not illegal discrimination has occurred.

Although collecting the data would provide little additional information, it will cause creditors to incur massive costs. These costs will inevitably be passed along at least in part to consumers at a time when consumers and creditors alike cannot afford increased cost of credit. Imposing mandatory data collection requirements should be driven by evidence that there is a lack of access to credit or fairness in pricing based on discriminatory factors.

Today, most non-mortgage credit is underwritten and priced by creditors using objective, risk-based credit criteria without face-to-face interaction or any information regarding the applicant's race or other prohibited characteristics. These race-blind decision-making systems provide the very best assurances that consumers receive credit based on objective non-discriminatory criteria. It is hard to imagine that mandatory collection of racial information will improve this system. Collection and reporting of race and gender information also raises serious privacy concerns.

Our experience with HMDA has shown that it is sometimes possible with the addition of other publicly available data to identify consumers in the HMDA loan registers. The collection and reporting of non-mortgage credit data significantly increases the risk that a consumer's sensitive personal information will enter the public domain. Also, it may be that consumers will object to being asked information about their race and see this as a violation of their privacy.

In conclusion, Mr. Chairman, we believe that the Equal Credit Opportunity Act and Regulation B protect consumers from discriminatory lending practices and the current prohibition on data collection should be retained. Going forward, we must be careful not to undo the progress that has been made in creating a credit granting system that is race- and gender-neutral.

That concludes my testimony. I thank you for inviting me to testify, and I would be happy to answer any questions.

[The prepared statement of Mr. Himpler can be found on page 71 of the appendix.]

Chairman WATT. Thank you for your testimony.

Mr. Corralejo, you are recognized for your testimony for 5 minutes.

STATEMENT OF JORGE C. CORRALEJO, CHAIRMAN, LATINO BUSINESS CHAMBER OF GREATER LOS ANGELES

Mr. CORRALEJO. Thank you, Mr. Chairman, and members of the Financial Services Committee for inviting me to participate in this very important hearing today.

I sit here on behalf of the Latino Business Chamber of Greater Los Angeles. The Chamber does its best to represent the interests of over 200,000 Latino-owned businesses in the Los Angeles area. It also represents the interests of tens of thousands or more Statewide, and hundreds of thousands more nationally.

Because of the dramatic growth of ethnic minority populations and their businesses as well, lenders must and are taking a different and more realistic look at their future business client base. For example, over 50 percent of the State of California's population is ethnic minority. Their rate of growth and the development of small business is higher than the national average.

In our community, the Latino community, the small business growth rate is 3 times the national rate. In our many discussions with bankers, they are often at a loss as to how to approach many minority business communities. Data collection will immensely help them. Through our various Reg B policy discussions within our Chamber and with other minority business chambers, we have universally agreed upon the need for collection and review of data by race, ethnicity, and gender as a benefit to all. This advantage would clearly be exercised by lenders in their marketing efforts to penetrate new and emerging ethnic communities. Information of this type, HMDA, has greatly increased the number of home loans to minority communities.

It is our expectation that the number of loans to small businesses would increase several fold with this policy change. The economic contributions and growth in minority communities would be substantial. In the minds of Latino business owners, the collection of this data makes very good business sense. Minority small businesses depend heavily upon home equity funds for small business start-up and/or expansion.

A major question in the small business arena is how great of an impact will the foreclosure crisis have on the small business community and, in this case, minority small business communities. Lenders need to know how this crisis impacts the future for small business clients and their ability to obtain small business loans in the future. The compilation of the data that we are requesting is an important component required for the progress of a whole picture on the national economy.

A key instrument to this policy alternative is the immediate appointment of a task force which would resolve the foremost details and the potential cost. This should include all relevant government regulators, lenders, and minority small business leaders and associations. The dialogue and strategies that will transpire from these meetings will not only bring resolutions to the data collection policy, but inadvertently address other common economic development issues as well.

I sit here today representing hundreds of thousands of Latino businesses in their support for legislation requiring the mandatory reporting of small business by race, ethnicity and gender by lending institutions with $1 billion or more in assets.

We further support legislation that would permit all lenders with the opportunity to volunteer a report on this same data prior to the date for mandatory reporting.

Thank you very much.

[The prepared statement of Mr. Corralejo can be found on page 65 of the appendix.]

Chairman WATT. Thank you so much for your testimony.

Ms. Sullivan, you are recognized for your testimony.

STATEMENT OF ANN SULLIVAN, PRESIDENT, MADISON SERVICES GROUP, ON BEHALF OF WOMEN IMPACTING PUBLIC POLICY

Ms. SULLIVAN. Chairman Watt and members of the subcommittee, thank you for inviting me to testify today.

I am here today representing Women Impacting Public Policy, a bipartisan organization that represents over half-a-million women business owners across the country.

I would like to address two issues today: One, the hurdles that women-owned businesses face with respect to access to capital; and, two, the need for additional data relevant to small women-owned businesses.

Let me just say at the outset it was only 34 years ago with the passage of the Equal Credit Opportunity Act that women were able to obtain their own credit in their own name. In 1988, landmark legislation H.R. 5050 built upon that progress by making business loans subject to that Act. This had a tremendous effect on the growth of women-owned businesses, which now total 10.6 million.

The Bureau of the Census began counting women-owned businesses in 1972 as a pilot project. The program originally only counted sole proprietorships. It was later expanded to include C corporations, so it included women-owned businesses with a much larger revenue stream.

Every year, WIPP conducts an annual survey of its membership. In the 2008 survey, we found that women are using more sources of capital than in the previous 2007 survey, and 60 percent of women business owners continue to seek outside funding for their businesses: 66 percent of the respondents use bank financing backed by home equity loans or other collateralized loans; 49 percent use credit card financing; 36 percent get their funding from family and friends; 22 percent use SBA loans; 10 percent utilize angel investors; and 5 percent use SBA Microloans.

The good news from the WIPP's annual survey is that women appear to be making gains and obtaining credit to grow their businesses, but the struggles still continue. It is much more subtle, if discrimination in fact does exist. It is not as blatant as approval or denial. Rather, it is in the terms offered.

While the problems I am going to mention may not be limited only to women-owned businesses, and are shared by other small businesses, let me just give you a few examples of barriers that they face. First, for early-stage businesses, the collateral requirements are high. Unless you have personal property to pledge against the loan, it is likely you won't receive any financing.

Second, banks will not accept a signed government contract as collateral, which is often the most secure stream of funding the small business has to offer. Third, government agencies can prohibit small businesses from bidding by setting the bonding requirements artificially high. The small business cannot obtain that level of bonding, so they cannot bid. It is an easy way to keep small businesses out.

Fourth, the ownership terms for venture funding often prohibit women-owned businesses from using that avenue for funding; and, fifth, SBA loan fees have now become a real issue in whether members choose to use them or not. With regard to SBA loans, 40 percent of all long-term capital for small businesses is provided through the SBA loan programs.

I believe some important changes have taken place since 2004 that have really had significant consequences for the lending programs.

Congress stopped subsidizing the rate for small business loans and it lowered the guarantee. That resulted in an increase of lender and oversight fees.

Those increased fees, of course, are passed on to the borrower. The House FY 2009 Financial Services Appropriation Bill included $100 million to subsidize the loan guarantee program and reduce the lender fees. Unfortunately, it was not included in the Senate. We hope that the House will insist on its position with regard to this funding.

The topic of discussion in this hearing is whether lenders should be required to collect race and gender data of borrowers for small business lending. Let me just note that the SBA certainly tracks all of its lending. We recommend that the committee take a look at how they collect their data and perhaps use it as a model for possible expansion of data collection for small business loans.

The data on women-owned businesses and small businesses in general is hardly robust. Very few sources of data exist. The Census Bureau Statistic of U.S. businesses produces data by NAIC's codes. Every 5 years, the Census Bureau conducts an economic census and that data lags 3 years behind. The Bureau of Labor Statistics produces employment statistics by firm size, which we use.

Studies on small business lending, as you know, are very limited. One of the few sources that we had, which I understand is not going to be continued, is the Federal Reserve's survey of small business finances.

We in the small business community, especially the women-owned business community, use that survey as the basis for many of our statistics. With regard to whether or not the data should be mandated, we do not feel qualified to comment, but we encourage the committee to seek the most reliable method of data collection. With increased data collection, privacy issues should also be considered.

Regulation B was amended to track minority and women lending. We would request assurances that this additional data collection includes safeguards to protect the data from unlawful usage. In summary, the GAO report was not really able to ascertain whether or not women-owned businesses faced higher credit denial rates than white, male businesses. But from the many stories we hear across the country, we know that it is a difficulty for women-owned businesses to obtain growth capital for their businesses.

We believe that increased information on lending can be a very valuable tool to identify potential barriers to obtain that capital.

Thank you for giving me the opportunity to testify. I am happy to answer any questions.

[The prepared statement of Ms. Sullivan cn be found on page 76 of the appendix.]

Chairman WATT. Thank you, and thank all of the witnesses for your testimony.

We will now proceed to the questions of the members, and I will recognize myself for 5 minutes for questions.

One of the concerns that has been raised is the great variation, once you get outside the mortgage data collection, the great variation in kinds of loans. You have automobile loans. You have credit cards. You have small business loans. You have various and sundry other kinds of credit extended.

Mr. Cavalluzzo, Mr. Gnaizda in particular, are there some categories where we should possibly looking at not collecting data?

Mr. CAVALLUZZO. Well, my work found large differences among small business lending, and, the differences that we found were far greater than what researchers have found in the home mortgage market.

So I would definitely stress that area needs to be looked at. Now, as far as areas that may not need to be looked at, people have suggested, and whenever I raise the question of credit cards, because credit cards are through the mail, that discrimination is not an issue.

Chairman WATT. That is what Mr. Himpler said. I think there are some categories where you can't get to the race data, but is that really true?

Mr. CAVALLUZZO. Well, that is what I was just about to say. You know, how do they decide who gets those mailings? Are certain zip codes receiving fewer mailings? I think the area that one would want to focus their energies would be a little bit different. So in credit cards, we might want to look at how people are deciding where these mailings get sent.

In auto loans, a large percentage of auto loans are done at the dealership. The underwriter never interacts, meets with the borrower; however, there is the potential for issues at the dealership and that may be an area that could use some focus.

With auto loans, because there is a strong incentive to sell the car, we might not see differences at the acceptance stage, but we might see it in pricing.

Mr. GNAIZDA. Mr. Chairman, our members have a slightly different view. They believe that the greatest consequences are in regards to potential discrimination and lack of marketing opportunities for small businesses; and, our position would be we would focus on that. But we have no objection; and, in fact, we strongly support full data collection in every area, because in every area there will be forms of discrimination. However, there may not be the will in Congress to go that far, and there may be increasing political opposition if we expand it beyond small business; and, that is why we have done it that way.

Regarding the studies on discrimination, the Federal Reserve has never done a good study on small business discrimination; and the GAO has never done a study, although they have done a little analysis. We did an analysis 10 years ago for Los Angeles and South Central, and what we found is that most African-American and Latino business owners said that it was not discrimination that was the problem. It was the fear of discrimination; that is, they didn't even apply for the credit because they feared discrimination.

That is consistent with Capital Management's position as well. We have also done a follow-up study in July of 2008, regarding Latino and Asian-American business owners in California. It is a random survey. It is small. We are going to turn it over to the Federal Reserve on Friday. We are going to ask them to follow up. It shows that 75 to 80 percent believe there's either discrimination or lack of interest in small, minority-owned businesses. So I think we have the empirical evidence or we could easily demonstrate it to focus on small business and mandatory collection.

Chairman WATT. Would the problem of fearing rejection or fearing discrimination be addressed by reporting in some measure?

Mr. GNAIZDA. Yes, because Wachovia Bank, Bank of America, and Wells Fargo, for example, because I have spoken to all of their chairmen, would aggressively market to minority- and women-owned businesses. They now won't do that except for Wells Fargo because they can't collect the data, and therefore they can't tell how successful they are. No one wants to pour hundreds of millions of dollars into marketing without being able to look at the results.

So I think almost instantly we'll be successful, and that is why we are going to urge the Federal Reserve immediately, as of January 2009, to allow any financial institution that wishes to replicate the Wells Fargo model.

Chairman WATT. My time has expired. The gentleman from North Carolina is recognized for 5 minutes for questions.

Mr. MCHENRY. Thank you, Mr. Chairman. Now, to follow up on your answer, Mr. Gnaizda, so what you are saying is Bank of America and those large institutions you mentioned currently discriminate because they don't have to report data?

Mr. GNAIZDA. No. I didn't say they discriminate.

Mr. MCHENRY. Well, that is what I understood. You said they wouldn't market to them, because they don't have to disclose the data.

Mr. GNAIZDA. No. They won't market effectively because they can't measure the results. So, there's a form of inadvertent discrimination, but deliberately, Bank of America does not in my opinion want to discriminate. They recognize the enormous potential, particularly of minority- and women-owned businesses. In California, Bank of America knows that half of all new businesses are minority-owned.

Mr. MCHENRY. So therefore, wouldn't they market generally?

Mr. GNAIZDA. Yes.

Mr. MCHENRY. Across communities; isn't that being done?

Mr. GNAIZDA. No, they would use what I would call a white, male business approach that is tried and true, and they don't use any other approach except for Wells Fargo, which has its own form of measuring results. It is not as accurate as would be under mandatory reporting, so I think this will be a golden opportunity for every major financial institution. And, Greenlining has met with occasionally every one of those.

Mr. MCHENRY. Let me ask this question, Mister—

Will you say your name?

Mr. CAVALLUZZO. Cavalluzzo.

Mr. MCHENRY. Cavalluzzo, thank you.

You know, in terms of economics, if there is a vacuum created, someone will move into that vacuum. And based on the data you present, it seems to me that somebody can make a fortune by providing a service to a group that has been discriminated against.

At least that is one way to look at it as, you know, why are people not jumping into that lurch? Can you give me based on your study in that regard?

Mr. CAVALLUZZO. We actually tried to address the point that you just raised by saying, "That is right." Taste-based or prejudicial discrimination is not profit maximizing; and, in fact, if it exists, competition over time should try to mitigate it. People ought to come in and fill that background. So we looked at differences in different types of markets to see if the markets with less competition, the differences are more pronounced.

We found some modest evidence that indeed was the case. Unfortunately, I don't have a good answer for you as to why we are still seeing these differences, even though I think you are right. Now, some forms of discrimination are economic based, despite being illegal, such as what's known as statistical discrimination. That is, if it is costly or difficult to measure risk characteristics of the borrower one could use race as a proxy or as a measure of that as opposed to collecting the data.

We can't disentangle those issues as clearly as I would like to be able to, so it is hard to know why people haven't come in.

Mr. MCHENRY. Okay. You know, in your study, the question I have is you went to the borrowers to do the study because you couldn't get the data from the lenders.

Is there a potential if you had the information from the lenders that the conclusion would be different or perhaps more refined?

Can you address it from that data set since that is what we are talking about?

Mr. CAVALLUZZO. Lender data has its advantages without a doubt. We would get a much better sense of the true underwriting model. We would know better what's on the application and would be able to construct models that perhaps better resemble what goes into the actual underwriting decision.

We had very rich data. The small business data series provided very rich data. It is hard to say with any empirical study, even using lender data, if we saw large differences, that those differences would be due definitively to discrimination.

I don't know that we could make much stronger statements than we have already made, but it would complete the picture more.

We have looked at it from the borrower's side. We have looked at it from the lender's side and collectively here is what the data point to.

Mr. MCHENRY. Thank you.

Chairman WATT. The gentleman from Missouri.

Mr. CLEAVER. Thank you, Mr. Chairman.

Mr. Himpler, I am going to ask you questions simply because I can pronounce your name easily, so I am not picking on you. Your testimony, however, is amazing. On page 3 of your testimony, you open and say, "There is scant statistical evidence to demonstrate that race and gender play a role in access to or the cost of non-mortgage credit."

How do you respond to the GAO report, which suggests that discrimination does in fact play a role in non-mortgage lending?

Mr. HIMPLER. Congressman, the GAO concluded that it may play a role. It doesn't say that it does. Two, the report by the GAO is based on reports. It is not based on statistical analysis.

Mr. CLEAVER. How can you be certain that there is no discrimination unless you already have the data and you are analyzing it?

Mr. HIMPLER. We believe that the regulators have the data that they need.

Mr. CLEAVER. Based on what?

Mr. HIMPLER. Based on their ability to take a look at individual loan files.

Mr. CLEAVER. No. No, the regulators have data. How do you know they have it?

Mr. HIMPLER. I do know, in one instance in particular I will speak to, that the Fed has worked with the credit bureaus to get essentially the same sort of data that we would get from a sort that we are talking about by looking at credit histories, credit scores, by census track.

You are going to achieve the same outcome so that you have with what we are looking at achieving.

Mr. CLEAVER. So you have analyzed it?

Mr. HIMPLER. No, sir. I have not analyzed it.

Mr. CLEAVER. How do you know? If you haven't analyzed it, how do you know?

Mr. HIMPLER. How do I know what, sir?

Mr. CLEAVER. How do you know the data Federal agencies are collecting would suggest that there would be no discrimination?

Mr. HIMPLER. I don't know that, sir. What I am saying is the evidence that is out there right now does not provide us with empirical data to make that conclusion.

Mr. CLEAVER. So there is no discrimination?

Mr. HIMPLER. I am not saying there is no discrimination, sir. What I am saying is that the request to collect the data that we are talking about will, like HMDA, not show discrimination. What it does is provide a flagging system for the regulators to do further analysis. But at the end of the day, regulators or researchers have to look at individual loan files to determine whether or not discrimination existed. There is no way of getting around it, and we have talked about comparing this to HMDA.

I think it is important for the committee to understand. Ms. Braunstein made a comparison that we want to make sure we don't compare apples and oranges. Extending the analogy from HMDA to other types of lending is not like comparing apples and oranges. It is like comparing apples and concrete. With mortgage lending, you have a nationalized, standardized system.

Using Fannie and Freddie automated underwriting, everybody is playing from the same deck of cards, if you will, or the same song sheet in terms of criteria that they use. When it comes to small business lending, when it comes to personal loans, when it comes to auto finance, you don't have any sort of nationalized, standardized system. So, the question was raised as to whether or not we could do this.

Yes, we could collect all the information that is necessary to make the determination. But essentially, what that would be is an unusable database.

Mr. CLEAVER. Maybe I can get at it from this way.

Mr. HIMPLER. Sure.

Mr. CLEAVER. In your testimony you asked that we not act against Regulation B so that we will not undo the progress that has been made in creating a credit granting system that is race and gender neutral.

Tell me what progress you are speaking about.

Mr. HIMPLER. Essentially what we are talking about is as recent as 20 years ago. I would like to make the analogy that credit was like an on/off switch. If you had pristine credit history you had access to credit. If you didn't, you were dealing with folks that nobody wants to deal with. With the technology developments and risk-based pricing, we have gone from an on/off switch to more of a dial.

Creditors base the prices that they charge customers using the credit factors that those borrowers bring to the table. It is not an either/or. It is a range.

Mr. CLEAVER. So we have made significant progress, and your goal is to make sure we don't undo it.

Mr. HIMPLER. Absolutely, I mean, the one thing Mr. Gnaizda mentioned was his analysis, and we would be more than happy to work with his organization to take his study to the regulators, have them assess the study in order to validate it to the lending institutions they are talking about, to the market, to the folks in every community across this great land.

Mr. CLEAVER. Yes. I mean, you are talking about progress. And I have been black every day of my life and I, you know, can sit here and talk to you about progress. And I am troubled by the fact that you are almost suggesting here that there is no problem, and we probably shouldn't even be doing this hearing.

Mr. HIMPLER. That is not what I intended to convey at all. We share your commitment to wanting to end discrimination. We are just not sure that collecting the data set of the type we are talking about, putting race and rates and gender information together without any credit information or other credit factors gets us in that direction.

Those data sets are already available to regulators if they want to access them, essentially through the credit bureaus as a screening tool. But at the end of the day, you still have to look at the individual loan files. There is no way of getting around it. That is what Ms. Braunstein meant.

Mr. CLEAVER. Yes, you look at an individual loan file, and there is plenty of information that can be extracted that can be used for discrimination. I mean, somebody's name is Shaft, or they have a zip code or Mr. T, or something, and you know if they went to Howard University. I mean, there are all kinds of ways to extract information for purposes of discrimination, and I don't think we ought to deny that.

That is one of the reasons it is continuing to hang around is because we are denying it instead of challenging it, and I am just concerned. I read your report three times, because I wanted to conclude that I had misread it; but I didn't, and I am extremely concerned, you know. You even speak about the negative effects of data collection, as if collecting the data will generate greater discrimination. How do you do that?

Mr. HIMPLER. Not greater discrimination; it will reduce access to credit. It will raise the cost for creditors. Ultimately, it will raise that cost and at least in part will be passed the law into the consumer. As costs rise, people have less access to credit.

Mr. CLEAVER. Of course, that is already happening.

Mr. HIMPLER. You just don't want to make it worse.

Mr. CLEAVER. Worse than what happened in the subprime market?

Mr. HIMPLER. Yes.

Mr. CLEAVER. I mean, every study shows that people were targeted for subprime loans. People went after certain people. The brokers, the real estate companies in some instances, went after a target group. Am I wrong?

Mr. HIMPLER. I am not familiar with the studies you are talking about, sir.

Mr. CLEAVER. Okay, well, let's not—forget a study. Who do you think were the targets of the subprime loans? You don't know?

Mr. HIMPLER. No.

Mr. CLEAVER. In almost all the newspapers, it has been clear, Latinos and African Americans. And I know that is surprising to you.

Mr. HIMPLER. No, I would say a substantial number of subprime borrowers are Asians and non-Hispanic whites.

Mr. CLEAVER. Well, why do you think they were targeted?

Mr. HIMPLER. Based on the credit factors that they brought to the table, sir.

Mr. CLEAVER. That had nothing to do with race?

Mr. HIMPLER. I am not going to sit here and say that there are no instances of discrimination. I have no evidence to back up that claim, but we in the lending community base our credit decisions on objectified credit histories that we get from the credit bureaus. The Federal Reserve came to this conclusion that credit scores are predictive.

Mr. CLEAVER. My final question: Your recommendation is that we do nothing?

Mr. HIMPLER. My recommendation is that we not do this.

Mr. CLEAVER. So what should we do?

Mr. HIMPLER. One of the things is that in listening to Mr. Gnaizda, he has proffered a study that he thinks will move the ball forward in terms of encouraging major institutions to get more aggressive in their marketing. I will commit to you right here today. We would be happy to work with his organization, to go to the regulators, to validate their results. And once they get the Federal regulators' seal of approval, which I think is what would help gain the confidence of the financial institutions, and take that to the financial institutions.

Mr. CLEAVER. That is a good answer.

Mr. GNAIZDA. I don't think that is a solution of any kind at all. Greenlining has raised with every financial institution, including your members, doing such studies. They have always refused to do so. We have had to foot the bill ourselves.

We are happy to work with the Federal Reserve and we will make our invitations to the major financial institutions independent of the association, and independent of any delay, because I don't want to have a delay until we have a study of 5 million, which your members will probably request at a minimum.

Mr. HIMPLER. And, all I am saying is taking your results, having the Federal regulators look at them as an independent reviewing body, and then taking those results forward.

Chairman WATT. The gentleman's time has expired.

We are going to go another round, because I have a few more questions.

Mr. Himpler, did your organization support collection of HMDA data?

Mr. HIMPLER. No. We did not.

Chairman WATT. Okay, so you oppose that, too?

Mr. HIMPLER. Yes.

Chairman WATT. A part of our responsibility that we have undertaken is to try to look at the cost. And on page 4 of your testimony you cite the "massive" cost that creditors would incur if they were required to collect this data.

Can you quantify what "massive" is? What information do you have that you can provide to the committee about the extent of the cost that would be associated with this?

Mr. HIMPLER. Like Ms. Braunstein, it would be a back of the envelope estimate, Mr. Chairman.

Chairman WATT. But we are looking for something more than a back of the envelope, and I am not sure that you should have it this morning; but if you come before this subcommittee and testify that there is a "massive" cost associated with it, then we need to be evaluating what that cost is. And the only way we can do that is to get something other than a conclusory word like "massive."

Mr. HIMPLER. May I?

Chairman WATT. So I am not suggesting that I need it this morning, but part of our responsibility is to look at the actual projected cost. And if you have information on that, we would welcome you to submit it in writing to us, not do it on the back of an envelope. Because our inquiries are a little bit more serious than the back of an envelope would suggest.

Mr. HIMPLER. I did not mean to imply the inquiry was not serious. What I can tell you in terms of using the word "massive" is that a substantial number of lending institutions, finance companies that were discussed by Ms. Braunstein, do not come under Federal oversight.

Chairman WATT. I am aware of that. That was my next question, in fact, but the cost of doing this for them would be?

Mr. HIMPLER. A significantly higher portion relative to their business size.

Chairman WATT. What makes you conclude that?

Mr. HIMPLER. A number of them are not computerized in terms of their lending. A lot of loan files are—

Chairman WATT. Who is not computerized in their lending? Tell me somebody who is not computerized in their lending that is engaged in the lending business?

Mr. HIMPLER. I would say Regional Finance of Mississippi.

Chairman WATT. Regional Finance of Mississippi?

Mr. HIMPLER. A number of our companies are small companies.

Chairman WATT. I understand that, but you said you were going to give me the names of some people who are not computerized and they are issuing credit?

Mr. HIMPLER. No. No, in terms of the data set in terms of collecting HMDA-like data, they do not have it.

Chairman WATT. I understand that. Nobody has a system set up to collect this data at this moment. We understand that. I mean, because nobody has required them to collect it up to this point, but when you represent to me that somehow this is disproportionate for people who are regulated or unregulated as opposed to those who are regulated, I don't understand that.

Mr. HIMPLER. This type of data collection is not something you can buy right off the shelf, so you have to outsource that, bring people in to work with your systems, work with your lending officers and your branches.

Chairman WATT. Mr. Himpler, I am going to issue you an open invitation. We have made a commitment here this morning to have a hearing about the cost, because I think it is important for us to assess not only the benefit of collecting data, but the cost that would be incurred in the collection process. And, so, if you would in the next 30 days give us as complete information as you can give us about your analysis of what you characterize as "massive" costs associated with what could be required.

I understand that there are costs associated. We haven't denied that. It was part of my opening statement if you were here. And I understand that it is our obligation to assess at some level the benefits against the cost, and the only way we can do that, I think, we know the benefits of doing this, although you argue with those, too.

What we are interested in is getting a better handle on what the cost would be, and so I am issuing you an invitation to submit that in writing.

Mr. McHenry.

Mr. MCHENRY. Mr. Himpler, what are the privacy concerns?

You have testified about HMDA data, last year in the prior Congress. I don't have the date in mind, but can you talk about the privacy concerns in collecting this type of data?

Mr. HIMPLER. Sure. In the HMDA context, using HMDA loan registers and other publicly available data, currently, you can determine exactly who got what loan in giving census tracks—not across-the-board—but it is possible to do.

Our fear in this regard is that particularly with respect to auto finance lending, looking at census tracks and other available information such as title registries, that you would be able to do exactly the same sort of thing, redact out of the data collection what rating your neighbor got on his or her Honda Accord or Ford Escort.

Mr. MCHENRY. Okay. You know, the issue here, we go back to HMDA data. This is instructive for me. It seemed like the large financial institutions were not serving the groups that we are concerned about here today. And I think that was brought out.

Mr. Gnaizda, you are nodding, but I think the HMDA data showed that some of these large financial institutions were not going out and doing it. And back to my concept with Mr. Cavalluzzo, at least the economic notion, I don't know if it is reality, and that is what we are trying to hash out here today. I think the chairman's intent to see if this data bears that out, but the vacuum is filled.

I believe in terms of the HMDA data, the data showed that the subprime marketplace when it actually filled that vacuum, some of these larger institutions were not doing this. So you had smaller institutions that had different pricing models that went in and figured out a way to do it. And Mr. Gnaizda, go right ahead.

Mr. GNAIZDA. Yes, we quite agree with you. That is the problem, that if you created an enormous vacuum the unregulated will engage in unscrupulous behavior. That has what has caused the subprime crisis.

Mr. MCHENRY. Well, that is not all of it. Let's not simplify this. I mean we have a huge economic issue here, and you can't simplify it to simply say you had a bunch of legal operators. You can't simplify it.

Mr. GNAIZDA. You had, for example, those on the edge like Countrywide that dominated the market and forced the scrupulous with a couple of exceptions to compete with them.

We don't want to create the lowest common denominator. We believe that the HMDA data you raised demonstrated the importance of this data. Richard Rosenberg, then president of the Bank of America, had told Greenlining members that Bank of America took advantage of every opportunity to make loans to African Americans and Latinos and resented the community's views that they did not. When HMDA data was forced upon them, the first year after they collected it, he asked us to come and meet with them. And he said, "I was wrong. We did not maximize the opportunities, and now we will."

And that is exactly what I think will happen when we have Reg B being abolished and there is mandatory reporting. The major banks and their CEOs will come here in 5 years and perhaps thank you.

Mr. MCHENRY. So would you say, I mean, I know you are not in a lending marketplace, but I would say that a car loan is different from a home loan and is different from just a personal loan. And having gotten all three, I know the hoops that you go through are very different and your asset requirements and everything else.

So in terms of getting the depth of the pricing model and the risk model, how do you really do that, Mr. Cavalluzzo in terms of statistical analysis? Because you may have one firm, and you can see this with banks currently in terms of how strong certain banks are versus how at risk others are based on their own pricing model. You know, I go to one bank and they say, you know, heck no, we are not giving you a loan. You turn around to another bank and you can get it. You know, so in terms of the pricing model, how can you account for that in a statistically reliable way comparing apples to apples?

Mr. CAVALLUZZO. That is right. Small business lending is a very complex issue. When I went to banks to start my research, I found some banks told me, "We just look at the credit score. That is what we use." Other banks wanted a full balance sheet, income statement, to understand the business that the firm is engaging in. It is a very hard problem.

Even bank underwriting models vary by the institution. So in part, and that is one of the limitations to borrower data, that lender data could help to address—getting data from the lender would potentially allow a researcher to let that underwriting model vary.

Mr. MCHENRY. Well, if the chairman will indulge me for a moment here, there are two elements there. There is the competitive nature between the institutions doing the lending, and you have some institutions that believe their pricing model, their assessment of risk, is better and sharper than the other guy's down the block. Therefore, they don't want to release that. So you have some privacy issues within institutions. Secondly, counter to that you have individuals as a consumer in trying to get a loan who don't know the different pricing mechanisms. So how do you on one hand let individuals know in the same manner allow these institutions to figure out their competitive advantages. I mean, how do you keep that data, you know, out of the competitor's hands.

Mr. CAVALLUZZO. Well, the name of the lending institution doesn't have to be disclosed within the data.

Mr. MCHENRY. But you can pretty easily figure it out. I am from a small town; and, I mean, you can give me a data set, and I guarantee I can figure out which one of the three banks in my town it is.

Mr. CAVALLUZZO. If the data set were restricted to your town. But if the data set were for the entire country or the entire State, I think it would be much more difficult.

Mr. MCHENRY. But in terms of lending, you can see census track information is what Mr. Himpler pointed out.

How do you restrict that? You know, because we do have privacy concerns.

Mr. CAVALLUZZO. I think that the regulators need to take care with data that they actually do disclose, I don't think that they necessarily need to disclose information that would allow a researcher to identify the particular institution.

Yet, still, a researcher can learn an enormous amount from that set of data. In our data we had no idea what the lending institutions were. In fact, regional codes were nine large regions across the country.

Mr. MCHENRY. But it is sort of a sliding scale. It is tricky to do.

Mr. CAVALLUZZO. To mask certain pieces of the data?

Mr. MCHENRY. Yes.

Mr. CAVALLUZZO. I don't believe it is that tricky.

Mr. MCHENRY. Okay. Well, thank you for your testimony. I appreciate you all going through the second round.

And, Mr. Chairman, I think the question here, and I am glad you are going to go for a hearing on the cost, because I think it is a great unknown. Everybody admits it will cost something. The question is what is that cost. We know the consumer will bear that cost, whatever it is, whether it is very small or very large.

And so, Mr. Chairman, I think it is a laudable goal, and we have to figure out the best way of approaching it. I am grateful you are having this hearing.

Chairman WATT. Mr. Cleaver.

Mr. CLEAVER. Thank you, Mr. Chairman.

I have two questions.

How are you today, Ms. Sullivan?

Ms. SULLIVAN. You don't want me to fall asleep, right?

[Laughter]

Mr. CLEAVER. Yes, well, your name is easy to pronounce and I just wanted to make sure you were included. Thank you.

Mr. Himpler.

Mr. HIMPLER. Still here, Congressman.

Mr. CLEAVER. I am stuck on "We must be careful not to undo progress that has been made in creating a credit planning system that has race and gender neutral." And I am trying to see how we are on the verge of undoing that progress.

Mr. HIMPLER. It is a very good question, first off. What I said in the first round of questions was that we have gone from a denial of access or the unavailability of credit to segments of our population as recently as 30 years ago to systems now where we can base credit approvals on objective, credit-scoring models that take advantage of objective criteria that does not involve prohibited characteristics in granting those approvals.

Our concern was that with some of the collection: (1) it will increase the cost that will be passed along to the consumer—that increased cost may take some folks out of the equation in terms of affordability; and (2) it will raise privacy concerns because of the availability of publicly available data matched up with the type of collection that we have that will increase the fear that Mr. Gnaizda talked about earlier from wanting to have their private information revealed and would thus opt out.

We think both cost and from privacy concerns that could roll us back.

Mr. CLEAVER. Roll us back to 30 years ago.

Mr. HIMPLER. Not to 30 years ago, but it is backwards. It is not forwards.

Mr. CLEAVER. I am getting a headache.

Mr. HIMPLER. I don't mean to give you a headache, Congressman.

Mr. CLEAVER. No, it is too late. You know, there are all kind of ways to find out. I mean, to look at a document and see red flags, if you want to call it that, that would point to a specific racial or ethnic group and then make decisions based on that. I mean, you would not think that the gentleman sitting next to you to your left is Irish by looking at the name. Am I right about it?

Mr. HIMPLER. Yes, you are right, but you wouldn't think by looking at my name that I am half Mexican either, would you?

Mr. CLEAVER. No. No. But I could tell by your statement that you haven't been treated that way.

Mr. HIMPLER. Not true.

Mr. CLEAVER. That is all, Mr. Chairman.

Chairman WATT. Thank you.

Bottom line here, our inquiry is cost versus benefit, benefit versus cost. So let me just ask each one of the five witnesses to address, first of all, Ms. Sullivan, going from you to Mr. Cavalluzzo.

What is your assessment of the cost benefit analysis on HMDA? Has HMDA been more beneficial than costly?

And what is your assessment of the projected cost-benefit analysis on other kinds of lending other than mortgage lending if we were to require it be reported mandatory, Ms. Sullivan, HMDA cost benefit, non-HMDA cost benefit?

Ms. SULLIVAN. We are not experts on HMDA. But I would say that all this talk about how much everything is going to cost is just confusing. And maybe the data is so much more comprehensive that you are talking about than what the SBA collects; they are not direct lenders.

Lending institutions are reporting to them. I have never heard of any onerous costs associated with it. I have participated in plenty of small business lending Roundtables in the House and the Senate and no one has ever raised that. It seems to me that it is pretty simple.

With regard to 7(a) loans, I can see that only 4 percent of African Americans used the loans in FY 2001 and it increased 5 percent in FY 2007. Clearly, the 7(a) program is not reaching out to the African-American population. It looks like there needs to be some improvement. I mean just even simple data collection like this is helpful to our segments of the industry, and it is also helpful to policymakers. It gives you benchmarks about where the lending is and what needs to be improved. I just don't see why this can't have the same relevance and the same kind of benefits for a larger data collection that you are talking about.

Chairman WATT. Mr. Corralejo.

Mr. CORRALEJO. "Corralejo."

Chairman WATT. "Corralejo."

Mr. CORRALEJO. Thank you.

You know, I hear discussion about the ultimate costs passed back onto the borrower, and that could be the case. We don't know. But I think that there is such a potential for growth here in the minority communities, I don't think they need to be passed along to borrower. There is another option here. I think this is a question of growth. I think the same way that HMDA has attributed to greater loans to minority communities, I think this will be the same thing with minority business people. So, as banks grow and they open new branches, there are costs at opening branches, but the benefits far outweigh the costs. And I think that is the formula that we are looking here: does that potential really exist.

And in our discussions with numerous bankers—we have numerous bankers as our partners—they are dying for a way to figure this out. Not that they have yet, but I think clearly this is one of the means and methods that we seriously need to take a look at. So I think in the end my assumption is that this is a cost of increased business and not necessarily passed along to the borrower.

Chairman WATT. I take it you are not dealing with those banks or members of Mr. Himpler's association.

Mr. CORRALEJO. But we deal with small banks, and that is why in our testimony we talked about banks with 1 billion in assets or more, because we understand there are differences. So these are the details that need to be worked out.

Chairman WATT. Mr. Himpler, on the cost benefit analysis of HMDA, first of all, and you have already actually testified about the cost benefit analysis of your assessment of the cost benefit analysis of what may be proposed, but I am not sure I have you on record.

I know your association opposed collection of HMDA data, but now that it is out there, it has been done for a while, what is your assessment of the cost benefit analysis?

Mr. HIMPLER. It would be silly to say that it hasn't been beneficial to the regulators in terms of their ability to identify potential problems and do further investigation. But you can't get a determination of actual discrimination from HMDA data. There is no credit information.

Chairman WATT. What we do want to look at is pushing the data fields collection of other data fields where you can make that determination. But that is a subject for another day.

Mr. HIMPLER. Right, I will leave it alone, but that does come at a potential cost of harm to the business community in terms of comparing race and rates, or ethnicity and rates, without any credit information that they are guilty until proven innocent. And that is a cost. So there is cost and benefit, and there is also the cost of the collection you have for the first time in the last 3 and 4 years, a number of mortgage companies that had never collected HMDA data period. So there was a ramp-up to that.

As far as the cost associated with the proposal today, I just want to make sure folks understand exactly what we are saying: that there are easier ways to do this; that we will achieve the same sort of outcome from data sets that are already out there from the bureaus with respect to research or that can be used by the regulators as a flagging mechanism to do the further analysis that they need to do on a more cost-effective basis.

Chairman WATT. Mr. Gnaizda.

Mr. GNAIZDA. Yes.

Chairman WATT. Same questions.

Mr. GNAIZDA. Yes, Mr. Chairman, we have analyzed the HMDA data.

The number of African Americans and Latinos who have received home loans at fixed rates—these are prime fixed-rates every year once HMDA data was available—increased substantially. So there are millions of African Americans and Latinos and Southeast Asians who own homes today at fixed rates and are not subject to the present crisis due to HMDA collection. We believe many major banks, if their CEOs came, would testify to that.

Now, with regard to cost-benefit-analysis regarding the future and small business lending, the benefits outweigh any possible cost, even if exaggerated three-fold. And that is because the same thing that happened with HMDA, more homeowners, as Mr. Corralejo has said, there will be more small businesses that are women-owned and minority-owned that will be the beneficiaries of prime, small business lending by major financial institutions. And we believe that the Federal Reserve can assist in this.

That is why we are going to meet with Ms. Braunstein on Friday. They should call a task force immediately, and they should have the 10 largest financial institutions doing small business lending. We have identified them, and they should bring them in quickly, and by September begin a task force.

Thank you.

Chairman WATT. You have gone over that and that is why I am stopping you.

Mr. Cavalluzzo.

Mr. CAVALLUZZO. First, I am not aware of the data sets that Mr. Himpler refers to on this topic; and, I know the literature extremely well in this area. I think that the differences we document in our research, while I understand that there are costs to the lending institutions, I think the differences we document suggest that the cost to society are potentially quite large and that, I think, fair treatment needs to examine both the costs to the lender and the cost to society at large. The cost to lending institutions, though, may be less than I think we were being led to believe, because banks already codified this data.

Many banks transfer this data to credit scoring models, so that these credit scoring models can be refined and improved upon. Banks pay credit scoring agencies to do this, so a lot of this data collection and transferring is already taking place.

I think that banks could actually find this data useful, so that they can better understand the lending process. The lending process doesn't need to be a black box to consumers or lenders. If people can understand what it takes to improve their credit score, then they are better borrowers.

I think there are benefits to many pieces of society, rather than just the cost to lender. Lenders may actually find benefits in all of this. In particular, we may find that these data help us fill that vacuum that is out there for these firms that aren't getting the credit they need.

Chairman WATT. Your testimony has been amazingly helpful, I think, in helping us evaluate that.

The Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Mr.

Himpler, for example, we will submit the request for your cost information in writing.

Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

We thank you all immensely for being here today, and for your interest in this subject, and unless Mr. McHenry has any other comments, I declare that the hearing is adjourned.

Thank you so much.

[Whereupon, at 12:37 p.m., the hearing was adjourned.]

A P P E N D I X

July 17, 2008

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Statement of

Sandra F. Braunstein, Director

Division of Consumer and Community Affairs

Board of Governors of the Federal Reserve System

before the

Subcommittee on Oversight and Investigations

Committee on Financial Services

U.S. House of Representatives

July 17, 2008

Chairman Watt, Ranking Member Miller, and members of the Subcommittee, I want to thank you for this opportunity to discuss whether the collection of data by creditors on credit applicants' personal characteristics (such as race, ethnicity, and sex) for non-mortgage loans is appropriate, and if so, how this might best be accomplished.

In my remarks today, I will provide background information on efforts by the Federal Reserve Board to combat credit discrimination, as required by the Equal Credit Opportunity Act (ECOA), and on the collection, reporting, and public disclosure of applicant characteristic data, as required by the Home Mortgage Disclosure Act (HMDA). I will also outline the Federal Reserve's fair lending examination program for non-mortgage products, and discuss the cost-benefit tradeoffs involved in collecting, reporting, and publicly disclosing applicant characteristic data for non-mortgage lending, including small business.

A. Background on Credit Discrimination and Data Collection

ECOA, enacted in 1974, generally prohibits creditors from discriminating against any credit applicant on any prohibited basis (such as race, national origin, religion, age or sex) in a credit transaction. ECOA is implemented by the Board's Regulation B. In fashioning Regulation B, a fundamental question for the Board was whether permitting lenders to note characteristics that, by law, they cannot consider, would advance or impede the goals of ECOA. The statute itself is silent on this issue.

In 1977, the Board adopted a rule generally prohibiting creditors from collecting data on the personal characteristics of loan applicants. At the same time, however, the Board required creditors to collect applicants' race/national origin, sex, marital status, and age for home purchase and refinance loan transactions. The Board adopted this limited data collection requirement based on frequent and serious allegations of unlawful discrimination in the home mortgage market and the significant impact that access to mortgage credit can have on consumers. Collection of these data was designed to help enforcement agencies better monitor home mortgage lenders' compliance with ECOA. The Board did not, however, require reporting or public disclosure of applicant characteristic data collected in mortgage transactions.

Reporting and public disclosure of the personal characteristics of individual borrowers and applicants for home mortgage loans occurred when the Congress amended HMDA in 1989, and the Board revised Regulation C to implement those amendments. HMDA is a disclosure statute that requires lenders to collect, report, and publicly disclose information about housing-related loans and applications for these loans, including several borrower or applicant personal characteristics.

HMDA has three purposes. One purpose is to provide the public and government officials with data that will help show whether lenders are serving the housing needs of the neighborhoods and communities in which they are located. A second purpose is to help government officials target public investment to promote private investment where it is needed. A third purpose is to provide data that assist in identifying possible discriminatory lending patterns and facilitate the enforcement of anti-discrimination laws, such as ECOA.

HMDA requires mortgage lenders to disclose annually information about each application or loan (such as the loan type and purpose); each applicant or borrower, (ethnicity, race, sex, and income); and each property. Since 2005, pursuant to Board changes to Regulation C, lenders have also been required to report certain price data on higher-priced loans. Based on cost and privacy concerns, however, HMDA data lack several factors that lenders routinely use to make credit decisions and set loan prices, such as information about the borrower's creditworthiness and loan-to-value and debt-to-income ratios. Although HMDA data alone cannot prove discrimination, the data can facilitate fair lending enforcement by helping regulators identify lenders that warrant further review.

In 1999, the Board proposed to amend Regulation B to allow creditors to collect applicant characteristic data voluntarily. This proposal was very controversial. Consumer groups generally favored lifting the prohibition, but believed that voluntary collection should only be a "first step" toward mandatory data collection. Members of the industry generally opposed lifting the prohibition, fearing that voluntary collection would lead to mandatory collection and impose substantial costs and burdens on the industry. They also believed that data collected on a voluntary basis without standards would be unreliable, of questionable value, not comparable from creditor-to-creditor, and subject to misinterpretation. Some consumer groups also recognized that voluntary data collection may not produce quality data. The Board did not propose, or request comment on, mandatory collection of applicant characteristic data or public disclosure of such data for non-mortgage loans in its 1999 proposal.

In 2003, the Board adopted a final rule that retained the general prohibition on collecting applicant characteristic data for non-mortgage loans. The Board concluded that voluntary data collection would not be effective or desirable because a voluntary collection regime would not produce reliable or useful market-wide data. Under a voluntary data collection regime, the data would be incomplete because some creditors would elect not to collect. In addition, the reliability of the data could not be assured because the data would be collected using different standards, criteria, and methods. Thus, the data would not be comparable from creditor to creditor. At the same time, the Board revised the general prohibition on data collection to permit creditors to collect information about non-mortgage credit applicants' personal characteristics for the purpose of conducting a self-test in accordance with ECOA's self-test privilege.[1] Some industry commenters indicated that creditors likely would not collect applicant characteristic data voluntarily unless they could take advantage of the self-test privilege.

B. Fair Lending Enforcement for Non-Mortgage Loans

The Board has a rigorous fair lending enforcement program that includes non-mortgage lending. This is consistent with the Board's longstanding commitment to ensuring that every bank it supervises complies fully with the federal fair lending laws (ECOA and the Fair Housing Act). Fair lending is an integral part of every consumer compliance examination. Following the Interagency Fair Lending Examination Procedures, each fair lending examination includes an assessment of the bank's fair lending risk across all types of lending, such as mortgage, consumer, auto, and business lending. Based on this assessment of risk, examiners identify specific business lines on which to focus, and in every examination they evaluate in detail at least one product or class of products.

When examiners find fair lending violations, the Board takes appropriate supervisory action. If there is reason to believe that an institution has engaged in a pattern or practice of discrimination under certain provisions of ECOA, the Board, like the other federal banking agencies, has a statutory obligation to refer the matter to the Department of Justice (DOJ).[2]

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[1] Congress added the self-test privilege to ECOA in 1996 as a way to encourage creditors to assess voluntarily the level or effectiveness of their compliance with ECOA and Regulation B. A self-test is a program, practice, or study designed and used by the creditor specifically to determine compliance with ECOA. A report or result of the self-test is privileged and may not be obtained or used in an examination or investigation, or in any proceeding or lawsuit alleging a violation of ECOA or Regulation B.

[2] After receiving an agency referral, DOJ reviews the matter and decides if further investigation is warranted. A DOJ investigation may result in a public civil enforcement action or settlement. DOJ may decide instead to return the matter to the Board for administrative enforcement. If a matter is returned to the Board for administrative enforcement, the Federal Reserve ensures that the bank corrects the problems and makes amends to the victims.

During the first six months of 2008, the Board referred two institutions to DOJ after concluding that there was reason to believe that the institutions had engaged in a pattern or practice of discrimination. Both referrals involved marital status discrimination in non-mortgage lending. One referral involved illegal spousal guarantees in commercial and agricultural lending. The other referral involved illegal spousal signature practices in automobile lending.

In 2007, the Board referred eight institutions to DOJ. Five of these eight matters involved non-mortgage lending, including auto, commercial, agricultural and consumer lending. One non-mortgage referral involved racial discrimination in the pricing of automobile loans. The institution purchased loans in which auto dealers had charged higher interest rates, through the use of mark-ups, based upon the race of the borrowers. This pricing was permitted by the institution, which received a share of the mark-ups. Four non-mortgage referrals involved marital status discrimination in agricultural, business, and consumer loans.

In 2006, the Board referred four institutions to DOJ. Three of these four referrals involved non-mortgage lending--two non-mortgage referrals involved marital status discrimination in auto loan pricing and one involved age discrimination in consumer lending.[3] The Board referred a total of five matters to DOJ in 2004 and 2005, four of which involved marital status discrimination in auto and commercial lending. As these referrals demonstrate, the Board has a strong fair lending enforcement program for non-mortgage lending.

To test for discrimination, Federal Reserve examiners use statistical techniques, where appropriate, and review information in loan files. When testing for discrimination in mortgage lending, examiners analyze data collected under HMDA to determine the race, ethnicity, and sex of the applicant or borrower. In non-mortgage lending, where lenders do not collect data about

[3] ECOA generally prohibits creditors from considering age when evaluating creditworthiness, except that a creditor may consider the age of an applicant 62 years or older in the applicant's favor.

race, ethnicity or sex, examiners may use proxies, such as names or census tract demographic data, to ascertain this information.

In both mortgage and non-mortgage lending, examiners regularly test for redlining by comparing lending patterns between minority and non-minority neighborhoods. Examiners then determine if a lender is treating neighborhoods differently based on the race or ethnicity of their residents.

C. The Collection of Applicant Characteristic Data for Non-Mortgage Loans

There are four possible approaches to the collection of applicant characteristic data: a general prohibition on data collection; voluntary data collection; mandatory data collection without public disclosure; and mandatory data collection with public disclosure. I will discuss each of these approaches, and then address specific issues related to data collection for small business loans.

1. Four Approaches to Data Collection

A general prohibition on collecting applicant characteristic data is the approach followed in Regulation B for non-mortgage loans. For credit that typically is granted using automated underwriting systems and without face-to-face contact between the creditor and the consumer, such as credit cards, this approach seems clearly appropriate. There do not appear to be widespread fair lending concerns with regard to credit cards that might indicate a need for the collection of applicant characteristic data.

Voluntary collection of applicant characteristic data is the approach considered, but rejected, by the Board in 2003. As discussed previously, voluntary data collection would not be effective or desirable because it would not produce reliable or useful market-wide data. Therefore, voluntary data collection does not appear to be a useful approach.

Mandatory collection of applicant characteristic data without public disclosure is the approach that the Board adopted under Regulation B in 1977 for mortgage loans to obtain information for monitoring purposes. This approach can provide supervisory agencies that regularly examine creditors for fair lending compliance with additional data that can be useful in identifying possible discriminatory practices. However, many creditors, such as non-bank finance companies and auto dealers, are not subject to regular examinations for fair lending compliance. Thus, data collection without public disclosure may not enhance fair lending enforcement against creditors that are not subject to routine oversight.

Moreover, a requirement to collect applicant characteristic data for non-mortgage loans would impose costs on creditors. These costs must be weighed against the benefits of collecting these data. Depending upon the complexity of the products for which data must be collected and the nature and scope of the data that must be collected to identify potential discrimination, these costs could be significant and could outweigh the benefits of requiring collection.

Mandatory collection of borrower and applicant characteristic data with public disclosure is the approach used under HMDA. Public disclosure can provide heightened scrutiny of lender practices by entities other than enforcement agencies. It may be that the availability of HMDA data has led some mortgage lenders to review their loan decisions more carefully to ensure compliance with fair lending laws. The transparency provided by the 1989 amendments to HMDA, which required mandatory data collection, reporting, and public disclosure of borrower, applicant, and loan data, has been viewed by some to have reduced discrimination in mortgage lending more so than the requirement in Regulation B to collect applicant characteristic data for mortgage loans. It would be impossible to validate or refute that argument statistically, however.

Although such an approach would provide greater transparency than mandatory collection alone, it also raises significant policy choices and cost-benefit considerations that Congress should make. A fundamental question is the proper scope of any mandatory collection, reporting, and public disclosure requirement for non-mortgage loans. Congress is in the best position to decide whether such a requirement should apply to all non-mortgage loans, or some subset of those loans.

Another key issue is whether the benefits of mandating data collection and public disclosure for some or all non-mortgage loans outweigh the costs. It is questionable whether any data collection, reporting, and public disclosure requirement can be designed to conclusively show the existence of discrimination. The usefulness of a system that could identify possible discriminatory practices without conclusively proving discrimination, and justification of the costs of implementing such a system, are policy judgments for Congress to make. In summary, we believe Congress is in the best position to make the policy and cost-benefit determinations discussed above, just as Congress did when it amended HMDA in 1989 to require the collection and disclosure of borrower and applicant characteristic data for mortgages.

2. Data Collection Issues Related to Small Business Lending

Small businesses are an integral part of the U.S. economy. Ensuring equal access to small business credit for all qualified business applicants is critical to the welfare of local communities and the economy as a whole.

Small business lending, however, is more complex than mortgage lending and varies across lenders much more than mortgage lending. There are many different types of small business lending, including credit lines, business credit cards, vehicle and equipment loans, mortgages, capital leases, and trade credit. There are also many different types of small business lenders, including banks, credit card companies, finance companies, and trade creditors. Small businesses in one industry may have very different credit needs than small businesses in other industries. Small business loans may be secured or unsecured, or may be supported by the personal guarantee of the owner or owners of the business.

Many different types of data about business attributes and underwriting standards would have to be collected about small businesses and their owners in order to identify potential discrimination in small business lending. When evaluating small business loan applications, lenders may consider a variety of different factors about the business and its owners. Relevant factors may include: the age or longevity of the business; the track record of the business in terms of sales growth and profitability; the size of the business as measured by employment, sales, and assets; the industry in which the business operates and the risk of lending to businesses in that industry; the experience of the owners of the business; and the personal creditworthiness of the owners of the business. Therefore, it would likely be more difficult to capture the appropriate underwriting-related or pricing-related variables for small business lending than for mortgage lending.

Younger and smaller businesses generally are considered more risky than larger, more established businesses. Younger firms, for example, may have difficulty borrowing from lenders that require prospective borrowers to provide several years of financial statements with their loan applications. Similarly, certain types of businesses, such as restaurants, generally are considered more risky than businesses engaged in other industries.

Given the complexity of small business lending and the various factors evaluated in making loans to small businesses, it would be challenging to design a system for collecting, reporting, and publicly disclosing the personal characteristics of small business owners and other relevant information that would be useful for identifying possible discriminatory practices in small business lending. In addition, the costs to industry for implementing such a system could be quite significant.

Conclusion

The Board is committed to addressing racial and ethnic gaps in the availability and affordability of credit. The availability of HMDA data has provided transparency in the mortgage market and spurred efforts to address racial and ethnic disparities. A similar requirement to collect, report, and publicly disclose race, ethnicity, and sex data for other types of lending, such as small business and auto lending, could possibly enhance fair lending enforcement. However, such a requirement would be challenging to implement, especially given the complexity of small business lending, and could impose significant costs on lenders. Just as Congress required the collection, reporting, and public disclosure of applicant characteristic data in HMDA for mortgage loans, we believe that a decision about establishing a comparable collection, reporting, and public disclosure requirement for non-mortgage loans is also a decision for Congress to make.

Testimony of Ken S. Cavalluzzo,
Research Analyst, Wisconsin Capital Management

Before the House Financial Services Committee, Subcommittee on Oversight & Investigations

"GAO Report on Regulation B: Should Lenders Be Required to Collect Race and Gender Data of Borrowers for All Loans?"

Thursday, July 17, 2008

Introduction

Mr. Chairman, Ranking Member Miller, and other distinguished members of the Oversight and Investigations Subcommittee of the House Financial Services Committee, I want to thank you for giving me the opportunity today to speak about the credit market experiences of minority and female owned small businesses, and on whether lenders should be required to collect race and gender data of borrowers for all loans.

My testimony today is based on work I started as a graduate student at the Wharton School of the University of Pennsylvania where I received my doctorate in managerial accounting, and continued while on the faculty of Georgetown University's McDonough School of Business. My research was conducted in collaboration with Dr. Linda C. Cavalluzzo, senior economist at CNA, a non-profit research and analysis corporation headquartered in Alexandria VA, and Dr. John D. Wolken, senior economist at the Board of Governors of the Federal Reserve. Our research on this topic has been published in leading peer-reviewed academic journals sponsored by the University of Chicago and Ohio State University. I am currently a research analyst at Wisconsin Capital Management, an investment firm located in Madison Wisconsin.

Our research examines several different dimensions of the credit market experiences of female and minority owned small businesses. The common finding across all our work is that Black owned firms are denied credit at higher rates than White owned firms. The differences persist even after controlling for firm and owner traits that are relevant to loan-making decisions and reported in the data collected in special surveys of small businesses conducted for the Board of Governors of the Federal Reserve. The differences are economically meaningful and statistically significant. We also find evidence that Black, Hispanic and Asian owned firms have expressed unmet credit needs relative to firms owned by White males. Again, the differences are economically meaningful and statistically significant.

We found no evidence of differences in average acceptance rates or interest rates for female-owned firms.

My testimony is organized as follows:

First I will provide a discussion of our research, the data sets employed, and a summary of main findings. Second I will discuss some of the limitations to the research. Primarily, the data come from the borrower rather than from the lender. Although borrower data have their strengths, because respondents may not remember well, borrower data are generally considered weaker than data contained on actual loan applications for examining the accept/reject decision. I believe the limitations, together with the differences we document on credit access among demographic groups, strongly point to the need to collect both borrower and lender data. I will discuss some of the benefits to lender data. I will conclude with direct responses to the questions provided me by your staff.

Our Research on the Credit Market Experiences of Small Business Loans Across Demographic Groups

We examine some of the factors influencing observed differences in the credit market experiences of small businesses across demographic groups. Such differences can occur at many stages of the lending process. We analyze credit applications, loan denials, and interest rates paid. In addition, we examine data gathered from small business owners who said they did not apply for credit because they believed that their application would have been turned down. We also provide a quantitative assessment of the impact of differences in key variables in the lending decision on the differences in denial rates across demographic groups.

Why might we observe differences?

Observed differences in credit market access or cost among demographic groups may arise if the financial characteristics of the firm or its owners, or other risk factors, are associated with the demographic groups to which they belong. If this is the case, looking at differences in the average loan experiences of members of different demographic groups without taking these factors into account will give a misleading picture of how demographic membership affects credit market experiences. However, even after taking these factors into account, differences across demographic groups may remain. Let me give you several scenarios in which this may occur.

In the first case, economically important factors that *are used* by lenders in the loan-granting or rate-setting process are associated with demographic group, but *are not* incorporated into the researcher's analysis. This could occur if the relevant data are not collected and therefore are not available to the researcher. In this case, the estimated differences among the demographic groups will include the effects of these omitted factors and misrepresent the effects of demographic group on credit market differences. In effect, because of a lack of access to all of the relevant data, the researcher paints an inaccurate portrait of what is happening in the market place.

Here is a second scenario: differences could arise from variation in preferences for credit use, or the propensity to apply for credit, on the part of the borrower. For example, if some groups are more likely to turn to families for credit, rather than financial institutions, then reported results could misrepresent the denial rates that would have been observed if both groups relied on financial institutions equally. For this reason, it is important to think about the application process and in particular, whether some groups might not apply for credit for fear of being turned down.

In a third scenario, the *lenders themselves* may be unable to observe, or find it costly to collect, economically relevant information that is associated with demographic group. If lenders use demographic attributes as a substitute for that missing information, then the resulting disparate treatment has an economic basis. Economists call this form of disparate treatment statistical discrimination.

Finally, differences may also arise because of prejudicial behavior on the part of the lender. This difference is commonly referred to as noneconomic or prejudicial discrimination. I note that both statistical and prejudicial discrimination in lending are illegal under the Equal Credit Opportunity Act of 1974.

The data:

Each of our papers uses a different release from the Federal Reserve's Survey of Small Business Finance (SSBF) data series. The data were collected during three different time periods, 1988-1989, 1993-1994, and 1998-1999. Observations and variables collected varied by data set, with larger minority representation in the 1993 and 1998 data sets. In the interest of simplicity, I will focus my discussion around the 1993 data set. Most of my comments pertain to all three data sets.

The 1993 SSBF data set is among the most extensive public data sets available on small businesses. These data, collected via telephone interviews by the Federal Reserve and the Small Business Administration, are intended to provide national representation on the financing experiences of small businesses in operation in the United States during 1993 and 1994. Minority groups were oversampled in order to provide for more powerful tests specifically concerning the credit market experiences of minority owned small businesses. Our sample consists of 4,570 small businesses in operation as of 1993 and includes 1,025 minority owned businesses (431 Black, 301 Hispanic, and 303 Asian) 816 businesses owned by females, and 2,951 firms owned by White males.

We supplement the SSBF data with information furnished by the Federal Reserve on local bank market structure and Dun & Bradstreet firm credit (risk) scores. An important feature of the data set is that it includes firms that do not use credit markets. These data allow us to test for differences in application rates, and to investigate whether some small business owners who would have applied for credit did not because they thought that their application would be rejected.

The dataset provides rich information on the characteristics of firms and owners including information on the firm's age, geographic location, level of employment, industrial codes, ownership and management characteristics, capital structure, income statement, and balance sheet. In addition, the dataset contains important information on the credit history of the owner, characteristics of the applicant, and costs of the loan, such as the amount of money requested on the loan application, points and or fees paid to obtain the loan. Self-reported information pertaining to the credit history of the borrower include the frequency with which the owner reported delinquencies on personal and or business obligations, whether there were any legal judgments against the firm, whether the owner declared bankruptcy on any business within the past seven years, and whether the firm had been denied trade credit.

The dataset also includes key information on credit access and costs, as well as beliefs about the ability to obtain credit. These include whether the firm applied for a loan in the last three years, whether and why the owner believed that his loan request would have been rejected, the terms of the most recent loan the business received, and whether the firm was denied funding, both for the most recent loan application and for any application within the last three years of the interview date.

As should be clear, the data are extremely rich and provide extensive information on the firm and its risk characteristics. In each of the analyses, we investigate the importance of the financial characteristics of the firm, the characteristics of the principal owner (e.g., owner education and years of work experience), self-reported information on firm and owner credit history, a credit score constructed by Dun & Bradstreet, and information regarding a firm's relationships with financial institutions and suppliers.

In his 1957 book, *The Economics of Discrimination,* Nobel Laureate Gary Becker argued that highly competitive markets would purge prejudicial discrimination from the marketplace. In less competitive markets, however, prejudicial behavior could be sustained in the long term. We take advantage of this insight in the analysis by investigating whether observed differences in credit market experiences varied with the extent of competition among commercial lenders in the firm's local geographic area. The level of competition in banking markets is of particular interest because small businesses tend to borrow locally rather than nationally.

Findings:

The results indicate that Black owned small businesses are denied credit at economically meaningful and statistically different rates than White owned firms. This result is persistent and robust. The result obtains using both the 1993 and 1998 data sets, and in a combined Black-Hispanic variable using the 1989 data set. There is some evidence that the differences increase with lender market concentration. Although the magnitudes vary by the model employed, in general, Black owned firms are denied credit at almost twice the rate of White owned firms, after controlling for risk and other characteristics of the firm and owner. This result is corroborated by other papers that analyze the SSBF data sets (Blanchflower et al. 2003). Similar findings that Black owned businesses have less access to credit than White owned firms is also found by Faith Ando (1988) and Timothy Bates (1997), among others.

We found mixed evidence that Hispanic and Asian owned firms were denied credit at a greater rate than White owned firms. Using the 1998 data set, both Hispanics and Asians were denied credit at significantly higher rates than Whites, as were Hispanics in a combined Black and Hispanic variable using the 1989 data. Yet there were no differences in denial rates between Hispanics and White males using the 1993 data, and only some evidence of differences between Asians and Whites in those data. In contrast, essentially all average differences in denial rates between female and male owned firms are explained by the controls in our analyses.

In an analysis of application avoidance, we found that both Blacks and Hispanics were significantly more likely not to have applied for credit for fear of being turned down. Point estimates indicate that Black owners were about 37% more likely, and Hispanic owners were 23% more likely to have avoided applying for credit for fear of being turned down than were white males. There was no such evidence of differences for Asian or female owned firms.

Because of the role of application avoidance, denial rates may understate whether firms are meeting their desired credit needs. In an additional analysis, we estimated models intended to capture a firm's expressed credit needs. We found that Blacks, Hispanics, and Asians, but not females, were significantly more likely to have unmet credit needs than were firms owned by Whites. There was some evidence that unmet credit needs increased with lender concentration for Black and female owned firms.

We found no evidence of differences in average interest rates paid across demographic groups but some evidence that Hispanics paid more with increased lender market concentration.

Limitations of the SSBF Data Sets

Do the observed differences provide proof of discrimination in small business credit markets? Some have argued that although no single paper based on survey data taken on its own could prove discrimination, the totality of the evidence points to discriminatory treatment of Black business owners (Bates, 1999). And this may be. Yet there is an underlying characteristic behind all the papers on nonmortgage lending that I am aware; they are all based on data provided by the borrower, rather than on data provided by the lender. For reasons I will discuss, borrower data alone, while important, still provide an incomplete picture of the credit market experiences of small businesses.

In 2003, about 46 percent of the SSBF survey respondents answered the questions from memory, suggesting measurement error is an obvious concern. While random measurement error would not distort our findings, it does make the statistical tests less efficient. (Statistical inefficiency has the practical effect of increasing the chance that we wrongly conclude there is no discrimination.) To address this concern, we supplemented our data set with Dun & Bradstreet credit scores that should be less susceptible to measurement error, as these data are not self reported.

Because the data are from the borrower, rather than the lender, we cannot exactly replicate the lenders' underwriting model. Underwriting models and standards clearly vary across banks, adding a further wrinkle to the analysis. And omitted variables are a concern. For example, it is widely known that personal wealth is both important for obtaining small business loans (personal wealth could be put up as collateral for the loan) and associated with demographic group (Whites on average tend to be wealthier than other demographic groups). Thus an analysis that found higher denial rates for minorities than Whites and did not include information on personal wealth could be misleading if personal wealth would have explained those remaining differences. In my 1998 and 2002 papers, we did not have data on the personal wealth of the owner. In my 2005 paper, we did have that information and included it in our models. Despite personal wealth being important in the decision to extend credit, and that personal wealth varied across demographic groups, large differences in denial rates remained even after including personal wealth in the analysis. A potential explanation is that personal wealth was associated with other characteristics that were already included in the analysis. In other words, for omitted variables to lead to misleading conclusions they would need to 1) be associated with the demographic group, 2) be important to the decision to extend credit, and 3) provide additional information above and beyond those variables already included in the analysis.

Another limitation to the SSBF data sets for examining acceptance rates is that they do not provide a snapshot of the firm at the time of the loan application, but rather at the time of the survey, or for some data variables at the firm's most recent fiscal year end. Applicant acceptances are best investigated by studying business traits at the point when the loan application is submitted, or at the time of the accept/reject decision. One consequence of this trait is that the SSBF data mix loan proceeds into business traits recorded from successful loan applicants. In other words, SSBF could potentially combine an application acceptance that was three years old along with balance sheet information from the firm's most recent fiscal year. While we made some modifications to the data when possible, such as adjusting the firm's length of relationship with the lender based on the application date, we did not have adequate data to adjust all variables.

The SSBF data are not particularly helpful for guiding regulators towards efficient enforcement of fair lending laws. This is because the SSBF data cannot be used to compare lending across lenders. The sample size is too small. The overall sample is only 4,000 or so firms and few of these firms obtained loans from the same lender in the same location.

All of these limitations make it difficult to definitively prove discrimination with these data alone.

Strengths of Lender Data

Lender data could mitigate measurement error and could potentially help to address the omitted variables problem. The timing of the data would be at the application or approval stage and in the ideal, would replicate all the information on the loan application for each individual lender in each market. If such detailed data were made available to the public, the researcher could potentially replicate the underwriting models lenders use in their decision process.

But we are not talking here today about application data – rather we are talking about the personal characteristics of the applicant. And even if application data were made available, lender data alone still would not provide a complete picture of the credit market experiences of minority and female owned small businesses. Lender data would have nothing to say about the firms that are not applying for credit for fear of being turned down and would be of only limited usefulness for understanding the totality of unmet credit needs. Based on experiences with data disclosure required by the Home Mortgage Discloser Act of 1975 (HMDA), far from a complete set of relevant data would be collected and made accessible to the researcher (although it is getting better). The researcher probably wouldn't have the ability to validate data reported by the applicant either.

Yet despite the limitations, I think we could potentially learn a lot from lender data. Indeed, I believe that both borrower and lender data are important for understanding how small businesses fare in credit markets. In this regard, I am especially disappointed that the Federal Reserve has decided to discontinue its Survey of Small Business Finances.

Should personal characteristic data be collected on applicants for and borrowers of nonmortgage credit?

My understanding is that collection of personal characteristic data on applicants for nonmortgage credit amounts to including a spot on the loan application to indicate whether the applicant is minority or female owned. In this case, I believe that personal characteristic data should be collected on applicants for and borrowers of nonmortgage credit. I do not believe that collecting such data would be particularly onerous or costly to lending institutions. Here are some issues to consider:

I do not believe that such collection would materially heighten the likelihood of discrimination. According to the 2003 SSBF data, 78 percent of small business loans are on a face to face basis (66 percent of applicants initially go in person; another 12 percent eventually go in person). Additionally, small business lending tends to be relationship based. This means that the lender and small business owner often work together to create a profitable banking relationship for both the borrower and lender. So the opportunity to discriminate on personal characteristics already exists even in the absence of collection of such data.

Collecting personal characteristic data would likely benefit regulators for the enforcement of fair lending laws. In the absence of such data, regulators have little to guide them for investigating discrimination beyond complaints from borrowers. Such data could provide a useful screening device to help regulators focus their resources on the those areas most likely to benefit from greater scrutiny. In the absence of such data, regulators likely have to resort to audit studies and use testers to investigate lenders that they believe may be engaging in discriminatory practices. Such alternative techniques tend to be a very expensive means to investigate potential discrimination.

Collecting personal characteristic data would benefit lenders who do not discriminate. If claims of discrimination were made against a lender that did not discriminate, the lender would have easy access to readily available data to support its defense.

Availability of personal characteristic data could potentially benefit borrowers as well. We find that minority owned businesses are far more likely not to apply for credit for fear of being turned down. Collection of such data may help to mitigate these fears if applicants believe there are procedures in place to address concerns regarding potential discrimination. Collection of personal characteristic data may lend credibility to those beliefs. Yet I note that the potential benefits to customers are not as clear cut as they may seem. Less than one percent of applicants said that they feared being turn down because of discrimination. And some applicants may not like being asked about their race, gender, or ethnicity potentially fearing the data may be used against them.

Collection of personal characteristic data is relatively more complicated for small business loans than it is for home mortgages. Small business lending tends to be far more complicated than mortgage lending. The types of loans small businesses take out vary widely (revolving lines, auto loans, equipment loans, etc.) Small businesses often have multiple owners too. Houses can have multiple owners too. My point is only that standards need to be set and care needs to be taken when collecting the data.

Despite the difficulties associated with the collection process, I believe collection is an important step towards ensuring equal treatment of lending to minority and female owned small businesses.

Notwithstanding the limitations to my and others' research, differences in acceptance rates across demographic groups, and in particular for Black owned firms, is not a controversial result. The controversy is over why these differences persist. Yet the differences we and other researchers document can have great social importance even if we cannot definitively pinpoint their cause. If Black and other minority owned firms have less access to financing than White owned firms with similar risk characteristics, this may concern us as a society irrespective of the reason (Avery, 1999). I also strongly believe that without data on the personal characteristics and risk characteristics of the borrowers, we cannot learn much about how minority and female owned firms fare in credit markets.

What types of nonmortgage loans should be included if personal characteristic data is collected (e.g., small business loans, automobile loans, or other categories)?

I would encourage the collection of personal characteristics data on small business loans. My work establishes economically meaningful and statistically significant differences between Black and White acceptance rates on small business loans. Small businesses represent an important engine of growth for the U.S. economy. Small businesses are enormously dependent on financial institutions for financing as financial institutions account for the vast majority of debt financing flowing to small firms. Successful small businesses have been shown to create jobs, reduce local crime rates, raise living standards, and support charities among other things that benefit the entire local community.

The types of loans in the SSBF sample include automobile loans, equipment loans, mortgages used for business purposes, capital leases, term loans and lines of credit, but not credit cards. While it probably makes sense to collect data for a fairly broad set of loan types, care here needs to be taken as well. For example, it is my understanding that a high percentage of auto loans are made at the dealer, and the underwriter never meets the applicant. Assuming the concern is discriminatory practices on the part of the underwriter, I see no obvious value to collecting personal characteristic data in this case.

I do not have expertise on the other loan products asked about.

Should the collection of data be mandatory or voluntary?

My understanding is that under Regulation B, data collection on personal characteristics is allowed on a voluntary basis only in the context of a self test. I am told that few lending institutions actually run self tests. I would not expect many lenders to expand collection activities if a broader voluntary process were permissible.

While I would not expect many lenders to participate in voluntary collection, data from those lenders that did participate would likely be of only minimal value. Standards for collection would need to be set, else comparability of the data across lending institutions would be difficult. I would expect the lenders that report such data to be the least likely to engage in discrimination.

Should personal characteristic data be collected by the lenders and publicly reported, collected but not publicly reported, or collected but only reported to the appropriate federal banking regulator?

I note that data reporting is a more expensive activity than data collection. Additional costs include (among other things) expenses associated with information system integration and software development, data storage and verification, and employee training. Any such additional costs could be partially passed on to borrowers. Such costs may be limited for some banks as some lenders may already codify and transfer detailed information on loan applications to organizations like Fair Isaac where those data are used to develop, estimate and refine their credit scoring models so that loan approval and pricing decisions can be made. Of course, such costs must be weighed against societal costs to discrimination, such as increased crime rates and lower living standards (among other costs) that are very difficult to measure.

Bank management should want to know if their loan officers are engaging in prejudicial discrimination. Not only is such behavior illegal, it also reduces profits, as such loan officers would be turning down profitable loans. Thus, while costs of compliance obviously do exist, a thorough treatment of the costs would consider any offsetting benefits to society and lender profitability.

The collecting and reporting of personal characteristics would likely be useful to regulators. Regulators could use the information to guide them towards those lenders that appear most likely to be engaging in discriminatory practices.

One important caveat: I view the collection and reporting of personal characteristics on small business loan data to the public without reporting corresponding information on other firm and owner risk characteristics as a fairly meaningless and potentially dangerous exercise. Publicly disclosing personal characteristics of loan applicants without disclosing corresponding risk attributes could unfairly characterize some banks and indeed the entire lending industry as engaging in wide spread discrimination. Discrimination is an important and socially charged issue. False claims of discrimination help none of the parties involved. I think a serious injustice could be done by publicly reporting differences that have the potential to be interpreted as wide spread discrimination when in fact, discrimination may account for little, if any, of the observed differences.

Given the importance of financial institutions to the funding of small businesses, the important role small businesses play in the U.S. economy, and the wide differences in acceptance rates found between Black and White owned small businesses in the extant literature, I would like to encourage Congress to investigate the costs and benefits to mandating that all relevant information to the application and pricing decision be made public. In this spirit, Congress may also want to revisit the Federal Reserve Board's decision to discontinue the SSBF data series. Markets would function better if applicants knew the information that went into the underwriting decision. Regulators could regulate better. Borrowers could become better borrowers. Lenders would probably become better lenders. Obviously reporting data is more costly than simply collecting data, yet given the advancements and technological developments for data gathering, reporting and analyzing, historically it has never been cheaper.

Finally I would like to conclude with a passage from Bates (1999, page 268): "survey data will never give us perfect data, nor will prevailing research methodology permit all interested parties to reach complete agreement on the precise nature and magnitude of Black/White credit access issues. Disagreement will remain, but that is not important. What *is* important is that sufficient evidence of differential Black/White access to borrowing exists so that we can all agree upon the necessity of pinning down the nature of the processes that are producing this result. Those who would choose to ignore the prevailing evidence, dismissing discrimination because it is 'unproven,' are choosing to sanction profoundly unequal outcomes in small business credit availability. Ignoring the issue is no longer a reasonable option for a society committed to open, fair access to opportunities."

I believe that both borrower and lender data could go a long way towards understanding and perhaps improving many of the issues surrounding differences in the availability of credit to minority and white owned small businesses.

I appreciate the opportunity to testify, and I look forward to any additional questions you may have.

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Testimony before the House Financial Services Committee on Reg B
July 17, 2008
By Jorge C. Corralejo, Chairman of the Board
Latino Business Chamber of Greater Los Angeles

Testimony

Thank you, Mr. Chairman, and members of the Financial Services Committee, for inviting me, to participate in this very important hearing today. I sit here on behalf of the Latino Business Chamber of Greater Los Angeles. This chamber does its best to represent the interests of over 200,000 Latino owned businesses in the Los Angeles area and also the interests of tens of thousands more statewide, and hundreds of thousands, nationally.

Because of the dramatic growth of ethnic minority populations, and their businesses as well, lenders must, and are, taking a different and more realistic look at their future business client base. For example, over 50% of the state of California's population is ethnic minority. Their rate of growth in the development of small business is higher than the national average. In our (Latino) community alone, the small business growth rate is three times the national rate. In our many discussions with bankers, they are very often at a loss as to how to approach many minority business communities.

Through our various "Reg B" policy discussions with other minority business chambers, we have universally agreed upon the need for the collection and review of data by race, ethnicity, and gender as a benefit to all parties. This advantage would clearly be exercised by lenders in their marketing efforts to penetrate new and emerging ethnic communities. Information of this type (HMDA) has greatly increased the number of home loans to minority communities. It is our expectation that the numbers of loans to small businesses would increase several fold with this policy change. The economic contributions and growth in our communities would be substantial. In the minds of Latino business owners, the collection of this data makes very good business sense.

Minority small businesses heavily depend upon home equity funds for small business start-up and/or expansion. A major question in the small business arena is "How great of an impact will the foreclosure crisis have on the small business community, and, in this case, minority small business communities"? Lenders need to know how this crisis impacts the future for small business clients and their ability to obtain small business loans in the future. The compilation of the data that we are requesting is an important component required towards the progress of a whole picture on the national economy.

A key instrument to this policy alteration is the immediate appointment of a "Task Force" which would resolve the foremost details and the potential costs. This group should include all relevant government regulators, lenders, and minority small business leaders and associations. The dialogue and strategies that will transpire from these meetings will not only bring resolutions to the data collection policy, but, inadvertently address other common economic development issues as well.

I sit here today representing hundreds of thousands of Latino businesses in their support for legislation requiring the mandatory reporting of small business by race, ethnicity, and gender by lending institutions with 1 billion or more in assets. We further support legislation that would permit all lenders with the opportunity to voluntarily report on this same data, prior to the date for mandatory reporting.

Thank you.

Federal Reserve Transparency Could Stimulate the Economy and Help Expand Minority and Women-owned Business Opportunities

Testimony before the House Financial Services Committee on Reg B

July 17th, 2008

By: Robert Gnaizda, General Counsel

The Greenlining Institute

Testimony:

Fifteen years ago Greenlining Institute met with Federal Reserve Chairman Alan Greenspan to urge revisions of Reg B in order to track small business loans to minorities and women. On behalf of the U.S. Hispanic Chamber of Commerce, the California Black Chamber of Commerce, the Council of Asian American Business Associations of California, and the dozen other minority business associations that are part of the Greenlining Institute, we applaud this committee for these hearings.[1]

Greenlining does not believe that most of the major banks deliberately discriminate anymore regarding loans to minority and women-owned businesses. However, the present lack of transparency and the present blanket prohibition on financial institutions gathering and publishing data on their lending practices to the five million minority-owned businesses and eight million women-owned businesses specifically interferes with the free market right of banks to seek greater market opportunities among the two fastest growing segments of our national small business community. It is also possible that the present prohibition has caused <u>inadvertent</u> discrimination by some banks. But this will not be fully known until banks can compare their data with each other and federal banking regulators, Congress and minority business groups can review such data.

We strongly believe that given no other variables, except perhaps, where national security is involved, that transparency is essential. It is particularly essential in the area of small business lending since the vast majority of new jobs and expansion of businesses within the United States, including employment opportunities, are being created by our nation's small businesses.[2]

During Greenlining's more than one dozen meetings over the last fifteen years with Federal Reserve Chairmen Alan Greenspan and Ben Bernanke, we have raised the issue that HMDA transparency data has doubled, if not tripled, the number of home loans originated for minorities, and that SBA legislation requires comparable ethnic data for SBA guaranteed small business loans.

Both Federal Reserve Chairmen have strongly supported regulatory actions based upon comprehensive information. The gathering of small business data by race, ethnicity and gender is fully consistent with this desire and practice.

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[1] The Greenlining Institute is a national public policy and advocacy center that was originally formed to oppose redlining. Today its main goal is to encourage greenlining by promoting more lending, investments, philanthropy and other business opportunities in the inner-cities and in the areas of America that are under-served by our nation's regulated financial institutions. Robert Gnaizda is the General Counsel and a founder of Greenlining Institute. Greenlining today works closely with many major banks on many minority oriented programs. These financial institutions include BofA, Wells Fargo, Citigroup, JP Morgan Chase, WaMu, Wachovia, Merrill Lynch, U.S. Bancorp, Comerica Bank, Union Bank and Bank of the West. Greenlining also meets at least annually in D.C. with the Chairman of the Federal Reserve, the Chair of the FDIC, the Comptroller of the Currency and the Director of OTS. Its next *confirmed* meetings with these regulators are in D.C. on November 17th and 18th.

[2] Almost half (45%) of all businesses today are women and/or minority-owned.

Recommendations

Greenlining and the minority business organizations it represents, therefore, strongly support the following legislative actions:

- Mandatory reporting by 2011 for all institutions with one billion dollars or more in assets or making 500 or more small business loans a year.
- Voluntary reporting by all financial institutions as of the time legislation takes effect and applicable to *all* financial institutions.

In order to minimize the cost (and Greenlining disputes financial institutions' estimates of cost) and to reduce the complexity of the reporting, we urge that a Joint Task Force be formed by this September. It should include the Federal Reserve, OCC, FDIC, OTS, the top ten small business lenders by volume and the leadership from the African American, Latino and Asian American business and community groups.

This task force should develop by January of 2009 a common metric that will provide crucial information in a fashion that minimizes costs and complexity and maximizes the value of the information gathered. This could enable all financial institutions, assuming legislation is passed in 2009, to immediately begin to gather on a voluntary basis (and using a common metric) information that will allow them to immediately stimulate the economy by effectively marketing to our nations 13 million women and minority-owned businesses.

Presumably, this voluntary gathering of data will also be helpful for the Federal Reserve and other regulators in modifying the common metrics for reporting prior to mandatory reporting going into effect in 2011.

Absence of Data

Due to the restrictions on the gathering of data by race, ethnicity and gender for small business loans, there is no reliable data. However, Greenlining wishes to offer a parallel world where data is gathered that may be useful. Nationally, just one percent of contracts by Fortune 500 corporations are awarded to African American, Latino or Asian American businesses. Corporations that have wished to take advantage of minority and women-owned business opportunities, however, have far exceeded these numbers since they are not barred by regulation from gathering such data or marketing to such entities. For example, BofA, Wells Fargo and Union Bank award more than 15% of their contracts to minority and women-owned businesses, or five times the national average. It is likely that some financial institutions will achieve comparable exemplary results once freed of the "tyranny" of Reg B.

Today, Greenlining is aware of just one major financial institution that has, in effect, sidestepped the Federal Reserve's philosophy that "ignorance is bliss."

At the urging of minority business organizations represented by Greenlining, Wells Fargo's CEO established multi-billion dollar small business lending goals for women, African American, Latino and Asian American-owned businesses. For three of these four market segments, Wells Fargo has exceeded its multi-billion dollar goals. And in the case of Asian Americans, Wells Fargo is well on the way to exceeding its goal.

In the past, financial institutions have resisted CRA and resisted data collection for home lending and SBA lending. It is Greenlining's expectation that corporations hungry for additional data that will allow them to expand their domestic markets, will overwhelmingly support these suggestions. Should they do so in a cooperative partnership mode with regulators and small business groups, they can avoid or minimize what they allege to be the unnecessary costs and inefficiencies in data gathering.

In conclusion, we thank you Mr. Chairman and members of this committee for securing the GAO study. We pledge our full cooperation with all of the regulators and major financial institutions in helping stimulate our domestic economy through responsible and transparent lending for women and minority-owned businesses.

Testimony of Bill Himpler
for the
American Financial Services Association

Before The Subcommittee on Oversight and Investigations of
The House of Representatives Financial Services Committee

Fair Lending – Race and Gender Data in Nonmortgage Lending

July 17, 2008

Good morning, Chairman Watt, Ranking Member Miller and Members of the Subcommittee. My name is Bill Himpler and I am Executive Vice President for Federal Affairs at the American Financial Services Association. AFSA's 350 members include consumer and commercial finance companies, auto finance companies, card issuers, mortgage lenders, industrial banks and other firms that lend to consumers and small businesses.

Mr. Chairman, I commend you and your colleagues for holding this hearing. We recognize the importance of ensuring that all persons have equal access to credit and are committed to eliminating discrimination in lending. We believe that the Equal Credit Opportunity Act and Regulation B contain the necessary restrictions and enforcement tools to end discrimination, and we do not believe that access to affordable credit will be enhanced by requiring non-mortgage creditors to collect race and gender data. To the contrary, imposing data collection obligations may decrease the credit options available or increase the cost of credit for consumers. While both the government and the industry have strived to make the credit application process as colorblind as possible, we believe the proposed requirement being discussed today goes against this goal.

Current Obligations

Regulation B currently prohibits creditors from collecting information about an applicant's personal characteristics, including race and gender, in connection with non-mortgage credit. This prohibition ensures that the decisions in non face-to-face transactions are race neutral. For example, in the indirect finance situation, an auto finance company makes a decision about whether or not to purchase a retail installment sales contract based upon the applicant's creditworthiness, not race. The decision is race neutral because the finance company does not typically have contact with the applicant and, therefore, does not have race information. Similarly, when an applicant applies for a credit card over the telephone, online, or by mail, the creditor will not know the applicant's race or gender. These scenarios differ from the concerns that gave rise to the mandatory collection of race information in the mortgage context, where historically many applications were made in face-to-face transactions.

Little Evidence to Suggest Discrimination

There is scant statistical evidence to demonstrate that race or gender plays a role in access to or the cost of non-mortgage credit. Rather, studies suggest credit scores and related risk factors determine access to and the cost of credit. The Federal Reserve Board conducted a study to determine the relationship between credit scores and actual credit losses and how these relationships vary for groups protected under the Equal Credit Opportunity Act.[1] The Federal Reserve Board concluded that credit scores accurately predict credit risk for the population as a whole and for all major demographic groups. The study revealed that, on average, blacks and Hispanics have lower credit scores than non-Hispanic whites and Asians.[2] This study suggests that if creditors collect data on race, the results would demonstrate a disparity in access to or pricing of credit that would be consistent with credit risk factors and not necessarily any discriminatory conduct by creditors.

Some have raised concerns about discrimination in small business lending. Small business lending presents even more complexities than consumer lending because the credit decision may be based on a multitude of factors. In assessing the risks associated with small business credit, the creditor will consider the size and type of business, as well as the business experience of the owners. In addition, the creditor will often consider each owner's credit history. There may be a mix of ownership that crosses race and gender lines. There is a very real difficulty in classifying the "race" of a small business. Given the various factors at play in small business lending, the collection of race and gender data will not explain access to and cost of credit.

Negative Effects of Data Collection

The findings in the Federal Reserve Board's 2007 study on credit scores lead to the very important question about the value of requiring creditors to collect race and gender data. We believe that there is little value to be gained, especially in light of the significant change in the law that would be required and the massive data collection that would follow.

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[1] Report to Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit, August 2007, p. S-1.
[2] *Id* at S-2.

The Federal Reserve Board has already concluded that the benefits of voluntary collection and reporting of race and gender data would not outweigh the potential harm. In 2003, after an extensive review of approximately 600 comment letters on the issue of whether or not to lift the prohibition on collection of race and gender data on credit applications, the Federal Reserve Board decided to retain the prohibition for two primary reasons. First, collection of data that was not available before could create a risk of discrimination if it was made available. Second, the data, at least voluntarily provided data, would be of questionable reliability.[3]

If voluntary collection is unreliable, then the alternative would be mandatory data collection. From experience with HMDA reporting requirements, we know that collection and reporting requirements require tremendous time and resources. Lenders must collect, compile, organize and clean the data. They must then analyze the data to explain how any perceived discriminatory result relates to creditworthiness factors. Based on the 2007 credit score study, we would expect the data to reveal that minorities, on average, pay more for credit. Thus, there may be little additional information gained. From our experience with HMDA reporting, we also know that a mere correlation between race and pricing, without consideration of detailed creditworthiness factors, cannot tell us whether illegal discrimination has occurred.

Although collecting the data will provide little information, it will cause creditors to incur massive costs. Those costs will inevitably be passed along, at least in part, to consumers at a time when consumers and creditors alike cannot afford increases in credit costs.

Imposing a mandatory data collection requirement should be driven by evidence that there is a lack of access to credit or fairness in pricing based upon discriminatory factors. In the more than thirty years since the enactment of the Equal Credit Opportunity Act, creditors' systems for underwriting and pricing non-mortgage credit has undergone tremendous change. Today, most non-mortgage credit is underwritten and priced by creditors using objective, risk-based credit criteria, without face-to-face interaction or any information regarding the applicant's race or

[3] *See* Supplementary Information on Final Rule amending Regulation B, 68 Fed.Reg. 13144, 13148 (March 18, 2003).

other prohibited characteristics. These race-blind decisioning systems provide the very best assurance that consumers receive credit based on objective, nondiscriminatory criteria. It is hard to imagine that mandatory collection of racial information will improve this system.

Collection and reporting race and gender information also raises serious privacy concerns. Both consumers and their creditors have a vital interest in protecting the privacy of consumers' personal information. Our experience with HMDA reporting has shown that it is sometimes possible, with the addition of other public data, to identify consumers in HMDA loan registers. The collection and reporting of data for non-mortgage credit transactions significantly increases the risk that a consumer's sensitive personal information will enter the public domain. Also, it may be that consumers will object to being asked information about their race and see this as a violation of their privacy.

Recommendations

We believe that the Equal Credit Opportunity Act and Regulation B protect consumers from discriminatory lending practices, and the current prohibition on data collection should be retained. Any possible benefits to collecting these data are outweighed the potential harms and costs. In the current financial market, there would be no substantial benefits to consumers who would share the costs incurred by creditors in such a compliance effort. What's more, we must be careful not to undo the progress that has been made in creating a credit granting system that's race and gender neutral.

Mr. Chairman, we stand ready to work with you as needed. I want to thank you again for inviting me to participate in this important hearing. That concludes my statement and I would be happy to answer any questions.

WIPP Decide
The Voice for In Business
In Our Nation's Capital

1615 L St. NW Suite 650 Washington, DC 20036

Statement of Ms. Ann Sullivan

On Behalf of
Women Impacting Public Policy

Submitted to

U.S. House of Representatives Financial Services Committee
Subcommittee on Oversight and Investigations

"GAO Report on Regulation B: Should Lenders Be Required to Collect Race and Gender Data of Borrowers for All Loans"

July 17, 2008

Chairman Watt and Members of the Subcommittee, thank you for inviting me to testify on access to capital issues that women business owners face. I am here today representing Women Impacting Public Policy (WIPP), a bipartisan organization that represents well over half a million women and minority business owners. WIPP represents both individual women business owners and a coalition of 45 small business organizations. I serve as WIPP's government relations advocate in Washington.

I would like to address two issues today – one, the hurdles women-owned businesses face with respect to access to capital and two, the need for additional data relevant to small women-owned businesses. Let me just say at the outset that it was only 34 years ago, with the passage of the Equal Credit Opportunity Act, that women were able to obtain their own credit in their own name. In 1988, landmark legislation, H.R. 5050, built upon that progress by making business loans subject to the Equal Credit Opportunity Act. This had a tremendous effect on the growth of women-owned businesses, which now total 10.6 million. The Bureau of the Census began counting women-owned businesses in 1972 as a pilot program. The program originally only counted sole proprietorships owned by women. More than a decade later, H.R. 5050 expanded the Census data collection to include counting "C" Corporations owned by women, which meant that the Census began counting women-owned businesses with a more significant revenue stream. This year, the women's business community is celebrating the 20 year passage of H.R. 5050 around the country. Everywhere we go, women business owners attest to the struggles of securing capital and describe stories of difficulty both then and now.

Every year WIPP conducts an annual survey of its membership. In the 2008 Survey, we found that women are using more sources of capital than in the previous 2007 survey and 60% of women business owners continue to seek outside funding for their businesses. Sixty-six percent of the respondents use bank financing backed by home equity loans or other collateralized loans; 49% use credit card financing; 36% get their funding from family and friends; 22% use SBA loans; 10% utilize angel investors and 5% use SBA Microloans. In addition, 63% of those surveyed believe Congress should provide tax incentives to stimulate angel investment in small businesses. Access to capital continues to be a high policy priority for WIPP and the organizations that work with us.

The good news from WIPP's annual survey is that women appear to be making gains in obtaining capital to grow their businesses. But the struggle continues for many women and minority-owned small companies to obtain the growth capital they need. We hear from our members that, although they are able to access capital, their struggle is in securing favorable terms that make business sense. So, if discrimination exists, it is not as blatant as approval or denial, rather it is in the terms offered.

While the problems I am going to mention may not be limited to women-owned businesses only, and may be shared by all small businesses, let me give some examples of issues our members face when trying to secure capital. For early stage businesses, the collateral requirements are high. Unless you have personal property to pledge against the loan, it is very likely that you will not be able to secure financing. Even for more established businesses that are "C" Corporations, banks still require pledges of personal property as collateral. Second, banks will not accept a signed government contract as collateral, which is often the most secure stream of funding the small business has to offer. Third, with regard to the construction business, government agencies can prohibit small businesses from bidding by setting the bonding requirements artificially high. The small business cannot obtain the level of bonding required, so they cannot bid--an easy way to keep small businesses out. Fourth, the ownership terms for venture funding often prohibit women-owned businesses from using that avenue for funding. In the words of one WIPP member who has been exploring venture capital, "getting venture capital is really just selling your business cheaply." Fifth, SBA loan fees have now become a real factor in whether or not our members choose to use them.

With regard to SBA loans, 40% of all long term capital for small businesses is provided through the SBA loan programs. I believe some important changes have taken place in the last four years which have been detrimental to the SBA lending programs. In 2004, Congress stopped subsidizing the rate for small business loans and lowered the guarantee. This resulted in an increase of lender and oversight fees. Those increased fees are, of course, passed onto the borrower. According to the fee information published by the SBA, a $1,000,000 7(a) loan would be charged a 3.5% guaranty, which is charged to the borrower. So for example, the fee on this loan is $35,000. With the combination of high fees and more conservative lending by the banks, it is no wonder that SBA lending is down. The House FY09 Financial Services Appropriations bill included $100 million to subsidize the 7(a) loan guarantee program and reduce lender fees. Unfortunately, this was not included in the Senate's version of the bill. We urge the House to insist on its position with regard to this provision.

The topic of discussion in this hearing is whether lenders should be required to collect race and gender data of borrowers for small business lending. Let me just note, the SBA certainly tracks all of its lending. The lending data is broken down by African American, Hispanic, Asian, Native American, Other Minorities and Women. For example, the number of loans to women in the 7(a) loan program increased by 2% from FY01-FY07. The number of 504 loans given to women decreased 2% since 2001 and Microloans to women dropped from $11 million in FY01 to $9.6 in FY07.

It is our experience that collection of this data is very valuable for policymakers, the SBA and small business groups, such as WIPP, who track lending to their segment of the industry. If the SBA can track its loans, even though they are not direct lenders, it does not seem out of the realm of possibilities that this data could be collected in the same manner and shared with regulators. We recommend this Committee take a look at how SBA collects its data, and perhaps use this as a model for possible expansion of data collection for small business loans.

The data on women-owned businesses and small businesses, in general, is hardly robust. Very few sources of data exist. The U.S. Census Bureau's Statistics of U.S. Businesses produces data by NAICS codes. Every five years, the U.S. Census Bureau conducts an economic census. Typically, the data lags three years behind. The Bureau of Labor Statistics produces employment statistics by firm size. However, studies on small business lending are very limited. The Federal Reserve produces its Survey of Small Business finances (SSBF) every five years. This survey is important to the women's business community and use the SSBF for much of its economic data. The National Women's Business Council, the Center for Women's Business Research, and the SBA Office of Advocacy all use the SSBF for analyses of the state of small, minority and women-owned business financing. WIPP has expressed the importance of this survey to the Federal Reserve Board and hopes this survey will continue to be conducted.

With regard to whether or not the data should be mandated, we do not feel qualified to comment but encourage the Committee to seek the most reliable method of data collection. With increased data collection, privacy issues should always be considered. If Regulation B was amended to track minority and women lending, we would request assurances that this additional data collection include safeguards to protect the data from unlawful usage.

In summary, the GAO was not really able to ascertain whether or not women-owned businesses faced higher credit denial rates than white male businesses. From the many stories we hear across the country, we know that women still face difficulties in obtaining growth capital for their businesses. We believe that increased information on lending could be a valuable tool to identify potential barriers to obtain that capital.

Thank you for giving me the opportunity to testify. I am happy to answer any questions.

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Oversight and Investigations, Committee on Financial Services, House of Representatives

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FAIR LENDING

Race and Gender Data Are Limited for Nonmortgage Lending

Statement of Orice M. Williams, Director
Financial Markets and Community Investment

GAO
Accountability * Integrity * Reliability

GAO-08-1023T

July 17, 2008

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Highlights

Highlights of GAO-08-1023T, a testimony before the Subcommittee on Oversight and Investigations, Committee on Financial Services, House of Representatives

FAIR LENDING

Race and Gender Data Are Limited for Nonmortgage Lending

Why GAO Did This Study

The Federal Reserve Board's (FRB) Regulation B, which implements the Equal Credit Opportunity Act of 1974 (ECOA), generally prohibits lenders from collecting certain data from loan applicants, such as their race or gender, for nonmortgage loans (e.g., small business loans). FRB has stated that this provision of Regulation B minimizes the chances that lenders would use such data in an unlawful and discriminatory manner. However, others argue that the prohibition limits the capacity of researchers and regulators to identify possible discrimination in nonmortgage lending.

This testimony is based on the GAO report, *Fair Lending: Race and Gender Data Are Limited for Nonmortgage Lending* (GAO-08-698, June 27, 2008). Specifically, GAO analyzes (1) studies on possible discrimination in nonmortgage lending and the data used in them, (2) FRB's 2003 decision to retain the prohibition of voluntary data collection, and (3) the benefits and costs of a data collection and reporting requirement. For this work, GAO conducted a literature review; reviewed FRB documents; analyzed issues involving the Home Mortgage Disclosure Act (HMDA), which requires lenders to collect and publicly report data on personal characteristics for mortgage loan applicants; and interviewed FRB and others.

FRB did not take a position on this report's analysis. In addition to restating its rationale for retaining the prohibition of voluntary data collection, FRB summarized GAO's findings, including the potential benefits and costs of additional data for fair lending enforcement.

To view the full product, including the scope and methodology, click on GAO-08-1023T. For more information, contact Orice M. Williams at (202) 512-8678 or williamso@gao.gov.

What GAO Found

GAO's June 2008 report found that most research suggests that discrimination may play a role in certain types of nonmortgage lending, but data limitations complicate efforts by researchers and regulators to better understand this issue. For example, available studies indicate that African-American owned small businesses are denied loans more often or pay higher interest rates than white-owned businesses with similar risk characteristics. While the primary data source for these studies, a periodic FRB small business survey, provides important insights into possible discrimination, it also has limits compared to HMDA data. For example, the FRB survey data are collected from borrowers rather than lenders, which limit their usefulness as a means to assess lending practices. In addition, federal bank regulators that enforce ECOA said that HMDA data facilitates the identification of lenders that may be engaging in discriminatory mortgage lending. In the absence of such data for nonmortgage loans, regulators may rely on time-consuming and less reliable approaches to identify possible discrimination, such as assuming a loan applicant is Hispanic based on his or her last name.

While testimony from researchers and other information GAO collected did not fully agree with all aspects of FRB's 2003 rationale for retaining the prohibition of voluntary data collection, there was general agreement that such voluntary data would have limited benefits. FRB did not adopt a proposal that would have allowed lenders to collect data, without any standards, because it said the proposal would have (1) created an opportunity for lenders to use the data for discriminatory purposes and (2) such data would not be useful since lenders may use different collection approaches. While some researchers and others agreed with FRB's first rationale, others said that data collection alone would not necessarily create the risk for discrimination because, in some cases (e.g., small business lending), lenders may already be aware of applicants' personal characteristics as such lending is often done on a face-to-face basis. Even so, a range of researchers, regulatory staff, and others agreed that voluntarily collected data would not likely materially benefit efforts to better understand possible discrimination because the data would be collected on an inconsistent basis or few lenders would participate out of concern for additional regulatory scrutiny of their nonmortgage lending practices and the potential for litigation.

Requiring lenders to collect and publicly report data on personal characteristics for nonmortgage loan applicants could help address current data limitations that complicate efforts to better assess possible discrimination. However, such a requirement would impose additional costs on lenders that could be partially passed on to borrowers. These potential costs include those associated with information system integration, software development, data storage and verification, and employee training. Limiting a requirement to certain types of loans could help mitigate such costs but may also involve complexities that would need to be carefully considered. For example, to the extent that small business lending is more complicated than other types of lending, lenders may need to collect and report additional information on a range of underwriting standards in addition to data on personal characteristics so that informed judgments can be made about their lending practices.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the available research on the potential for discrimination in nonmortgage lending and the Federal Reserve Board's (FRB) basis for largely retaining Regulation B's prohibition against the voluntary collection of data on personal characteristics for nonmortgage loan applicants. As you know, the Equal Credit Opportunity Act (ECOA) of 1974 prohibits discrimination in lending based on an applicant's personal characteristics, such as race, gender, color, religion, national origin, marital status, or age.[1] A provision of Regulation B, which implements ECOA, generally prohibits lenders from asking for, inquiring about, or documenting such information for individuals who apply for nonmortgage loans, such as small business, automobile, or credit card loans. In 1975, FRB established the general prohibition as a means of discouraging discrimination in lending, based on its belief that if lenders could not inquire about or note such information on applicants' personal characteristics, they would be less likely to unlawfully consider it when making lending decisions. However, some members of Congress and consumer advocates argue that the prohibition on data collection has limited the ability of researchers, regulators, Congress, and the public to monitor nonmortgage lending practices and to identify possible discrimination.

In response to such criticism, the FRB, in 1999, proposed and considered an amendment to Regulation B that would have removed the prohibition and permitted lenders to voluntarily collect data on personal characteristics, without any restrictions or standards, for nonmortgage loan applicants. However, in 2003, after reviewing more than 600 public comment letters on the proposed amendment and taking other steps, FRB ultimately decided to leave the basic elements of the prohibition intact. FRB did not adopt the amendment because the agency believed it would have (1) created an opportunity for lenders to use the data for discriminatory purposes; and (2) generated data that would not be useful or reliable because lenders would likely adopt inconsistent data collection approaches. However, some members of Congress and consumer advocates questioned FRB's decision, particularly its conclusion that such data could be used for unlawful discrimination. To support their position, they argued that requiring lenders to collect and publicly report data on

[1]Pub. L. No. 90-321, title VII, as added by Pub. L. No. 93-495, title V, § 503, 88 Stat. 1521 (Oct. 28, 1974) (codified, as amended, at 15 U.S.C. §§ 1691 *et seq.*).

personal characteristics of mortgage loan applicants under the Home Mortgage Disclosure Act of 1975 (HMDA), as amended, has made lenders less likely to engage in discriminatory mortgage lending practices, and facilitated the ability of regulators to monitor and enforce compliance with fair lending laws.

My comments today are based on findings from our June 2008 report entitled *Fair Lending: Race and Gender Data Are Limited for Nonmortgage Lending.*[2] Specifically, I will discuss (1) available research on possible discrimination in nonmortgage lending and review the strengths and limitations of the data used in the studies, (2) FRB's 2003 basis for largely retaining Regulation B's prohibition against the voluntary collection of data on personal characteristic for nonmortgage loan applicants, and (3) the potential benefits and costs of a data collection and reporting requirement and options to mitigate such costs.

To prepare our June 2008 report, we conducted a literature review to identify studies that used nationwide databases and statistical techniques to identify possible discrimination in nonmortgage lending and assessed the strengths and weaknesses of key data used to support the studies' findings, particularly in comparison to HMDA data. Further, we reviewed relevant FRB documents pertaining to Regulation B and did a content analysis of a random sample of 90 from the more than 600 comment letters that FRB received in response to the proposed 1999 amendment to the regulation. We also conducted interviews with a range of researchers who have assessed potential discrimination in nonmortgage lending, staff involved in fair lending law enforcement from bank regulators, representatives from banking organizations and consumer groups, and officials from organizations that represent minority and women-owned businesses.

We conducted the audit work underlying the report from September 2007 to June 2008 in Washington, D.C., in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[2]GAO, *Fair Lending: Race and Gender Data Are Limited for Nonmortgage Lending,* GAO-08-698 (Washington, D.C.: June 27, 2008).

In summary, we found that most studies suggest that discrimination may play a role in certain types of nonmortgage lending, but data limitations have complicated efforts by researchers and regulators to understand the extent to which possible discrimination occurs. For example, available research on minority business lending generally indicates that African-American business owners are denied loans more often or pay significantly higher interest rates than white-owned businesses with similar risk characteristics. However, the data used in these studies are collected from small business borrowers rather than lenders and, therefore, cannot be used to conduct in-depth analyses of the practices of individual lenders or the lending industry generally. In contrast, studies on possible discrimination in mortgage lending often use HMDA data, which are collected directly from a large population of lenders and thus provide for more in-depth research among other benefits.[3] Further, we found that data limitations may also impede the relative efficiency of the bank regulators' fair lending examination process for the nonmortgage sector as compared with the mortgage sector.

While testimony from researchers and other information we collected did not reflect full agreement with all aspects of FRB's 2003 rationale for retaining Regulation B's general prohibition on collecting data on personal characteristics, most experts agreed with the agency's overall conclusion that voluntarily collected data would offer limited benefits as a means of better identifying possible discrimination in nonmortgage lending. FRB's conclusion that voluntary data collection could create some risk of discrimination, while supported by some interviewees, was challenged by a range of researchers, regulatory staff, and others we contacted. For example, several researchers said that voluntary data collection would not necessarily increase the risk of discrimination because, in certain cases—such as small business lending, which is often done on a face-to-face basis—lenders could already observe an applicant's race and gender. Even so, a range of researchers, regulatory staff, and representatives from both consumer and banking groups we contacted generally agreed with FRB that lenders would likely adopt different approaches to collecting and using data on personal characteristics, potentially limiting the reliability and usefulness of the information. They also said that relatively few, if any,

[3]However, as described in this testimony, studies that use HMDA data to assess possible discrimination in mortgage lending have been controversial because the data do not include key underwriting variables such as a loan applicant's credit score. Some studies have used HMDA data in conjunction with underwriting data available from other sources to better detect potential discriminatory mortgage lending practices.

lenders would likely choose to collect such data out of concern that their nonmortgage lending practices would become subject to increased regulatory oversight and potential litigation.

Finally, we found that requiring lenders to collect and publicly report data on personal characteristics for nonmortgage loan applicants, similar to HMDA requirements, could help address current data limitations but would also involve costs and complexities that would need to be considered. In concept, such a requirement could facilitate efforts by researchers, regulators, and others to better assess potential discrimination in nonmortgage lending. However, such a requirement would also impose additional costs on lenders for items such as system integration, software development, and training that could be partially passed onto borrowers. One option to potentially mitigate some of these costs would be limiting data collection and reporting to specific types of lending, such as small business lending, but this option may also involve additional complexities and costs that must be considered. For example, to the extent that small business lending is more complicated than other types of lending, lenders may need to collect and report additional information on a range of underwriting characteristics in addition to data on personal characteristics so that informed judgments can be made about their lending practices. Alternatively, lenders could be required to collect data on personal characteristics and make such data available to regulators to facilitate the fair lending examination process and potentially decrease costs, but, in the absence of a public reporting requirement, this option would not enhance the ability of researchers, Congress, and others to better assess the potential for discrimination.

FRB did not take a position on this report's analysis. In addition to restating its rationale for retaining the prohibition of voluntary data collection, FRB summarized GAO's findings, including the potential benefits and costs of additional data for fair lending enforcement.

Background

Regulation B imposes a general prohibition on collecting data on personal characteristics for nonmortgage loan applicants. But in 2003, FRB expanded its exceptions to this prohibition to include permitting lenders to collect data on race, gender, and other personal characteristics in connection with a self-test for the purpose of determining the effectiveness of the lender's compliance with ECOA and Regulation B. A self-test is any program, practice, or study that is designed and used by creditors to determine the effectiveness of the creditor's compliance with ECOA and Regulation B. The results of a self-test are privileged—that is, they cannot be obtained by any government agency in an examination or investigation in any lawsuit alleging a violation of ECOA.

Although Regulation B prohibits creditors, except in limited circumstances such as conducting a self-test, from collecting data on personal characteristics for nonmortgage loan applicants, creditors are required to collect such data for mortgage loan applicants. Specifically, HMDA, as amended in 1989, requires certain financial institutions to collect and publicly report information on the racial characteristics, gender, and income level of mortgage loan applicants.[4] In 2002, FRB, pursuant to its regulatory authority under HMDA, required financial institutions to report certain mortgage loan pricing data in response to concerns that minority and other targeted groups were being charged excessively high interest rates for mortgage loans.

Authority for enforcing compliance with ECOA with respect to depository institutions, such as Federal Reserve System member banks, national banks, state-chartered banks, saving associations, and credit unions, lies with the five federal regulators—FRB, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA).[5] To carry out their responsibilities, the agencies may conduct periodic compliance examinations of depository institutions. These compliance exams generally assess depository institutions' loan underwriting guidelines and credit decisions to detect possible discrimination in both mortgage and nonmortgage lending.

FRB's Survey of Small Business Finances (SSBF) is one of the principal sources of information available on the factors that affect the availability of credit for small businesses. FRB has conducted the SSBF about every 5 years from 1987 through 2003 from a nationwide sample of small businesses of varying sizes, locations, and ownership characteristics. In 2007, FRB decided to discontinue the SSBF due to its cost and other

[4]Pub. L. No. 94-200, title III, 89 Stat. 1125 (Dec. 31, 1975) (codified, as amended, at 12 U.S.C. §§ 2801 *et seq.*).

[5]Other agencies with enforcement authority under ECOA with respect to certain nondepository institutions include, among others, the Securities and Exchange Commission, the Small Business Administration, and the Farm Credit Administration. To the extent that ECOA does not assign to another federal agency responsibility for enforcing compliance with respect to a particular creditor, the Federal Trade Commission has enforcement authority for such creditors.

considerations. However, according to FRB officials, FRB plans to include elements of the SSBF in another survey, the Survey of Consumer Finances (SCF), starting in 2010.

Studies Suggest That Discrimination May Play a Role in Certain Types of Nonmortgage Lending, but Data Limitations Complicate Efforts to Better Understand the Issue

The limited number of studies on nonmortgage lending that met our criteria for selection in our June report focused primarily on the small business sector, and suggested that certain minority-owned businesses may be denied loans more often or be offered higher interest rates than similar white-owned businesses. However, the key data source for most of these studies, FRB's SSBF, has certain limitations compared with HMDA data, and this may limit the data's usefulness as an analytical tool. The few studies we identified that addressed possible discrimination in automobile and credit card lending relied on SCF data, which has certain limitations similar to those of the SSBF data. Further, our report found that data limitations may also impede the relative efficiency of the bank regulators' fair lending examination process for the nonmortgage sector as compared with the mortgage sector.

Research Suggests That Possible Discrimination Exists in Small Business Lending, but the Data Used in Such Studies Have Limitations

Primarily using data obtained from FRB's SSBF, all eight studies we identified on minority business lending generally found that lenders denied loans to minority-owned businesses (seven of the eight specifically refer to African-American-owned businesses) or required them to pay higher interest rates for loans significantly more often than white-owned small businesses. This finding generally remained consistent after considering a variety of risk factors, such as borrower creditworthiness, industry sector, and other firm characteristics (e.g., business location, assets, and profits). In addition, studies have found that Hispanic-owned businesses were denied credit or charged higher interest rates more often when compared with white-owned businesses with similar risk characteristics. On the other hand, some studies we reviewed did not identify evidence that women-owned businesses face credit denials or higher rates significantly more often than male, white-owned businesses.

While studies using SSBF data have provided important insights into possible discrimination in small business lending, researchers and FRB officials also pointed out a number of limitations:

- SSBF data are collected from individual small business borrowers rather than lenders, which limit their analytical value.[6] For example, SSBF data do not allow researchers to assess the overall small business lending underwriting standards or lenders' performance by type of institution, by size, or by geographic or metropolitan region.

- SSBF survey data are self-reported and are not verified by FRB. For example, FRB relies upon survey respondents to accurately report their race, gender, and other characteristics, as well as requested information on their business and their financing. Since the survey may be conducted long after the survey respondent applied for credit, the timing of the SSBF increases the risk that respondents may not accurately recall and report information from the time when the credit decision was made.

- FRB conducts the SSBF about every 5 years rather than annually and, therefore, the survey results may not be timely. To illustrate, most of the studies that we reviewed were based on data that are about 10 years old from surveys conducted in 1993 and 1998. Researchers and FRB officials that we spoke with said it may also take FRB a significant period of time to review and process the SSBF data prior to releasing it to the public.

In contrast, HMDA data offer certain advantages over SSBF data as a research tool to assess possible discrimination in mortgage lending. In particular, HMDA data are collected directly from a large and identified population of mortgage lenders on a consistent and annual basis. Researchers have used HMDA data to conduct analyses of possible discrimination by type of lending institution, size of the institution, and geographic or metropolitan area. FRB also requires that lenders help verify the HMDA data they report, such as applicant data on personal characteristics and the interest rates charged on certain types of mortgages.

Despite these advantages, we noted that analyses of HMDA data as a basis for conducting research on possible discrimination in mortgage lending have been criticized for not including key loan underwriting variables,

[6] It should be noted that data collected from borrowers can have distinct advantages. For example, survey respondents would know better than lenders whether they had been discouraged from applying for credit and could more accurately describe their race or gender.

such as the borrowers' credit scores or mortgages' loan-to-value ratios.[7] Some argue that such underwriting variables may account for many apparent discrepancies between minority and white mortgage borrowers. To compensate for the lack of underwriting variables in the HMDA data, several researchers have collected such data from proprietary sources and matched it with HMDA data.[8]

The Few Studies That Have Identified Possible Discrimination in Automobile and Credit Card Lending Use Data That Have Strengths but Also Limitations

According to a study on auto lending, racial discrimination could play a role in differences between the treatment of minority and white borrowers.[9] The study relied on data from FRB's SCF, which asks a nationwide sample of about 4,500 U.S. consumers to provide detailed information on the finances of their families and on their relationships with financial institutions. Because SCF data is also collected from borrowers rather than lenders, like SSBF data, it cannot be used as a basis for assessing individual lenders' lending practices or lending practices industrywide (i.e., by type of institution, size of institution, or geographic or metropolitan area).

The two studies we identified that also relied on SCF data had mixed results with respect to possible discrimination in credit card lending. One study found that minorities were likely to pay higher interest rates on credit card debt than white credit cardholders even after considering the payment history and financial wealth of each group.[10] Another study did

[7]Steven R. Holloway and Elvin K. Wyly, "The Color of Money Expanded: Geographically Contingent Mortgage Lending in Atlanta," *Journal of Housing Research* 12, no.1. (2001): 55-90; and Robert Avery, Kenneth P. Brevoort, and Glenn B. Canner, "Opportunities and Issues in Using HMDA Data," *Journal of Real Estate Research* 29 (2007): 351-379.

[8]Alicia H. Munnell, Geoffrey M.B. Tootell, Lynn E. Browne, and James McEneaney, "Mortgage Lending in Boston: Interpreting HMDA Data," *American Economic Review*, 86, no. 1 (1996); Debbie Bocian, Keith S. Ernst, and Wei Li, "Race, Ethnicity and Subprime Home Mortgage Pricing," *Journal of Economics and Business*. 60, nos. 1 and no. 2 (2008); and Kenneth P. Brevoort and Glenn B. Canner, "Opportunities and Issues in Using HMDA Data," *Journal of Real Estate Research*, 29 (2007): 351-379.

[9]Darryl Getter, "Consumer Credit Risk and Pricing," *The Journal of Consumer Affairs* 40, no.1 (2006): 41-63. Other research has looked at possible discrimination in the prices charged for new automobiles, as opposed to studies that analyze interest rate pricing for automobile loans. See: Ian Ayres and Peter Siegelman, "Race and Gender Discrimination in Bargaining for a New Car," *The American Economic Review*, 85, no. 3 (1995): 304-321; and Ian Ayres, "Fair Driving: Gender and Race Discrimination in Retail Car Negotiations," *Harvard Law Review*, 104, no. 4 (1991): 817-872.

[10]Getter, "Consumer Credit Risk and Pricing."

not find that minority credit cardholders paid higher interest rates as compared with white credit cardholders after controlling for creditworthiness factors.[11] These studies showed the strength of the SCF as a data source (e.g., the ability to consider data on personal characteristics and loan underwriting factors), as well as its limitations (e.g., the data are collected from borrowers rather than lenders).

Data Limitations May Also Impede the Efficiency of the Fair Lending Examination Process for Nonmortgage Lending

Representatives from the four federal bank regulatory agencies we contacted (FRB, OCC, FDIC, and OTS) said that the availability of HMDA data has facilitated the fair lending law examination process. In particular, agency staff said that the analysis of HMDA data provided insights into lenders that might be at high risk of engaging in potentially discriminatory practices in mortgage lending. While agency staff said that HMDA data were only a first start in the investigative process (because they must evaluate a range of underwriting criteria and practices that may help explain disparities in a lender's mortgage lending patterns), HMDA data allowed them to prioritize their examination resources.

We found that in the absence of similar race, gender, and other data on personal characteristics for nonmortgage loan applicants, examiners may rely on time-consuming and possibly unreliable techniques to assess lenders' compliance with fair lending laws. Under the *Interagency Fair Lending Examination Procedures*, examiners can use established "surrogates" to make educated guesses as to the personal characteristics, such as race or gender, of nonmortgage loan applicants to help determine whether the lenders they regulate are complying with established laws and regulations in extending credit to minority and other individuals targeted for loan applicants. For example, examination guidance allows examiners, after consulting with their agency's supervisory staff, to assume that an applicant is Hispanic based on the last name, female based on the first name, or likely to be an African-American based on the census tract of the address. While these techniques may help identify the racial or gender characteristics of loan applicants, they have potential for error (e.g., certain first names are gender neutral, and not all residents of a particular census tract may actually be African-American).

[11] Amberly Hazembuller, Britton Lombardi, and Jeanne Hogarth, "Unlocking the Risk-based Pricing Puzzle: Five Keys to Cutting Credit Card Costs," *Consumer Interests Annual*, 53 (2007): 73-81.

As a result of the limitations of the data on personal characteristics for nonmortgage loan applicants, as well as regulatory guidance directing examiners to consider using surrogates, federal oversight of lenders' fair lending law compliance in this area may be less efficient than it is for mortgage lending. According to a comment letter submitted by a Federal Reserve Bank to FRB as it considered amending Regulation B in 1999, its examiners were unable to conduct thorough fair lending examinations or review consumer complaints alleging discrimination for nonmortgage products due to the lack of available data. Moreover, our reviews of agency fair lending examination guidance and discussions with some agency staff (OCC, FDIC, and OTS) suggest that, due in part to HMDA data availability, agencies focus most of their resources on possible discrimination in mortgage lending rather than nonmortgage lending. We plan to further explore the issue of fair lending enforcement in future work, including the impact of potential data limitations on regulatory agencies' oversight and enforcement of the fair lending laws for mortgage and nonmortgage lending.

Voluntary Lender Collection of Data on Personal Characteristics Would Likely Offer Limited Benefits in Better Understanding Possible Discrimination in Nonmortgage Lending

While some individuals we contacted generally agreed with FRB's 2003 conclusion that permitting lenders to voluntarily collect data on personal characteristics for nonmortgage loan applicants could create some risk of discrimination, many other individuals we contacted expressed skepticism about this argument. Even so, a range of researchers, regulatory staff, and representatives from both consumer and banking groups we contacted generally concurred with FRB that voluntarily collected data might not be useful or reliable and that very few banks would choose to collect it. Consequently, the benefits of permitting lenders to voluntarily collect data on personal characteristics as a means for researchers, regulators, and others to better understand possible discrimination in nonmortgage lending would likely be limited.

Researchers and Others Had Mixed Views on FRB's Conclusion That Voluntary Data Collection Could Create Some Risk for Discrimination in Nonmortgage Lending

Some researchers, staff from a bank regulatory agency, and representatives from banking and business trade groups we contacted generally agreed with FRB that permitting voluntary data collection on personal characteristics could create a risk that the information would be used for discriminatory purposes. These officials told us that the best way to protect borrowers against discrimination is to minimize the availability of information to lenders about their personal characteristics.

However, many other researchers, staff from some regulatory agencies, and officials from consumer groups expressed skepticism on this conclusion. First, a staff member from a regulatory agency, several researchers, and representatives from consumer groups said that, in certain cases, lenders were already aware of the race and gender or other information on personal characteristics of nonmortgage loan applicants. Therefore, simply collecting data on personal characteristics on applicants in such cases would not necessarily create a risk of discrimination. Other researchers and officials from banking institutions disagreed. They noted that, in some cases, lending decisions may be made by officials who do not interact directly with loan applicants.

Second, lenders' voluntary collection and use of data on personal characteristics for nonmortgage loan applicants, outside of the ECOA self-test privilege, would also be subject to varying degrees of regulatory scrutiny, which could serve to deter lenders from using such data for discriminatory purposes. Similarly, all lenders that chose to collect and use such data for discriminatory purposes would face the risk of public disclosure of such practices through litigation. Further, according to a variety of researchers and officials we contacted, as well as FRB documents we reviewed, there is no evidence that lenders have used HMDA data for discriminatory purposes. These officials generally attributed the transparency of the HMDA program, through regulatory reviews and public reporting requirements, as serving to help deter lenders from using the data to discriminate in mortgage lending.[12]

Finally, FRB could potentially have mitigated some of its concerns that voluntarily collected data could be used for discriminatory purposes by

[12]We recognize that there are differences in the level of transparency between HMDA's data collection and reporting requirements and the voluntary data collection proposal that FRB considered in 1999 for nonmortgage loan applicants. In particular, FRB did not propose that lenders who chose to collect such data report it to the public whereas lenders are required to report HMDA data.

including, as part of its 1999 proposal, minimum procedures for the collection and use of such data. FRB established such procedures for federally regulated lenders that choose to conduct a self-test. These procedures include developing written policies describing the methodology for data collection and keeping data on personal characteristics separate from loan underwriting data that are used to make credit decisions. Imposing such minimum procedures and requirements for a voluntary program could serve to enhance regulators' oversight of lenders' data collection, processes, practices, and uses of the data, and further deter possibly discriminatory practices.

Many Researchers and Others Agreed That Voluntarily Collected Data May Not Be Reliable or Useful in Helping to Better Identify Possible Discrimination in Nonmortgage Lending

Even so, many researchers, regulatory staff, and representatives from consumer groups and banking trade groups agreed with FRB's conclusion that the reliability of voluntarily collected data may be limited in identifying possible discrimination in nonmortgage lending. In particular, they agreed with FRB that, due to potentially inconsistent data collection standards, it would be difficult to use voluntarily collected data to compare fair lending performance across different lenders. Additionally, there may be data inconsistency problems for any given lender that chooses to collect data on personal characteristics for nonmortgage loan applicants. For example, a lender could "cherry pick," or collect racial, gender, and other data on personal characteristics on applicants only for certain loan products that they felt would reflect favorably on their fair lending practices and not collect data for other products.

Just as FRB could potentially have mitigated some of its concerns about the possibility that lenders would use voluntarily collected data for discriminatory purposes by adopting minimum procedures, as mentioned previously, it could also potentially have considered adopting data collection standards. Such standards could have served to better ensure the consistency of the data and enabled regulators and others to use the data to assess individual lender performance and compare lending practices across different financial institutions. However, according to a senior FRB official, a researcher, and a bank industry trade association official, the imposition of such standards would have undermined the voluntary nature of the data collection proposal. For example, FRB could be required to conduct examinations to help ensure that federally regulated lenders were collecting the data in a manner consistent with any such standards. Moreover, the establishment of such data collection standards might also have further diminished lender interest in a voluntary program, which researchers, FRB officials, and others said was already limited due to the potential for increased regulatory and public scrutiny of their lending practices. According to bank regulators and banking trade groups, very few, if any, lenders choose to conduct self-tests out of concern that the results of such tests would be subject to regulatory review even though they are privileged.

Finally, while some officials we contacted and documents we reviewed said that any data that was collected and potentially reported by lenders would provide important insights into nonmortgage lending practices that are not currently available, other researchers and researchers suggested that such data would be prone to substantial selection bias. That is, the data would likely be skewed by the possibility that only lenders with good fair lending compliance records would choose to collect such data. Consequently, although voluntarily collected data on personal characteristics could provide some benefits, it would not likely materially assist the capacity of researchers, regulators, and others to better understand possible discrimination in nonmortgage lending.

A Data Collection and Reporting Requirement Could Further Efforts to Better Understand Possible Discrimination in Nonmortgage Lending but Would also Involve Complexities and Costs That Would Require Consideration

In concept, a requirement that lenders collect and publicly report data on the personal characteristics of nonmortgage loan applicants, similar to HMDA requirements, could help address some of the existing data limitations that complicate efforts by researchers, federal bank regulators, and others to identify possible discrimination. However, mandatory data collection and reporting would impose some additional costs on the lending industry, although opinions differed on how burdensome these costs might be. While options exist to potentially mitigate some of these costs, such as limiting data collection and reporting to specific types of lending, these options also involve additional complexities and costs that must be considered.

Researchers and Regulators Could Benefit from Mandatory Data Collection and Reporting, but Lender Costs Would Increase

Required data collection and reporting for nonmortgage loan applicants, similar to HMDA's requirements, could help address some of the existing limitations of available data and facilitate the efficiency of the fair lending examination process for nonmortgage lending. Such data would be more timely than SSBF data, and the implementation of data collection standards could help ensure its reliability. For example, researchers and financial regulators would be able to analyze the practices of specific lenders and compare practices across lenders, assessing lending practices by type, size, and location of the institutions, similar to analyses done currently with HMDA data. While such analyses would represent only the first step in determining whether or not particular lenders were engaging in discriminatory practices, they could potentially help regulators prioritize their examinations and better utilize existing staff and other resources.

While it is not possible to quantify the potential costs associated with a reporting requirement, in part because the requirements could vary, banking organizations and banks that we contacted identified a variety of additional costs that lenders might face. These officials also said that they were concerned about such costs and that the additional expenses associated with data collection and reporting would, in part, be passed on to borrowers. According to the officials, most of the costs associated with a reporting requirement would involve developing the information technology necessary to capture and report the data, including system integration, software development, and employee training. Moreover, the officials said that, as with HMDA data, verifying, any reported data would also entail costs, including expenses associated with conducting internal audits. The regulatory agency responsible for assembling, verifying, and reporting the data to the public would also accrue costs for these activities.[13]

Some researchers and representatives from consumer groups we contacted said that they did not think that the costs associated with required collection and reporting of data on personal characteristics of nonmortgage loan applicants would be significant because many lenders already collect and report data on personal characteristics under HMDA. But representatives from banks and banking organizations, along with one researcher, said that lending information systems and personnel were not

[13]According to FRB officials, it will cost the agency approximately $3.5 million to process the 2008 HMDA data.

integrated in many mortgage and nonmortgage organizations. For this reason, they reiterated that a data collection and reporting requirement would involve additional system integration and employee training costs, among others.

Limiting a Data Collection and Reporting Requirement to Specific Types of Nonmortgage Loans Would Also Have Benefits and Costs

One potential option to mitigate the costs associated with a requirement that regulated lenders collect and report data on the personal characteristics of those seeking nonmortgage loans would be to limit the requirement to certain types of loans, such as small business and/or automobile loans. Similar to mortgage loan applications, small business and automobile loan applications are often made on a face-to-face basis, which could enhance the ability of lenders to help verify the race, gender, or other personal characteristics of the applicants. In contrast, lenders' capacity to record data on personal characteristics for other types of nonmortgage applicants, such as applicants for credit card loans, may be limited by the fact that credit card loan applications and credit decisions are typically done by mail or over the Internet.

However, researchers, federal bank regulatory staff responsible for fair lending oversight, banking officials, and representatives from some consumer groups we contacted cautioned that there were still significant complexities and potential costs associated with a data collection and reporting requirement that was limited to small business lending. Unlike mortgage and automobile lending, which have relatively uniform underwriting criteria, these officials said that small business loan underwriting is heterogeneous and more complex. For example, the types of financing that small businesses typically seek can vary widely, ranging from revolving lines of credit to term loans, and the risk of the collateral pledged against these loans may also vary widely (i.e., from relatively secure real estate to inventory).[14] As discussed previously, studies of possible discrimination in small business lending that use SSBF data consider a variety of other indicators of creditworthiness, such as applicants' credit scores, personal wealth, and history of bankruptcy. Without information on key underwriting variables, the officials said, research based on the reported data could be subject to significant controversy and potential misinterpretation, much like research based on HMDA data, which lacks information on these variables. At the same time,

[14]We note, though, that small business owners may also use their personal residences as collateral to secure business loans.

costs for the necessary technology, employee training, and data verification would likely increase as the range of data that lenders were required to collect and report increases.

One option to potentially enhance federal oversight of the fair lending laws, while mitigating lender cost concerns, would be to require lenders to collect data on personal characteristics for small business loan applicants, and perhaps other types of nonmortgage lending like automobile lending, and make the data available to regulators but not require public reporting of such data or any other information. This approach could facilitate federal bank regulators' ability to prioritize fair lending examinations for regulated lenders because the agencies currently do not have ready access to data on personal characteristics for nonmortgage loan applicants. It could also limit lender costs because they would not have to collect, publicly report, and verify data on a range of underwriting variables because regulators already have access to this information. However, due to the lack of a public data reporting requirement, such an option would not enhance the capacity of researchers, Congress, and the public to better understand the possibility of discrimination in nonmortgage lending.

In closing, assessing the potential for discrimination in nonmortgage lending is an important and complex issue. While current data sources, primarily FRB's SSBF and SCF provide important insights into possible discrimination in certain types of lending, they both have limitations that may impede the ability of researchers, regulators, Congress, and the public to further assess lender compliance with the fair lending laws. It is also not yet clear how FRB's decision to discontinue the SSBF and incorporate elements of the survey into an expanded SCF beginning in 2010 will impact the already limited amount of information about possible discrimination in nonmortgage lending. Therefore, from a public policy perspective, now may be the time to consider whether the benefits of additional data for research and regulatory purposes outweigh the costs of collecting the data, as well as the trade-offs of various options to enhance available data, from a purely voluntary program to a data collection and reporting requirement, and decide whether such a requirement is warranted.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions you or other Members of the Subcommittee may have.

GAO Contact and Staff Acknowledgments

For further information about this testimony, please contact Orice M. Williams on (202) 512-8678, or at williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this testimony include Wesley M. Phillips, Assistant Director; Benjamin Bolitzer; Emily Chalmers; Kimberly Cutright; John Forrester; Simin Ho; Omyra Ramsingh; Robert Pollard; Carl Ramirez; and Ethan Wozniak.

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U.S. House of Representatives
Committee on Financial Services
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BERNARD SANDERS, VT

February 12, 2004

The Honorable Alan Greenspan
Chairman
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Dear Chairman Greenspan:

We are writing to encourage the Federal Reserve to eliminate the prohibition on allowing creditors to collect and publicly report the race and gender of all business loan applicants that exists under Regulation B, which implements the Equal Credit Opportunity Act (ECOA). This important change would provide the same race and gender data for business loans as is currently available for home mortgage loans under the Home Mortgage Disclosure Act (HMDA), and access to this data could lead to more business lending to minorities and women.

After 1990, when creditors were required under HMDA to collect and publicly disclose an applicant's race, ethnicity, gender, income and location, the number of home mortgage loans to minorities, women and low-income individuals increased. Requiring creditors to collect and publicly disclose the race and gender information of all applicants for business loans could increase access to business capital for minority and women-owned businesses in the same way that HMDA requirements resulted in more home mortgage lending to under-served populations.

We appreciate the fact that the Federal Reserve did amend Regulation B last year to allow a creditor to collect race and gender information for non-mortgage credit as long as it was for the purpose of conducting a self-test for compliance with ECOA. But, we believe this change does not go far enough because it does not provide for the public dissemination of race and gender information on business loans. The importance of permitting this information to be publicly reported is underscored by the fact that the Community Reinvestment Act (CRA) permits business lending to minority and women-owned businesses to be taken into account in demonstrating an institution's record of meeting the credit needs of the communities in which they are located. Since the CRA allows the public to comment on an institution's lending record, allowing the data to be publicly reported is critical. Greater transparency on the race and gender information of all business loans, therefore, is the most effective way to monitor and enforce fair lending compliance for business loans.

While the prohibition under Regulation B was originally intended to ensure that creditors did not discriminate against loan applicants, the unintended consequence of preventing creditors from collecting and publicly reporting race and gender information has been to mask creditors' business lending practices to minorities and women. In order for Congress to ensure that the purposes of ECOA

Honorable Alan Greenspan
Page Two

are being met, we would appreciate it if the Federal Reserve would conduct a thorough analysis of the patterns of business lending to minority and women-owned businesses, and report its findings back to Congress. If the Federal Reserve is ultimately unable to obtain access to the relevant information needed to conduct this analysis then it also important for the Federal Reserve to report this finding back to Congress. We look forward to working with the Federal Reserve on this matter.

Sincerely,

Barney Frank
Melvin L. Watt
Carolyn B. Maloney
Michael E. Capuano
David Scott
Gregory W. Meeks
Harold Ford
Stephen Lynch
Paul E. Kanjorski
Mike Ross
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MAR 8 2004

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ALAN GREENSPAN
CHAIRMAN

March 8, 2004

The Honorable Barney Frank
Ranking Member
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Congressman

Thank you for your recent letter encouraging the Board to eliminate the prohibition in Regulation B against the collection by creditors of information on the race and gender of business loan applicants. Regulation B implements the Equal Credit Opportunity Act (ECOA). You support greater transparency on the race and gender of applicants for business loans as a more effective way to monitor and enforce fair lending compliance for business loans; and believe that the consequence of the prohibition has been to mask creditors' business lending practices to minorities and women.

As noted in your letter, the Board adopted the regulatory provision prohibiting collection of personal characteristic data in connection with nonmortgage credit to further the purposes of the ECOA in the 1970s. This provision was based on the premise that if creditors have limited information about the personal characteristics of applicants, they are less likely to use such information unlawfully. At the same time, the Board prescribed mandatory data collection in home purchase loan transactions because of serious and frequent allegations of unlawful discrimination in the home mortgage market. Even then, however, there was no requirement for the compilation and public disclosure of home mortgage lending data collected until the Congress amended the Home Mortgage Disclosure Act in 1989.

Following a recent multiyear review of Regulation B, the Federal Reserve Board last year voted unanimously to retain the general prohibition on inquiring about, or noting, nonmortgage credit applicants' characteristics, such as race and gender. We continue to believe that restricting creditors' access to information about applicants' personal characteristics contributes to deterring credit discrimination. Congress could, of course, require mandatory collection and public reporting of data on small-business lending to address concerns about potential discrimination.

In your letter, you ask that the Federal Reserve conduct a thorough analysis of the patterns of business lending to minority and women-owned businesses, in order to ensure

The Honorable Barney Frank
Page 2

that the purposes of the ECOA are being met. In recent years, Federal Reserve staff has investigated these issues in a series of research papers. Each of these papers was based on information derived from the Federal Reserve's Surveys of Small Business Finances (SSBF), a survey which is conducted every five years or so. This survey collects comprehensive information on the financial services and borrowing experiences of small businesses, including those owned by minorities and women. The current survey is underway and data from the survey are expected to be publicly available by mid-2005.

In 1999, the Federal Reserve sponsored a conference on Business Access to Capital and Credit. That conference included three papers that focused specifically on the credit market experiences for business owners of different racial, ethnic, or gender characteristics. More recently, two additional studies by Federal Reserve staff have examined these issues. The five papers use several different measures of credit market experiences, including (1) the incidence of loans; (2) application rates; (3) denial rates; (4) interest rates on loans; and (5) the influence of fear of loan denial on application patterns. Each paper documents racial and gender differences in credit market experiences. They show that these differences are often explained by firm and non-demographic owner characteristics such as firm size and the credit history of the firm and its owners. Board staff can provide these papers to your staff upon request.

Determining whether and to what extent discrimination may play a role in explaining differences in the credit market experiences of small businesses owned by individuals from different demographic groups is extremely difficult. The SSBF is useful because it allows for the documentation of the differences in credit market experiences and provides clues regarding the reasons for these differences. These data, however, cannot identify all of the factors involved in the credit-granting decision. Although the survey data are quite detailed, they do not provide complete information on the details of the circumstances surrounding small business credit requests. As a consequence, the strength of the conclusions one may draw regarding discrimination from these data alone is limited.

hope this information is helpful to you

Sincerely,

Congress of the United States
House of Representatives
Washington, DC 20515

February 14, 2007

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Dear Mr. Chairman:

We urge the Federal Reserve to eliminate the general prohibition under Regulation B, which implements the Equal Credit Opportunity Act (ECOA), on allowing creditors to collect and publicly report the race and gender data of small business loan applicants.

While the Federal Reserve has amended Regulation B to allow a creditor to collect race and gender data for non-mortgage credit as long as it was for the purpose of conducting a self-test for compliance with ECOA, it is time for the Federal Reserve to take the next step and allow the collection and public dissemination of race and gender information on small business loans.

The current prohibition under Regulation B is based on the flawed premise that if creditors have limited information about the personal characteristics of applicants then they are less likely to use such information unlawfully. We believe, however, the positive impact of the data collection and disclosures required under Regulation C, which implements the Home Mortgage Disclosure Act (HMDA), is a good example of the benefits of greater transparency of data about loan applicants' personal characteristics. As underscored by the Federal Reserve Bulletin article, *Higher-Priced Home Lending and the 2005 HMDA Data*, the increased HMDA disclosures revealed wide disparities in the rates of approval in loan applications across racial and ethnic lines, which led many lenders to strengthen their fair lending compliance programs and to expand their outreach to under served communities. Rather than contributing to credit discrimination, we believe collecting and publicly reporting race and gender data on applicants for small business loans could lead to increased lending to women- and minority-owned businesses in the same way that the HMDA disclosures resulted in more home lending to women and minorities.

It is true that Congress could require mandatory collection and public reporting of data on small business lending. However, as noted by the Federal Reserve Governor Jeffery Bucher at a hearing held by the House Subcommittee on Consumer Affairs of the Committee on Banking, Currency and Housing in 1975 on the ECOA, the Federal Reserve should be ready to

The Honorable Ben S. Bernanke
February 14, 2007
Page two

amend the ECOA regulations as "promptly as may prove necessary in the light of experience."[1] As discussed above, our experience with HMDA has shown us that greater transparency of information on the personal characteristics of loan applicants helps to promote fairness and expand access to credit. It is time the Federal Reserve to remove the current prohibition under Regulation B on collecting and publicly reporting racial and gender data on small business loan applicants, and we encourage the Federal Reserve to move quickly on this important matter.

Sincerely,

BARNEY FRANK
Member of Congress

MAXINE WATERS
Member of Congress

MELVIN L. WATT
Member of Congress

LUIS V. GUTIERREZ
Member of Congress

BARBARA LEE
Member of Congress

---

[1]Statement of Hon. Jeffery M. Bucher, Member, Board of Governors of the Federal Reserve System, House Subcommittee on Consumer Affairs of the Committee on Banking, Currency and Housing hearing, Tuesday, April 22, 1975.

MAR 13 2007

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

March 13, 2007

BEN S. BERNANKE
CHAIRMAN

The Honorable Barney Frank
Chairman
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your recent letter concerning the general prohibition against creditors collecting race and gender data on small business loan applicants under Regulation B, which implements the Equal Credit Opportunity Act (ECOA). Regulation B prohibits a creditor from inquiring about or collecting data on the race, color, religion, national origin, or gender of an applicant or other persons in connection with a credit transaction, except in limited circumstances. As you note, Regulation B currently allows a creditor to collect race and gender data for non-mortgage credit, including small business loans, in connection with conducting a self-test for compliance with ECOA.

You have asked the Board to amend Regulation B to allow the collection and public dissemination of race and gender data on small business loan applicants. You argue that the current prohibition under Regulation B is based on the flawed premise that, if creditors have limited information about the personal characteristics of applicants, then they are less likely to use that information unlawfully. You also state the belief that the data collection and disclosures required under Regulation C, which implements the Home Mortgage Disclosure Act (HMDA), illustrate the benefits of greater transparency of data about loan applicants' personal characteristics. In your view, the HMDA disclosures have revealed wide disparities in loan approval rates along racial and ethnic lines, and led many lenders to strengthen their fair lending compliance programs and to expand their outreach to underserved communities.

The Board is committed to ensuring that credit is made available to all qualified applicants in a fair and non-discriminatory manner. Currently, ECOA and Regulation B provide that a creditor may, through a program, practice or study, inquire about the race, color, religion, national origin, or gender of an applicant or any other person in connection with any type of credit transaction, including small business lending, for the purpose of determining the extent or effectiveness of complying with ECOA and Regulation B. This self-test provision allows creditors to ascertain and address existing or potential weaknesses in their lending.

With regard to the public disclosure of borrower race and gender data, as you note in your letter, HMDA sets forth a statutory framework lenders must follow for the disclosure to the public of the personal characteristics of their mortgage loan applicants and borrowers. ECOA does not provide a similar framework for lenders that collect data on the personal characteristics of their borrowers.

As you know, the Board in 1999 proposed to amend Regulation B to remove the general prohibition against inquiring about an applicant's race, national origin, religion, color, or gender for non-mortgage credit products and to allow creditors to collect this data voluntarily. The Board received more than 600 comment letters addressing the issue of data collection. After thoroughly considering the issue, the Board in 2003 decided to retain the general prohibition against inquiring about the personal characteristics of applicants for non-mortgage credit products, except if the creditor collects the data for the purpose of conducting a self-test. The Board concluded that lifting the prohibition and permitting creditors to collect and use applicant characteristic data for purposes other than conducting a self-test would create a risk that the data could be collected and used to discriminate against applicants on a prohibited basis. The Board also concluded that lifting the prohibition and permitting voluntary data collection would not produce reliable or useful market-wide data.

Concerns about the reliability and usefulness of voluntarily collected race and gender data still exist today. The data would differ from lender to lender because all lenders that collect data would not use the same collection standards, criteria, and methods. The reliability of the data also could not be assured without prescriptive standards, criteria, and methods of data collection. In addition, many creditors would likely not choose to collect data voluntarily based on concerns that the data could be misinterpreted and that they may be forced to divulge the data in private litigation. Thus, a voluntary collection regime likely would not yield useful market-wide data.

The Board shares your interest in ensuring that creditors do not discriminate against qualified applicants for any kind of credit, including small business credit, on a prohibited basis. While the Board supports steps to promote access to credit and rigorously enforces the fair lending laws for the banks it supervises, the Board believes that removing the Regulation B prohibition and allowing voluntary collection and public reporting of data is unlikely to be an effective way of promoting access to credit and ensuring that creditors do not engage in illegal discrimination.

I appreciate your views regarding how best to promote access to credit on a non-discriminatory basis and look forward to working with you to ensure fair access to credit for all qualified applicants.

Sincerely,

BARNEY FRANK, MA, CHAIRMAN

PAUL E. KANJORSKI, PA
MAXINE WATERS, CA
CAROLYN B. MALONEY, NY
LUIS V. GUTIERREZ, IL
NYDIA M. VELÁZQUEZ, NY
MELVIN L. WATT, NC
GARY L. ACKERMAN, NY
JULIA CARSON, IN
BRAD SHERMAN, CA
GREGORY W. MEEKS, NY
DENNIS MOORE, KS
MICHAEL E. CAPUANO, MA
RUBÉN HINOJOSA, TX
WM LACY CLAY, MO
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TIM MAHONEY, FL
CHARLES WILSON, OH
ED PERLMUTTER, CO
CHRISTOPHER S. MURPHY, CT
JOE DONNELLY, IN
ROBERT WEXLER, FL
JIM MARSHALL, GA
DAN BOREN, OK

JEANNE M. ROSLANOWICK
STAFF DIRECTOR AND
CHIEF COUNSEL

U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

July 16, 2007

SPENCER BACHUS, AL, RANKING MEMBER

RICHARD H. BAKER, LA
DEBORAH PRYCE, OH
MICHAEL N. CASTLE, DE
PETER T. KING, NY
EDWARD R. ROYCE, CA
FRANK D. LUCAS, OK
RON PAUL, TX
PAUL E. GILLMOR, OH
STEVEN C. LaTOURETTE, OH
DONALD A. MANZULLO, IL
WALTER B. JONES, JR., NC
JUDY BIGGERT, IL
CHRISTOPHER SHAYS, CT
GARY G. MILLER, CA
SHELLEY MOORE CAPITO, WV
TOM FEENEY, FL
JEB HENSARLING, TX
SCOTT GARRETT, NJ
GINNY BROWN-WAITE, FL
J. GRESHAM BARRETT, SC
JIM GERLACH, PA
STEVAN PEARCE, NM
RANDY NEUGEBAUER, TX
TOM PRICE, GA
GEOFF DAVIS, KY
PATRICK T. McHENRY, NC
JOHN CAMPBELL, CA
ADAM PUTNAM, FL
MICHELE BACHMANN, MN
PETER J. ROSKAM, IL
KENNY MARCHANT, TX
THADDEUS G. McCOTTER, MI

The Honorable David M. Walker
Comptroller General of the United States
Government Accountability Office
441 G St., NW
Washington, DC 20548

Dear Mr. Walker:

We are writing to request that the Government Accountability Office (GAO) review the impact of removing the prohibition under Regulation B, which implements the Equal Credit Opportunity Act (ECOA), on collecting and publicly reporting of race and gender data for non-mortgage credit.

As the GAO found in a June 2006 report, *Financial Services Industry: Overall Trends in Management-Level Diversity and Diversity Initiatives, 1993-2004* (GAO Report), women and minority-owned businesses often face challenges in obtaining loans and other types of financing. While several factors may explain some of the disparities, the GAO Report found that discrimination in the financial industry is at least partly to blame.

Unfortunately, there is a lack of available data revealing patterns of discrimination in business lending. The Federal Reserve's Regulation B, which implements provisions ECOA, prohibits lenders from collecting and publicly reporting data on the race and gender of non-mortgage loan applicants, such as businesses. The Federal Reserve maintains that requiring lenders to collect and publicly report such information could actually *increase* the potential for discrimination among financial institutions.

As stated in a February 2007 letter signed by the Chairman of the House Financial Services Committee Chairman Barney Frank, and Reps. Watt, Waters, Gutierrez and Lee, the Federal Reserve's decision not to amend Regulation B to eliminate the prohibition is based on a "flawed premise." It is difficult to understand how requiring lenders to collect information on the racial and gender characteristics of business loan applicants and making such information available to regulators, academics, Congress and others would increase discrimination. Indeed, mortgage lending to minorities increased after the passage of the Home Mortgage Disclosure Act (HMDA).

To assist the Subcommittee in its oversight capacity, we request that the GAO conduct a review of issues related to Regulation B including:

- A review of the legislative history of relevant sections of ECOA and the Federal Reserve's development and implementation of Regulation B as well as amendments to the regulation over the years;

- An assessment of the Federal Reserve's factual and analytical basis for concluding that revising Regulation B would likely increase discrimination against women and minority-owned businesses;

- Advantages and disadvantages to lenders and small businesses of amending Regulation B;

- An analysis of the potential costs associated with requiring lenders to collect and publicly report information on the racial and gender characteristics of non-mortgage loan applicants as well as options to mitigate such costs, including restricting the data requirements to loans for small women and minority-owned businesses, and the implications of using various definitions of "small businesses", including those used by other federal agencies such as the Small Business Administration (SBA); and

- An analysis of relevant HMDA issues, such as the impact that HMDA has had on the ability of regulators, academics, and the public to detect potential discrimination in mortgage lending, as well as a comparison of such analysis to the current state of knowledge regarding potential discrimination against business borrowers.

We request that GAO be prepared to report on its findings by spring 2008. If you have any questions, please contact Erika Jeffers, counsel to the Committee by phone at (202) 226-2745 or by e-mail at erika.jeffers@mail.house.gov, or Sanders Adu staff director of the Subcommittee by phone at (202) 226-2888 or by e-mail at sanders.adu@mail.house.gov.

Sincerely,

Barney Frank
BARNEY FRANK
Chairman
Financial Services Committee

Melvin L. Watt
MELVIN L. WATT
Chairman
Subcommittee on Oversight & Investigations

Carolyn B. Maloney
CAROLYN B. MALONEY
Chairman
Subcommittee on Financial Institutions and Consumer Credit

BARNEY FRANK, MA, CHAIRMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

July 10, 2008

Honorable JoAnn Johnson
Chairman
National Credit Union Association
1775 Duke Street
Alexandria, VA 22314

Dear Chairman Johnson:

The House Financial Services Committee has jurisdiction over the Equal Credit Opportunity Act (ECOA) which the Federal Reserve implements through Regulation B. The Committee, therefore, closely monitors the use of Regulation B and its effectiveness as a tool to ensure compliance with fair lending laws.

The Oversight and Investigations (O&I) Subcommittee of the House Financial Services Committee has scheduled a hearing on July 17, 2008 at which a United States Government Accountability Office (GAO) Report entitled "Fair Lending: Race and Gender Data are Limited for Nonmortgage Lending" (GAO-08-898) will be officially released. An advance copy of the report is attached for your review, which I respectfully request you not to share because the report is embargoed until the day of the hearing.

In preparation for this hearing, I request that your agency provide written responses to the following questions by **July 15, 2008** in order that your responses may be made part of the hearing record:

(1) Should personal characteristic data be collected on applicants for and borrowers of nonmortgage credit?

(2) What types of nonmortgage loans should be included if personal characteristic data is collected (e.g. small business loans, automobile loans, or other categories)?

(3) Should the collection of such data be mandatory or voluntary?

(4) Should personal characteristic data be collected by the lenders and publicly reported, collected but not publicly reported, or collected but only reported to the appropriate federal banking regulator?

Thank you in advance for your assistance in this matter.

Sincerely,

Melvin L. Watt, Chairman
Subcommittee on Oversight & Investigations
House Financial Services Committee

BARNEY FRANK, MA, CHAIRMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

July 10, 2008

Honorable John M. Reich
Director
Office of Thrift Supervision
1700 G. Street, N.W.
Washington, DC 20552

Dear Director Reich:

The House Financial Services Committee has jurisdiction over the Equal Credit Opportunity Act (ECOA) which the Federal Reserve implements through Regulation B. The Committee, therefore, closely monitors the use of Regulation B and its effectiveness as a tool to ensure compliance with fair lending laws.

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Thank you in advance for your assistance in this matter.

Sincerely,

Melvin L. Watt, Chairman
Subcommittee on Oversight & Investigations
House Financial Services Committee

BARNEY FRANK, MA, CHAIRMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

July 10, 2008

Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
3501 N. Fairfax Drive
Arlington, VA 22226

The House Financial Services Committee has jurisdiction over the Equal Credit Opportunity Act (ECOA) which the Federal Reserve implements through Regulation B. The Committee, therefore, closely monitors the use of Regulation B and its effectiveness as a tool to ensure compliance with fair lending laws.

The Oversight and Investigations (O&I) Subcommittee of the House Financial Services Committee has scheduled a hearing on July 17, 2008 at which a United States Government Accountability Office (GAO) Report entitled "Fair Lending: Race and Gender Data are Limited for Nonmortgage Lending" (GAO-08-898) will be officially released. An advance copy of the report is attached for your review, which I respectfully request you not to share because the report is embargoed until the day of the hearing.

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(4) Should personal characteristic data be collected by the lenders and publicly reported, collected but not publicly reported, or collected but only reported to the appropriate federal banking regulator?

Thank you in advance for your assistance in this matter.

Sincerely,

Melvin L. Watt, Chairman
Subcommittee on Oversight & Investigations
House Financial Services Committee

BARNEY FRANK, MA, CHAIRMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

July 10, 2008

Honorable Jovita Carranza
Acting Administrator
U.S. Small Business Administration
409 Third Street, S.W., Suite 7900
Washington, D.C. 20416

Dear Ms. Carranza:

The House Financial Services Committee has jurisdiction over the Equal Credit Opportunity Act (ECOA) which the Federal Reserve implements through Regulation B. The Committee, therefore, closely monitors the use of Regulation B and its effectiveness as a tool to ensure compliance with fair lending laws.

The Oversight and Investigations (O&I) Subcommittee of the House Financial Services Committee has scheduled a hearing on July 17, 2008 at which a United States Government Accountability Office (GAO) Report entitled "Fair Lending: Race and Gender Data are Limited for Nonmortgage Lending" (GAO-08-898) will be officially released. An advance copy of the report is attached for your review, which I respectfully request you not to share because the report is embargoed until the day of the hearing.

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(3) Should the collection of such data be mandatory or voluntary?

(4) Should personal characteristic data be collected by the lenders and publicly reported, collected but not publicly reported, or collected but only reported to the appropriate federal banking regulator?

Thank you in advance for your assistance in this matter.

Sincerely,

Melvin L. Watt, Chairman
Subcommittee on Oversight & Investigations
House Financial Services Committee

BARNEY FRANK, MA, CHAIRMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

July 10, 2008

Honorable Jessie K. Liu
Deputy Assistant Attorney General for Civil Rights
U.S. Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530

Dear Deputy Assistant Attorney General Liu:

The House Financial Services Committee has jurisdiction over the Equal Credit Opportunity Act (ECOA) which the Federal Reserve implements through Regulation B. The Committee, therefore, closely monitors the use of Regulation B and its effectiveness as a tool to ensure compliance with fair lending laws.

The Oversight and Investigations (O&I) Subcommittee of the House Financial Services Committee has scheduled a hearing on July 17, 2008 at which a United States Government Accountability Office (GAO) Report entitled "Fair Lending: Race and Gender Data are Limited for Nonmortgage Lending" (GAO-08-898) will be officially released. An advance copy of the report is attached for your review, which I respectfully request you not to share because the report is embargoed until the day of the hearing.

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(3) Should the collection of such data be mandatory or voluntary?

(4) Should personal characteristic data be collected by the lenders and publicly reported, collected but not publicly reported, or collected but only reported to the appropriate federal banking regulator?

Thank you in advance for your assistance in this matter.

Sincerely,

Melvin L. Watt, Chairman
Subcommittee on Oversight & Investigations
House Financial Services Committee

BARNEY FRANK, MA, CHAIRMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

July 10, 2008

Honorable William E. Kovacic
Chairman
Federal Trade Commission
600 Pennsylvania Avenue
Washington, DC 20580

Dear Chairman Kovacic:

The House Financial Services Committee has jurisdiction over the Equal Credit Opportunity Act (ECOA) which the Federal Reserve implements through Regulation B. The Committee, therefore, closely monitors the use of Regulation B and its effectiveness as a tool to ensure compliance with fair lending laws.

The Oversight and Investigations (O&I) Subcommittee of the House Financial Services Committee has scheduled a hearing on July 17, 2008 at which a United States Government Accountability Office (GAO) Report entitled "Fair Lending: Race and Gender Data are Limited for Nonmortgage Lending" (GAO-08-898) will be officially released. An advance copy of the report is attached for your review, which I respectfully request you not to share because the report is embargoed until the day of the hearing.

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(2) What types of nonmortgage loans should be included if personal characteristic data is collected (e.g. small business loans, automobile loans, or other categories)?

(3) Should the collection of such data be mandatory or voluntary?

(4) Should personal characteristic data be collected by the lenders and publicly reported, collected but not publicly reported, or collected but only reported to the appropriate federal banking regulator?

Thank you in advance for your assistance in this matter.

Sincerely,

Melvin L. Watt, Chairman
Subcommittee on Oversight & Investigations
House Financial Services Committee

Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, DC 20552 • (202) 906-6590

John M. Reich
Director

July 16, 2008

The Honorable Melvin L. Watt
Chairman
Subcommittee on Oversight & Investigations
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your July 10, 2008 inquiry about the possible collection and reporting of personal information for applicants and recipients of credit not secured by homes.

The Office of Thrift Supervision actively enforces fair lending laws and appreciates this opportunity to share our views with you. Please find attached responses to the questions raised in your letter.

If we can provide you with additional information regarding this matter, please contact me directly at 202-906-6590, or Barbara Shycoff, Managing Director, External Affairs, at 202-906-7165.

Sincerely,

John M. Reich
Director

Collecting and Reporting Personal Characteristic Data for Nonmortgage Lending

1) Should personal characteristic data be collected on applicants for and borrowers of nonmortgage credit?

OTS is committed to providing resources and tools to conduct effective examination to identify and address illegal lending practices. Data limitations complicate the ability to assess whether illegal discrimination occurs in nonmortgage lending transactions. However, the OTS believes that personal characteristic data should only be collected about nonmortgage credit applicants if a unified standard for the collection and processing of such data is implemented. Without such a standard, institutions would likely gather and organize information in different ways. This would limit the usefulness and reliability of data for examinations and civil rights enforcement purposes. We question whether it would be appropriate to ask institutions to bear the cost of such activities if the data they produce cannot be readily used.

Any new data collection effort would impose new costs as firms develop and support the information technology necessary to assemble and report applicable data and train their employees to use these systems. To mitigate this burden, the OTS suggests that smaller institutions with generally lower loan originations, be exempted. Such an exemption would be consistent with the approach taken to the collection and reporting of home mortgage data.[1] The OTS would be happy to work with you to design such a strategy.

2) What types of nonmortgage loans should be included if personal characteristic data is collected (e.g. small business loans, automobile loans, or other categories)?

Limiting new data collection and reporting to specific types of lending would lessen the regulatory burden imposed on the industry. However, because nonmortgage lending decisions (other than for credit cards) are not routinely based on standardized information, it is not clear which types of nonmortgage lending could be more readily analyzed by imposing new data collection and reporting requirements.

For example, sound small business underwriting requires an evaluation of the applicant's past business experience and plan for the investment of the current loan funds, factors which are absent in the home lending context. Automobile lending is complicated by the fact that manufacturers often link special financing to particular models in order to increase sales. Given the nature of nonmortgage lending, it may remain difficult to draw conclusions about potential discrimination even if additional personal characteristic data is collected and reported.

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[1] See 12 C.F.R. §203.2(e)(i).

3) Should the collection of such data be mandatory or voluntary?

The collection and disclosure of data about personal characteristics could provide insight into potential discrimination.[2] However, unless consistent data collection standards are adopted, it will be difficult for regulators or the public to use voluntarily collected data to compare fair lending performance across different lenders. Moreover, many lenders may decline to voluntarily collect data out of concern that the existence of such data could result in increased regulatory scrutiny and liability under the Equal Credit Opportunity Act (ECOA).[3]

Any new mandatory collection and reporting regime will require the industry to bear new costs. When evaluating whether the collection of additional data should be mandatory or voluntary, we suggest that you consider whether the potential benefits to be gained by the public and regulators outweigh the burden that would be placed on the loan originators that would be required to compile and report the data.

4) Should personal characteristic data be collected by the lender and publicly reported, collected but not publicly reported or collected but only reported to the appropriate federal banking regulator?

There are benefits and drawbacks to all of the strategies reflected in the question. Requiring lenders to collect and release data to the public might facilitate analysis of potentially discriminatory lending patterns. However, as noted above, the complicated nature of nonmortgage lending may make it difficult to use such data effectively. Regulators would face the same challenge in attempting to use such data, but having it would likely enable them to risk focus fair lending examinations more closely. If loan originators were required to collect, but not report, the data, they would still face the litigation risks that now make them wary of voluntarily collecting such information. As the Government

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2 Particularly where transactions are handled face -to-face, we are skeptical that a requirement to collect personal data would increase the likelihood of discrimination. In these situations, a borrower's personal characteristics are already observed by lenders.

3 Regulation B, which implements ECOA, prohibits the collection of personal data in the non-mortgage context, but already permits such information to be voluntarily collected for the purpose of conducting a self test. See 12 C.F.R. § 202.15. Based on our supervisory experience, lenders rarely take advantage of this exception out of concern that voluntarily collected data will create risks for them.

Accountability Office has noted, "...from a public policy perspective, considering the trade-offs of various options to enhance available data to assess potential discrimination in nonmortgage lending may be warranted."[4]

[4] See "Fair Lending: Race and Gender Data Are Limited for Nonmortgage Lending", GAO Report 08-698 at p. 8.

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

July 15, 2008

The Honorable Melvin L. Watt
Chairman
Subcommittee on Oversight & Investigations
Committee on Financial Services
House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Watt:

Thank you for your letter of July 10, 2008, regarding the upcoming Subcommittee hearing entitled, "GAO Report on Regulation B: Should Lenders Be Required to Collect Race and Gender Data of Borrowers for All Loans." You have requested the OCC's views respecting (1) whether data on personal characteristics should be collected on applicants for and borrowers of nonmortgage credit; (2) the types of nonmortgage loans that should be included if such data is collected; (3) whether the collection of such data should be mandatory or voluntary; and (4) whether any such data collected should be publicly reported, collected but not publicly reported, or collected but only reported to the appropriate federal banking regulator.

As a general matter, additional data on nonmortgage loans could improve the OCC's ability to screen for possible fair lending issues, high risk institutions, or loan files that warrant closer scrutiny. However, the benefits of additional data collection are also subject to some important caveats and the issue warrants careful review. For instance, the complexity of and variation in underwriting standards for small business loans could significantly limit the usefulness of data on applicant or borrower personal characteristics as fair lending risk indicators. Also, as GAO notes in its report, new requirements will impose additional costs on lenders, including those associated with information systems, software development, data storage, verification of data integrity, and employee training. Based on our experience with implementing HMDA requirements, we believe that such additional costs could be significant. Thus, it would be important to assess that additional information collected would indeed be usable and useful to identify potential fair lending risks.

In that regard, I also wish to emphasize that any additional data will serve only as a screening tool and risk indicator. Making a determination that an institution has engaged in illegal discrimination will continue to require on-site examination work and file review to evaluate the many factors used in making lending decisions. If additional information were to be collected and made publicly available, it would be important to make that point clear.

I appreciate the opportunity to share our views on this subject. If we can be of further assistance, please do not hesitate to contact me or John Hardage, Director for Congressional Liaison ((202) 874-4840).

Sincerely,

John C. Dugan

John C. Dugan
Comptroller of the Currency

July 16, 2008

The Honorable Melvin L. Watt, Chairman
United States House of Representatives
Committee on Financial Services
Subcommittee on Oversight & Investigations
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Watt:

I am responding to your July 10, 2008, letter concerning the Government Accountability Office's (GAO) report entitled "Fair Lending: Race and Gender Data are Limited for Nonmortgage Lending."

I appreciate you sharing an advance copy of the GAO's report. Since credit unions have limited fields of membership, the potential customer base is restrictive when compared with other types of lenders. However, I remain pleased credit unions overwhelmingly have fair lending practices for both mortgage and nonmortgage loans and proactively serve their fields of membership in a manner consistent with their legal authority.

The enclosure to this letter provides responses to the specific questions you raise in anticipation of your Subcommittee's hearing planned for July 17. Please contact me if I may provide additional information.

Sincerely,

JoAnn M. Johnson
Chairman

Enclosure

cc: Ranking Member Gary G. Miller

National Credit Union Administration Responses to Questions from the House Committee on Financial Services

1. Should personal characteristic data be collected on applicants for and borrowers of nonmortgage credit?

At this time, NCUA does not recommend adding additional data collection and reporting requirements for nonmortgage credit. NCUA is not aware of any widespread practices of discriminatory nonmortgage lending in federally insured credit unions. The agency bases this conclusion on the results of examinations and membership complaints the agency receives.

As a part of the risk-focused examination process, NCUA's field examiners assess credit union compliance with Regulation B, which enforces the Equal Credit Opportunity Act. This process includes a thorough review of credit union policies, procedures, practices, and service offerings. When agency staff notes violations, they report the specific issues in an electronic database known as the Consumer Regulation Violation Log. This resource allows the agency to quickly assess trends relative to compliance and includes both technical and substantive violations relative to both mortgage and nonmortgage lending. The database also documents plans for corrective action credit union officials agree to implement.

Since January 1, 2007, NCUA staff noted 125 violations of Regulation B. Of this total, 25 were substantive violations. Only 19 credit unions, representing less than three tenths of one percent of all federally insured credit unions, had substantive Regulation B violations over this period. The most common substantive issues were isolated credit practices that could result in a disparate impact on elderly borrowers. NCUA's records indicate for each substantive violation, credit union officials and the agency reached an agreement through the routine supervision process to initiate corrective action. NCUA's examiners indicate credit union officials are making sufficient progress in correcting the substantive violations.

Independent of the examination process, NCUA also assesses compliance with Regulation B through the member complaint process. NCUA may receive a complaint initiated by a member of a federal credit union at any time. While most complaints are in the form of a letter, individuals also have access to a toll-free number to contact NCUA. Members may also use NCUA's Internet site (www.NCUA.gov) to submit a complaint via e-mail.

Credit union members are aware of NCUA's role in assisting with the resolution of consumer concerns for two primary reasons: 1) notices of adverse action accompanying denials of credit at a federal credit union list NCUA's contact information; and 2) NCUA's Internet site provides a toll-free consumer assistance hotline number.

NCUA's complaint process encourages members to work with the credit union first. Typically, NCUA initially directs the federal credit union to investigate the complaint and provide the member a response with a copy to NCUA, or to respond to NCUA directly. NCUA reviews the federal credit union's response, and if necessary, will further investigate the complaint.

2. What types of nonmortgage loans should be included if personal characteristic data is collected (e.g. small business loans, automobile loans, or other categories)?

As noted in the response to question number 1, NCUA does not recommend collecting personal characteristic data for nonmortgage credit at this time. As the GAO notes in its report, such a requirement would impose additional costs on lenders that could be partially passed on to borrowers, and the ultimate benefit of the requirement is uncertain.

However, if the statutes should change to require this type of data gathering, NCUA would welcome the opportunity to cooperate in any interagency effort to ensure uniformity. NCUA would only recommend considering including small business loans and commercial loans for this type of data collection. NCUA also takes note of GAO's observation that the Small Business Administration already has a program in place for collecting certain demographic information for loans guaranteed under its programs.

3. Should the collection of such data be mandatory or voluntary?

As noted in the draft GAO report, Regulation B generally prohibits lenders from collecting demographic data for nonmortgage loan applicants unless the purpose of the data collection is to self-test internal safeguards against discrimination. NCUA believes prohibiting this type of data collection can have tangible benefits by keeping a focus on credit factors, rather than demographic characteristics, during the decision-making process. This is especially true for cases where lenders engage in indirect lending or process loans through non face-to-face settings, such as over the Internet. In view of these factors, NCUA recommends consideration of potential adverse consequences before allowing or mandating the collection of demographic information for nonmortgage loans.

Notwithstanding our general concerns, if Congress makes a change to the statute, voluntary data collection would be less burdensome, while mandatory data collection would result in greater data uniformity.

4. Should personal characteristic data be collected by the lenders and publicly reported, collected but not publicly reported, or collected but only reported to the appropriate federal banking regulator?

If the statutes change to require the collection of personal characteristic data for nonmortgage loan applications, NCUA recommends individual regulators report the results, in the aggregate, in an annual report to Congress. Other reporting alternatives would have significant costs without any clear benefits, given the extremely low level of Regulation B violations detected within the credit union system. Moreover, since credit unions have restricted fields of membership, public disclosures of nonmortgage loan application data could result in inappropriate comparisons with other lenders permitted to serve significantly more diverse and expansive customer bases.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

July 16, 2008

The Honorable Melvin L. Watt
Chairman
Subcommittee on Oversight & Investigations
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Thank you for your letter to Acting Administrator Jovita Carranza regarding the Government Accountability Office (GAO) Report entitled "Fair Lending: Race and Gender Data are Limited for Nonmortgage Lending" (GAO-08-898). We understand that the House Financial Services Committee has jurisdiction over the Equal Credit Opportunity Act (ECOA) which the Federal Reserve implements through Regulation B. In your letter you requested the U.S. Small Business Administration's (SBA) perspective on the collection of personal characteristic data to prepare for a July 17th hearing.

Compliance with fair lending laws by the lending community is an issue that the SBA takes seriously. We recognize that the collection of personal characteristic data can be important. Below, please find our responses to your four questions about the SBA's position on the collection of personal characteristic data:

1. Should personal characteristic data be collected on applicants for and borrowers of nonmortgage credit?

   SBA finds this information particularly useful in assessing the impact of our programs on small businesses in geographic and demographic groups. The information enables SBA to validate the effectiveness of our programs and identify sectors where the agency may need to apply additional effort.

2. What types of nonmortgage loans should be included if personal characteristic data is collected (e.g. small business loans, automobiles, or other categories)?

   It is our position that the collection of this data is useful for small business loans. As part of its statutory mission SBA is charged with providing capital to businesses that are not otherwise served by the conventional lending market. Through its 7(a) and 504 loan programs, SBA provides a government-backed guarantee to lenders for those borrowers who are deemed to be unable to obtain financing on reasonable terms through the conventional lending market.

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Page 2
The Honorable Melvin Watt

3. Should the collection of such data be mandatory or voluntary?

   To provide program oversight and to evaluate the effectiveness of our programs, the voluntary submission of this data is important to assist the SBA in this oversight and evaluation process.

4. Should personal characteristic data be collected by the lenders and publicly reported, collected, but not publicly reported, or collected but only reported to the appropriate federal banking regulator?

   SBA already publicly reports aggregate data on personal characteristics of its borrowers. This data is provided on a voluntary basis to the lender making the SBA guaranteed loan and passed on to SBA. The data is aggregated and analyzed as an assessment of the impact of SBA's financing programs in both geographic and demographic groups. The information enables SBA to validate the effectiveness of its programs and identify sectors where the agency may need to increase its reach.

We appreciate the opportunity to respond to the question about our data collection practice and welcome the opportunity to discuss this with you further. Should you have any additional questions or comments please contact the Office of Congressional and Legislative Affairs at (202) 205-6700.

Sincerely

Janet A. Tasker
for Eric Zarnikow
Associate Administrator
Office of Capital Access

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

THE CHAIRMAN

July 15, 2008

The Honorable Melvin L. Watt
Chairman
Subcommittee on Oversight & Investigations
Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

Dear Chairman Watt:

This letter is in response to your July 10, 2008 correspondence to which you attached the draft Government Accountability Office (GAO) Report entitled "Fair Lending: Race and Gender Data are Limited for Nonmortgage Lending."[1] You asked the Commission to respond to four questions in preparation for the Subcommittee's hearing scheduled for Thursday, July 17, 2008 at which the GAO report will be released officially. We understand that this response will be made part of the hearing record. Specifically, your questions seek the Commission's views regarding the current prohibition on the collection of race, gender and other personal characteristic information in nonmortgage credit transactions and whether this prohibition should be lifted to allow or mandate the collection and reporting of such data. As described below, the Commission's most recent fair lending enforcement experience has focused on mortgage lending. As a result, the Commission's views on this topic are necessarily limited.

The Commission enforces the Equal Credit Opportunity Act (ECOA), which prohibits discrimination against applicants for credit on the basis of race, national origin, sex, marital status, age or other prohibited factors.[2] The ECOA and the other statutes that the FTC enforces specifically exempt banks, savings and loan institutions, and federal credit unions from the agency's jurisdiction. The Commission, however, does have jurisdiction over nonbank financial companies, including nonbank mortgage companies, mortgage brokers, finance companies, and units of bank holding companies. As a general matter, the Commission engages in law enforcement investigations as opposed to regular examinations of the entities under its jurisdiction.

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[1]GAO, FAIR LENDING: RACE AND GENDER DATA ARE LIMITED FOR NONMORTGAGE LENDING, GAO-08-698 (June 2008).

[2]15 U.S.C. § 1691. Congress directed the Federal Reserve Board (FRB) to implement the ECOA through Regulation B, 12 C.F.R. § 202.

As detailed in the Commission's July 2007 testimony[3] before this Subcommittee, over the last 30 years, the Commission has brought over forty cases alleging violations of both the substantive and procedural protections in ECOA. Many of the cases alleged violations as to nonmortgage creditors, including automobile or mobile home financiers,[4] finance companies,[5] department store creditors,[6] and other nonmortgage creditors[7] – as well as mortgage-related entities.[8] The FTC brought its most recent substantive (*i.e.*, nonprocedural) ECOA discrimination cases against nonmortgage creditors in 1999.[9]

Since the late 1990s, with the dramatic growth of subprime mortgage lending, the Commission shifted its lending enforcement focus to deceptive or unfair acts or practices of mortgage lenders, brokers or servicers subject to its jurisdiction. In the last decade, the agency has brought 22 such actions, focusing in particular on the subprime market.[10] Several of these landmark cases have resulted in large monetary judgments, collectively returning more than

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[3]The Commission's testimony is available at www.ftc.gov/os/testimony/P064806hdma.pdf.

[4]*E.g.*, *United States v. Ford Motor Credit Co.*, No. 99-75887 (E.D. Mich. 1999) (auto); *United States v. Franklin Acceptance Corp.*, No. 99-CV-2435 (E.D. Penn. 1999) (auto); *Federal Trade Commission v. CIT*, No. 94-4092 (D.N.J. 1994) (mobile home).

[5]*E.g.*, *United States v. The Money Tree, Inc.*, No. 6-97-CV-7 (M.D. Ga. 1997); *United States v. Bonlar Loan Co., Inc.*, No. 97C-7274 (N.D. Ill. 1997); *United States v. Barclays American*, No. 91-14 (W.D.N.C. 1991); *United States v. Chesterfield*, No. 90-0347 (N.D. Ala. 1990) (several interrelated finance companies); *United States v. City Finance*, No. 90-246 (N.D. Ga. 1990); *United States v. Tower Loan of Mississippi*, No. 90-0447 (S.D. Miss. 1990); *United States v. Blake*, No. 90-1064 (W.D. Okl. 1990) and No. 09-2470HB (W.D. Tenn. 1990).

[6]*E.g.*, *United States v. J.C. Penney Company*, No. CV-96-4696 (E.D.N.Y. 1996).

[7]*E.g.*, *United States v. Sprint Corp.*, No. 04-00361 (N.D. Fla. 2004) (telephone service provider); *United States v. Academic Int'l*, No. 91-2738 (N.D. Ga. 1991) (encyclopedia seller).

[8]*E.g.*, *FTC v. Associates First Capital Corp.*, No. 01-00606 (N.D. Ga. 2001); *United States v. Action Loan, Inc.*, No. 3:00CV-511-H (W.D. Ky. 2000); *FTC v. Capital City Mortgage Corp.*, No. 98CV00237 (D.D.C. 1998) (2005 settlement); *United States v. Shawmut Mortgage Co.*, No. 93-2453 (D. Conn. 1993); *United States v. Paine Webber*, No. 92-2921 (D. Md. 1992).

[9]*United States v. Ford Motor Credit Co.*, No. 99-75887 (E.D. Mich. 1999) (auto financier); *United States v. Franklin Acceptance Corp.*, No. 99-2435 (E.D. Penn. 1999) (auto financier).

[10]The Commission's February 2008 testimony before the House Subcommittee on Financial Services and General Government, Committee on Financial Services described our mortgage lending enforcement program. The testimony is available at www.ftc.gov/os/testimony/P064814subprime.pdf.

$320 million to consumers. The Commission's enforcement and education mission in this area remains a high priority. In addition to its actions alleging unfair and deceptive lending practices, the Commission currently has several ongoing, non-public investigations of mortgage companies to determine whether violations of ECOA and Regulation B have occurred. The Commission uses the Home Mortgage Disclosure Act (HMDA)[11] pricing data, available since 2005, as a screening or targeting tool for these fair lending compliance investigations. HMDA data have been useful in facilitating the Commission's efforts to target companies for fair lending investigations.

With this background in mind, we turn to your four specific questions.

1. and 2. Should personal characteristic data be collected on applicants for and borrowers of nonmortgage credit? What types of nonmortgage loans should be included if personal characteristic data is collected (*e.g.*, small business loans, automobile loans, or other categories)?

Our earliest fair lending cases against nonmortgage creditors alleged violations of ECOA based policies and procedures that were discriminatory on their face, and thus did not require analysis of applicant data.[12] Our most recent fair lending enforcement program has focused on mortgage lending. Thus, the Commission does not have recent enforcement expertise on which to base its response to the important questions you raise regarding nonmortgage credit.

As a general matter, however, the Commission believes there is a potential law enforcement benefit from collecting personal characteristic data to the extent that it may facilitate the evaluation of ECOA compliance in a given investigation of a nonmortgage creditor.[13] Any benefits would need to be balanced carefully against the costs of such a collection

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[11]12 U.S.C. §§ 2801-11. HMDA is implemented by the FRB's Regulation C, 12 C.F.R. § 203.

[12]*United States v. Ford Motor Credit Co.*, No. 99-75887 (E.D. Mich. 1999) (alleged marital status discrimination where company's policy was to combine incomes of married co-applicants but not unmarried co-applicants); *United States v. Franklin Acceptance Corp.*, No. 99-CV-2435 (E.D. Penn. 1999) (alleged discrimination based on sex, marital status, and receipt of income from public assistance where company's policy was to refuse consideration of income from child support and certain Social Security benefits and to combine incomes of married co-applicants but not unmarried co-applicants); *United States v. Bonlar Loan Co., Inc.*, No. 97C-7274 (N.D. Ill. 1997) (alleged violations of ECOA where, among other things, company impermissibly asked for applicants' marital status and used application form that did not contain gender neutral language).

[13]In recognizing a potential law enforcement benefit, the Commission assumes that a determination can be made that this potential benefit outweighs the risk that the collection of personal characteristic data would be used for discriminatory purposes and the possibility that such collection is unreliable.

regime, including the need to protect adequately the sensitive data collected. In addition, the benefits and costs may differ for each category of nonmortgage loan (*e.g.*, small business, automobile, or other), requiring different analyses that may yield different conclusions.

3. Should the collection of such data be mandatory or voluntary?

As you know, the Federal Reserve Board (FRB) implements ECOA through Regulation B. In 2003, the FRB decided to retain the general prohibition on the collection of personal characteristic data in nonmortgage transactions after seeking public comment on a proposal to allow voluntary collection of such data. As part of its decision, the FRB revised Regulation B to permit lenders to collect this data solely for the purpose of conducting "self-testing" to allow lenders to assess their compliance with ECOA. At this point, the Commission does not have a basis to opine as to whether collection of the data, if permitted beyond the self-testing exception, should be voluntary or mandatory.[14]

4. Should personal characteristic data be collected by the lenders and publicly reported, collected but not publicly reported, or collected but only reported to the appropriate federal banking regulator?

A primary goal for a collection and reporting scheme would be to enhance enforcement of ECOA as to nonmortgage lenders and, specifically for the Commission, as to the nonbank lenders subject to the Commission's jurisdiction. As noted above, such data could be useful to our fair lending enforcement efforts in certain circumstances. Any benefit from data collection and reporting, however, must be balanced against the cost and burden to those creditors in collecting, maintaining and reporting such data. A collection and reporting scheme would impose costs on industry, which could raise the price of credit to consumers to cover those costs. The Commission does not have sufficient information to enable it to weigh the costs against the benefits and reach a conclusion on this issue. We note that the draft GAO report, after conducting research and interviews, declined to make a recommendation on this question but stated that,

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[14]In 1999, the FRB proposed revisions to Regulation B that would allow voluntary (but not mandatory) collection of the data. The Commission joined the Treasury Department and several other federal agencies in a comment that supported lifting the prohibition on voluntary collection. Joint Comment of FTC, Dep't of the Treasury, Dep't of Justice, Dep't of Hous. and Urban Dev., Office of Thrift Supervision, Office of the Comptroller of the Currency, Small Business Administration, and Office of Federal Financial Enterprise Oversight Regarding Regulation B (Nov. 15, 1999), available at http://www.ftc.gov/os/1999/11/regb.pdf. The Commission has not reexamined the issue since that time.

"from a public policy perspective, considering the trade-offs of various options to enhance available data to assess potential discrimination in nonmortgage lending may be warranted."[15]

By direction of the Commission

William E. Kovacic

William E. Kovacic
Chairman

[15]GAO, *supra* note 1, at 8, 28.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

July 16, 2008

Honorable Melvin L. Watt
Chairman
Subcommittee on Oversight and Investigations
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for the opportunity to respond to the questions you submitted in advance of a hearing before the Subcommittee on Oversight and Investigations on July 17, 2008.

Enclosed is my response to those questions. If you have further questions or comments, please do not hesitate to contact me at (202) 898-6974 or Eric Spitler, Director of Legislative Affairs, at (202) 898-3837.

Sincerely,

Sheila C Bair

Sheila C. Bair

Enclosure

Response to questions from the Honorable Melvin L. Watt
by Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation

Q1. Should personal characteristic data be collected on applicants for and borrowers of nonmortgage credit?

A1. The FDIC would defer to the Federal Reserve Board regarding the collection of personal characteristic data as they have the rulemaking under the Equal Credit Opportunity Act. Deciding whether to collect personal characteristic data of nonmortgage loan applicants and borrowers presents difficult issues, as articulated in the recent report by the Government Accountability Office. On the one hand, such information could be useful for detecting lending discrimination. On the other hand, collection of the information could be costly, and highlighting an applicants race and ethnicity could have unintended or counterproductive effects. Before such collection is undertaken, these difficult issues must be thoroughly considered and addressed, for example through notice and comment rulemaking, by the Federal Reserve Board.

Q2. What types of nonmortgage loans should be included if personal characteristics data is collected (e.g. small business loans, automobile loans, or other categories)?

A2. Determining whether it is appropriate to collect personal characteristic data for particular types of loans requires determining whether the potential value of the data for detecting discrimination is outweighed by the potential harm to applicants as described in the response to Question 1.

Q3. Should the collection of such data be mandatory or voluntary?

A3. If a decision is made to collect personal characteristic data, voluntary collection is unlikely to yield meaningful information that would allow the detection or prevention of discrimination. Mandatory collection of personal characteristic data, on the other hand, is potentially costly to the lender and ultimately the borrower. Reaching a decision on this question is illustrative of the types of difficult issues that must be weighed in deciding whether to collect such information.

Q4. Should personal characteristic data be collected by the lenders and publicly reported, collected but not publicly reported, or collected but only reported to the appropriate federal banking regulator?

A4. If it is determined that collection of personal characteristic should be required, then at a minimum it should be collected and maintained by institutions for the use of relevant regulatory agencies. While public access to the data yields benefits from broad research and analysis, constraints to protect individual applicants' privacy and address institutions' competitive concerns would need to be developed and implemented.

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July 16, 2008

Congressman Mel Watt
2236 Rayburn HOB
Washington, DC
20515-3312

Dear Congressman Watt:

On behalf of our low-income and elderly clients, the National Consumer Law Center ("NCLC") thanks the Oversight and Investigations (O & I") Subcommittee of the Financial Services Committee for scheduling a hearing on the topic of "GAO Report on Regulation B: Should Lenders Be Required to Collect Race and Gender Data of Borrowers for All Loans". Unfortunately, we are not able to send a representative to the July 17, 2008, hearing. Nonetheless, we would like to take this opportunity to provide the O & I Subcommittee with some background information from our advocacy and litigation experience that might be helpful in its deliberations.

The National Consumer Law Center is a nonprofit organization specializing in consumer credit issues on behalf of low-income and elderly individuals. We work with legal services, government and private attorneys around the country representing these vulnerable populations. As a result of our daily contact with these practicing attorneys and advocates we have seen examples of discriminatory lending to low-income and elderly people throughout the country. NCLC also is author of the widely praised eighteen-volume <u>Consumer Credit and Sales Legal Practice Series</u>, including *Credit Discrimination* (4th ed. 2005 with 2007 Supp.).

On March 16, 2005, Judge Aleta Trauger of the United States District Court for the Middle District of Tennessee ruled from the bench in the case of *Borlay v. Primus Automotive Financial Services*, Civil Action 3:02-0382, "that the plaintiffs have proved their case and that they will win in my decision." Thus ended a three week trial that resulted in what is believed to be the first, and to this date only, successful effort to obtain a judicial finding of disparate impact discrimination in a private, non-mortgage related, consumer credit case brought under the provisions of the Equal Credit Opportunity Act ("ECOA"), 15 U.S.C. §§1691 *et seq* since its enactment in 1974. NCLC was proud to serve as one of the co-counsel in the *Borlay* case (which subsequently settled), as well as part of the litigation team that brought and ultimately settled 10 other similar cases against auto financers around the United States.

The first two of these cases were filed in 1998. All of the complaints alleged that the defendant automobile finance companies established specific identifiable and uniform credit pricing systems that authorized unchecked, subjective markup of objective risk-based financing rates. The complaints further alleged that the effect of this subjective finance charge markup had, in violation of the ECOA, a widespread discriminatory impact on African-American and Hispanic financing applicants.[1]

As you are aware, the ECOA prohibits discrimination in all stages of a credit transaction, from the initial request for credit through final payment or a collection action. 15 U.S.C. §1691(a) (making it unlawful for a creditor to discriminate in "any aspect of a credit transaction."); Reg. B, 12 C.F.R. §202.2(m). See also *Coleman v. General Motors Acceptance Corp.*, 196 F.R.D. 315 (M.D. TN 2000), *Jones v. Ford Motor Credit Company,* 2002 WL 133481 (S.D.N.Y. June 17, 2002). The ECOA relies on the fundamental and indisputable concept that equally creditworthy consumers should be treated similarly. See, Reg. B, 12 C.F.R. § 202.6 ("creditor shall not take a prohibited basis into account in any system of evaluating the creditworthiness of applicants"). The ECOA is intended to insure that "...no credit applicant shall be denied the credit he or she needs and wants on the basis of characteristics that have nothing to do with his or her creditworthiness." S. Rep. No. 94-589, 94th Cong., 2d Sess. 3, reprinted in 1976 U.S. Code Cong. & Admin. News 403, 405.

The ECOA discriminatory impact standard does not require an intent to discriminate. It is enough that the markup policies, although racially neutral on their face, result in a discriminatory effect. The ECOA mandates that equal access to credit is such a fundamental necessity in our society that creditors have a duty to insure that their lending practices do not intentionally <u>or</u> inadvertently lead to unequal access to credit for any protected group.[2] Simply put, the legislation does not permit creditors to stick their heads in the sand and ignore reality by failing to monitor the ultimate outcomes of their policies and procedures.

To the contrary, ECOA makes it clear that creditors have an affirmative obligation, after the financial transaction has been consummated, to check whether their policies and procedures have generated unintended outcomes. The ECOA specifically provides for self-testing in order to determine ECOA compliance, to find possible violations and to take appropriate corrective action.[3] The statute creates a self-testing privilege that protects the results of self-tests and provides that they may not be obtained or used in any civil action.[4]

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[1] For a more detailed history of this litigation and analysis of the theories propounded in these cases *see,* Stuart T. Rossman, *Financing Fair Driving: Race Discrimination in Retail Car Loans,* 36 CLEARINGHOUSE REV. 227 (2002); *see also, Jones v. Ford Motor Credit Company,* 2005 WL 743213 (S.D.N.Y. March 31, 2005)[granting motion for class certification]; *Coleman v. General Motors Acceptance Corp.,* 220 F.R.D. 64 (M.D. TN 2004)[granting motion for class certification]

[2] See, Congressional Findings and Statement of Purpose for ECOA, Pub. L. 93-495, §502, 88 Stat. 1525 (Oct. 28, 1974)

[3] 15 U.S.C. § 1691c-1.

[4] 15 U.S.C. § 1691c-1(a)(2); Regulation B, Section 202.15, further refines the scope of the self-testing privilege and provides that it does not apply to the fact of testing, including methodology, scope, time period or dates of test. Nor does it apply to loan files themselves (including aggregated or summarized information).

Given the broad requirements, protections, remedies and powers provided by the ECOA, it should be questioned why it took over 30 years for there to be the first successful private enforcement of rights under the disparate impact provisions of the statute. Based on our experience in the auto finance discrimination, it is our opinion that the answer for this phenomenon is twofold.

First, without access to empirical aggregate data concerning the race, age or sex of the consumer pursuing non-mortgage related credit it is impossible for anyone to know that a creditor's credit policies have resulted in a disparate impact on a protected category. An individual who has been the victim of intentional discriminatory treatment may be able to collect direct or circumstantial evidence of actual discriminatory acts, practices or patterns of behavior regarding their own circumstances. However, an individual cannot even be aware of the fact that they have been the victim of the disparate impact of a credit policy without knowledge of all of the other transactions involving that credit policy and the ability to distinguish the race, sex or age of the consumers involved in such transactions.

In 2001, looking back on 10 years of empirical data in the auto industry, Professor Ian Ayres of Yale Law School, an expert witness for the plaintiffs in the *Borlay* case as well as in a number of the other auto finance discrimination cases brought by NCLC, concluded:

> While the impulse for race and gender discrimination in car markets (for example, the search for high-markup sellers) may not be the same impulse driving discrimination in other markets, the car market probably shares with other markets an important structural aspect that creates an opportunity to discriminate. Just as the car buyer has trouble knowing how other consumers are treated, there are myriad aspects of service and accommodation in which it is difficult for a consumer to know how other consumers are treated. A seller's nondiscrimination along these dimensions of service are a "credence" good that consumers to a large degree must simply take on faith. And these are just the dimensions where discrimination is most likely to persist.[5]

Until the filing of the auto finance discrimination cases under the ECOA, African American consumers simply did not know that they had been "marked up" or treated any differently than other consumers financing automobile purchases. These consumers trusted this dimension of service "on faith" and took in "on credence" that they were not being discriminated against - - and they were misled.

Second, even if one had the anecdotal "sense" that a particular credit policy had a discriminatory impact on a protected group, it was impossible to "prove" the violation under the ECOA without the necessary admissible evidence of that discrimination. In 1991, Professor Ayres published his groundbreaking article entitled *Fair Driving: Gender and Race Discrimination in Retail Car Negotiations* in the Harvard Law Review.[6] The article examined whether the process of negotiating for a new car disadvantaged women and minorities. "Testers" of different races and genders entered new car dealerships in the Chicago area and bargained to buy a car, using a uniform negotiation strategy. The study tested whether automobile retailers

[5] *Pervasive Prejudice*, (2001) p 161-2.
[6] 104 Harv. L. Rev. 817 (February, 1991).

reacted differently to the uniform strategy when potential buyers differed only by gender or race.[7]

The results were extremely disturbing.[8] The tests revealed that white males received significantly better prices than blacks and women. White women had to pay forty percent higher markups than white men; black men had to pay more than twice the markup, and black women had to pay more than three times the markup of white male testers.[9]

However, the size of the pool of credit applicants studied by Professor Ayres through his testers simply was too small to present a statistically significant data base sufficient to sustain a disparate impact burden of proof under ECOA in a court of law. Unfortunately, unlike the circumstances in the mortgage lending industry, where the Home Mortgage Disclosure Act ("HMDA"), 12 U.S.C. § § 2801-2810 and Federal Reserve Board Regulation C, 12C.F.R. § 203.2-303.6 require that mortgage lenders collect certain data on loan applicants and that the Federal Financial Institutions Examination Council prepare statements and produce various public reports on the practices of these individual lenders, no comparable publicly available race coded data base exists for non-mortgage loans. To the contrary, except for the self testing scenario provided by the ECOA discussed above (an obligation that, to the best of NCLC's knowledge and experience, has rarely, if ever, been undertaken by non-mortgage lenders pursuant to the statutory authority), the applicable laws currently prohibit the consideration, let alone collection, of such race based data.

In the auto finance discrimination cases the plaintiffs' attorneys developed a novel approach to creating a race coded data base that was large enough to perform aggregate analyses that were statistically significant. There currently are 14 states in the United States that include race as an identifying characteristic on their state drivers' licenses (Florida is the only state that maintains a separate "Hispanic" category). The original suits were brought in Tennessee, one of the 14 states where race is identified on resident drivers' licenses. The plaintiffs subpoenaed the records of the Tennessee Registry of Motor Vehicles to get electronic copies of all of the current residential drivers' licenses and matched the licenses against an electronic file of all of the defendant auto finance companies' consumer debtors in the state during a defined period of time. The computer comparison created a large pool of race-coded transactions that facilitated a disparate impact analysis by the plaintiffs' experts for the state.

The success of the Tennessee state-based data compilation effort encouraged the plaintiffs' counsel to seek to expand their research to the other 13 states where race is identified on drivers' licenses. More important, the results of the preliminary Tennessee disparate impact analyses were relied upon to convince the Federal Court in Nashville to permit the national studies to take place and to order the defendant auto finance companies to produce their

[7] *Id.* at 818.
[8] Ayres extrapolates the results of his 1991 study to conclude that a $500 overcharge per car means that blacks annually paid, at that time, over $150,000,000 more for new cars than they would have if they were white males. *Id.* at 872.
[9] *Id.* at 819; See also, Ian Ayres, *Further Evidence of Discrimination in New Car Negotiations and Estimates of its Cause,* 94 Mich. L. Rev. 109 (Oct. 1995), in which Professor Ayres' study was expanded and retested. The results were similar, but this time, unlike the original study, the black male testers were charged higher prices than the black female testers.

electronic files for all of their consumer debtors throughout the country during a defined period of time.

The computer comparison permitted us to develop race coded data bases for millions of transactions. Furthermore, as a result of the mobility of the American population, during the period of study a sufficient number of individuals moved to a state where race was included on their new driver's license, after financing a car in another state that did not, that we were able to race code a statistically significant data base for a total of 33 states (the original 14 states with race on their drivers' licenses and 19 more where race was not included on licenses). What we discovered when we completed our disparate impact analyses confirmed the results of our earlier, Tennessee limited, study, and served as the eventual evidentiary basis for our on-going national class-action litigation against the auto finance lenders.

Needless to say, this innovative process, though ultimately successful, was extremely expensive and time consuming for the plaintiffs and their counsel. Discovery, computer analysis, expert review and presentation to the Court required an upfront expenditure of over $1 million. The litigation of the cases spanned from 1998 to 2006. It is highly unlikely that many groups (and this litigation involved at least 7 law firms working on behalf of the plaintiffs in the various cases over time) would have the wherewithal or resources to pursue and prove such a disparate impact claim under the ECOA.

NCLC believes that there are policies being applied by lenders at this very time in a wide range of non-mortgage related finance transactions that may result in disparate discriminatory impacts on various protected groups under the ECOA. The question is who will be able to uncover these cases of discrimination and actively pursue effective remedies as promised under the ECOA? The problem is that without access to data similar in nature and type to that made available through the HMDA for mortgage transactions, no one will have an easy time coding an aggregate pool of information sufficient to prove there has been disparate impact discrimination as a matter of law under the ECOA.

We therefore answer the question posed by the GAO as to whether lenders should be required to collect race and gender data of borrowers for all loans under Regulation B with an emphatic "yes". Only by adopting fair and reasonable procedures for collecting and disseminating such data, as already is the case through the HMDA, will there be public awareness of possible disparate discriminatory impacts caused by policies maintained by creditors in every area of the personal financial credit marketplace. Without this data, government enforcement agencies or private consumer advocates will not have the information they need to fully and adequately protect the rights of credit consumers guaranteed by the ECOA. It should not be another 30 years before there can be another successful civil rights enforcement action under the statute to eliminate a credit finance policy that results in racial or sexual discrimination.

Thank you for your consideration in this matter. We appreciate the opportunity to present this written testimony to you and the O & I Subcommittee of the Financial Services Committee on a civil rights and access to consumer credit issue of great importance. If you have any questions or would like additional information or assistance, please feel free to contact us.

Very ~~truly~~ yours,

Stuart T. Rossman
Director of Litigation

- Attachment B

BOARD OF GOVERNORS OF THE

FEDERAL RESERVE BANK
OF CHICAGO

99 NOV 19 AM 11:33

MICHAEL H. MOSKOW
President
(312) 322-5001
(312) 322-2141 (Fax)

November 17, 1999

Jennifer J. Johnson
Secretary
Federal Reserve Board of Governors
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Ms. Johnson:

The Federal Reserve Bank of Chicago is pleased to present this response to the Board's request for comment on a number of proposed changes to Regulation B, which implements the Equal Credit Opportunity Act ("ECOA"). Given the authority that the Act affords the Board in writing Regulation B and in revising it as needed, we appreciate this important opportunity to provide our views to this process, as the changes will ultimately affect not only Federal Reserve regulated institutions, but lenders throughout the nation.

The increasingly rapid rate of technological development has had a tremendous impact on the nature and conduct of consumer, small business and small farm lending. Many products, policies and practices that are standard in today's' credit markets were never envisioned by the original ECOA, and even recent updates to Regulation B have been outstripped by the current lending environment. We hope that the recommendations of the enclosed paper assist the Board in developing appropriate responses to these changes, and in laying the groundwork for the future direction of ECOA regulation.

The Federal Reserve Bank of Chicago supports the Board's amendments to Regulation B, with the recommendation that a standardized collection methodology be included. In particular, we endorse the removal of regulatory restrictions on lending institutions from collecting information on applicants' race, ethnicity and gender. This may allow institutions to identify and reduce discriminatory lending practices and expand credit products to under-served communities. We do recommend that the Board include some standards for lending institutions to follow when implementing a voluntary collection program in order to overcome some of the inherent weaknesses of this type of program. We also suggest that the regulatory agencies and lending institutions embark on an extensive campaign to educate consumers on this change to ensure them this information will not be used in the credit decision.

230 SOUTH LASALLE STREET
CHICAGO, ILLINOIS 60604-1413

Thank you for the opportunity to respond and we look forward to assisting in any way in this effort to make Regulation B more responsive to the fair lending challenges presented in today's lending environment.

Sincerely,

Michael H. Moskow

Response to the Board's Request for Comment Regarding Proposed Revisions to Regulation B, Docket No. R-1008

Prepared by the staff of the Federal Reserve Bank of Chicago[1]
11/17/99

Summary of Recommendations

In summary, the Federal Reserve Bank of Chicago supports the Board's proposal for voluntary collection of race, ethnic and gender information ("monitoring data") currently prohibited in Regulation B. Removing this restriction from lending institutions may provide them with an opportunity to analyze and improve their credit practices. Their behavior, however, will be effected by the fact that examiners will have access to the data. We recommend that the Board develop a standardized framework for the voluntary collection process in order to minimize lenders' incentives to enhance the appearance of their data and to maximize the usefulness of the data to regulators. Lastly, we believe that further research is needed on the costs and benefits of mandatory collection and reporting and we recommend that the Board conduct these studies.

Introduction

The Board of Governors ("Board") has requested comment on its proposed revisions to Regulation B, which implements the Equal Credit Opportunity Act, and to the official staff commentary to Regulation B. The Board is requesting comment pursuant to its periodic review of Regulation B, as required by three congressional acts (section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994, section 610 of the Regulatory Flexibility Act of 1994, and section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996). The revisions currently proposed by the Board were developed partly in response to the comments received to its Advance Notice of Proposed Rulemaking ("Advance Notice"), published in March 1998. Our comment expands upon some of the themes of our response to the Advance Notice; additional responses have also been developed and are included.

The Board summarizes its request for comment ("RFC") into four general categories; 1) remove the general prohibitions against creditors noting characteristics such as race, sex and national origin of applicants for nonmortgage credit; 2) require creditors to retain certain records for preapproved credit solicitations; 3) expand from 12 to 25 months the record retention period for most business credit applications; and 4) various revisions to official staff commentary on Regulation B. This memorandum is organized to correspond with this sequence.

Response to Item #1: Board's proposal to remove prohibitions against creditors noting certain applicant characteristics for nonmortgage credit

[1] Lorraine Woos, Ken Davidson, William Lloyd, James Moser and Lisa Ashley

The characteristics that constitute prohibited bases upon which to make, wholly or in part, a credit decision, are listed in the Equal Credit Opportunity Act ("ECOA") and the Fair Housing Act ("FHA"). In order to effect compliance with certain fair lending efforts embodied in the Home Mortgage Disclosure Act ("HMDA"), creditors have been mandated, under specifically limited and defined circumstances, to proactively collect monitoring information on certain prohibited bases characteristics (race, ethnic origin, and gender). The current proposal by the Board recommends further modification of Regulation B to permit lenders, on a voluntary basis, to collect data on applicants' prohibited bases characteristics for any consumer, small business or small farm loan application. Lenders could use the information for a variety of purposes such as self-assessment for fair lending compliance, provided that the data is not illegally used in the credit decision. The Board has twice (in 1995 and 1998) requested comment regarding the advisability of voluntary recording of applicants' prohibited bases characteristics (for the purposes of this memorandum, "data"). The current RFC provides a comprehensive summary of the comments received both supporting and opposing voluntary collection of these data.

The following sections of this item discuss in greater detail our position on voluntary collection, as well as the benefits and costs of mandatory collection and reporting. In addition, we recommend that the Board, in conjunction with other federal regulators, implement a consumer education campaign on the new data collection program and on the way to file a complaint. Furthermore, we recommend that the Board review the existing procedures as to when examiners may require an institution to collect monitoring information.

Voluntary data collection

The benefits to be gained by a voluntary data collection are primarily to the lending institution. Certain lenders may use the data collection option to experiment with marketing, underwriting and other aspects of their loan programs to achieve greater penetration into minority and other protected class markets. It may also be useful in a firm's risk management activities, as a means for detecting and correcting discriminatory practices.

The regulatory burden of a voluntary program is low, as the collection decision is in the lending institution's control. Furthermore, voluntary collection may reduce regulatory costs and violations through the use of a universal application form. A universal application form would both provide cost savings to lenders by eliminating the need to stock different types of forms and would also ease the compliance burden. Arguably, one of the most cited compliance violation is "illegal collection of monitoring information," resulting from inadvertent use of the wrong form or confusion about when to collect monitoring information. Lenders would also realize savings with respect to staff training, compliance program management, audit, and other costs related to the varying requirements currently in place for collection of monitoring information.

In addition, a bank's participation in the voluntary data collection program could be considered an enhancement to the lender's Compliance Management Program ("CMP") as described in the Interagency Risk-Based Fair Lending Examination Procedures. This consideration under a CMP may provide an incentive for bank participation, as high-quality CMPs can contribute to a reduction in fair lending examination burden under the new guidelines. For example, it could eliminate focal points or reduce loan sample sizes. Also, voluntary collection could enable the bank to perform meaningful "self-assessments" as defined by the procedures. This could contribute to a basis for reduced examination burden[2].

While these benefits may potentially accrue to lending institutions, the mere fact that regulatory agencies will have access to this data will likely change the behavior of the institutions. They will have the incentive to collect data only if they are certain that it will reflect positively on their lending practices. They will be reluctant to collect data on programs that the outcome is uncertain. This behavior is at odds with the original purpose of allowing institutions the freedom to analyze their lending patterns. It is also in conflict with the desired outcome of reduced discriminatory credit practices.

It may be possible to partially mitigate this behavior by providing an incentive for banks to report undistorted data on their loan portfolios. If banks desire CRA credit on loans for which they are voluntarily collecting data or if they would like a reduction in examination burden, then we recommend that they be required to follow a structured methodology for collecting the monitoring data. While this would not overcome the problem of getting institutions with questionable profiles to collect the data, it does discourage institutions from collecting the data in a biased manner.

To expand on this idea, it is our opinion that few lenders will choose to implement voluntary collection, and those that do will be the lenders least likely to have fair lending compliance problems. The majority of lenders that implement voluntary data collection for self-monitoring purposes will be banks that have received high marks for their fair lending compliance programs. Conversely, it is unlikely that lenders with weak fair lending compliance programs, or with products or practices that pose a high level of fair lending risk, will voluntarily collect data that may confirm fair lending violations. This is especially the case, as confidentiality provisions that prohibit viewing or use of the data by federal regulators will not cover voluntary data collection. Given the profile of lenders that are most likely to initiate a voluntary collection program, the data will be biased. We question the regulatory value of this data absent a standardized framework.

Even banks with strong fair lending compliance programs and strong compliance records may not collect monitoring data because it could be used to their detriment during the fair lending examination process. In our experience, we find that most banks do not knowingly introduce loan policies or permit behaviors that run counter to fair lending compliance; in fact, many banks are surprised when agency examiners discover fair lending violations. While the self-management incentives in the new risk-based fair

[2] See the new Federal Reserve Bank of Chicago publication, "Banker's Guide To Risk-Based Fair Lending Examinations", which summarizes the new procedures, or the full text of the procedures, "Interagency Fair Lending Examination Procedures", for more detailed explanation of how enhanced CMPs or lender "self-assessments" can reduce examination burden.

lending examination procedures could result in banks independently improving their lending practices, the current environment appears to be one wherein they are not sufficiently confident about their lending policies, products and practices to risk discovery of fair lending violations.

Additionally, as noted in the Board's discussion, data collection standards could vary not only between lenders, but also within a given lender's operations. Lack of uniformity compromises data validity and reliability, and limits the comparability of data sets. Lack of mandated standards will also require lenders to create their own standards that may be designed to systematically enhance institutions' lending profiles. Therefore, to mitigate this behavior, we recommend that the Board set guidelines for data collection, similar to the level of guidance provided for HMDA reporting.

We also note that the possibility of "cherry-picking" exists under the Board's voluntary proposal. Unless specifically prohibited, a lender could collect data on applications for only one product within a product family, but not collect data for the entire product family (e.g., a particular type of auto loan product within the family of various auto loan products). Thus, a lender could "cherry pick", or limit data collection to loan products within a product family that it feels would reflect favorably on its fair lending practices, while ignoring other products in the product family that may pose a high degree of fair lending risk. We recommend that the Board include in its voluntary data collection program, a prohibition against this strategy that mirrors an existing prohibition in the CRA regulation[3].

We believe that a positive way to encourage banks to adopt a standardized collection program is to provide them with clear benefits associated with doing so. We suggest that if lenders utilize a collection framework developed by the Board, they could receive CRA credit for the non-HMDA lending portfolios that show their positive lending practices. The data collected would be more reliable since it was collected according to the standards. Another benefit to lenders could be a reduction in regulatory burden, as justified by a high-quality CMP.

Despite the recommendations above, we continue to have reservations about some aspects of the voluntary proposal. We are concerned regarding other uses, unrelated to fair lending, to which these data may be put. For example, data privacy issues currently loom in the forefront of recent public policy and financial legislation discussions. In light of the Gramm-Leach-Bliley Act of 1999 ("Act") privacy provisions, it appears that lenders may sell confidential customer information to unaffiliated third parties, as long as lenders notify applicants and allow them to "opt out". Furthermore, it appears that this data may be used either in house or by affiliates, for targeted solicitations as long as the information sharing policies are disclosed to the applicant at the time the relationship is established. We question whether monitoring data, collected under the Board's voluntary proposal, should be sold or shared, given that its use is prohibited in the provision of credit. We urge the Board to consider limiting the sale or transfer of the data to third parties and affiliates to cases when the uses qualify as affirmative outreach to protected

[3] Regulation BB Section 228.42(c) "Optional data collection and maintenance - consumer loans"

class applicants, using criteria similar to those specified in Section 202.8 of Regulation B, "Special-Purpose Credit Programs".

Second, since the voluntary proposal would apply equally to all lenders, we are concerned about the ability of loan companies to ensure that monitoring data is not used to discriminate. The level of proactive fair lending compliance management at loan companies is unknown, and since they do not receive regularly scheduled fair lending examinations and are not otherwise supervised with the same degree of intensity as banks, the risk of illegal use of monitoring data is relatively higher.

Finally, we believe that voluntary data collection is not likely to have a similar effect to that of HMDA data in assisting in the detection of discriminatory lending practices and in otherwise encouraging mortgage-related lending to underserved markets and groups. We point out that HMDA data collection is mandatory, standardized, and publicly reported. None of these provisions are included in the current RFC. Therefore, we do not believe that voluntary collection is likely to achieve HMDA-like effects.

Mandatory data collection and reporting

As first stated in response to the Board's 1998 Advance Notice, we reiterate that mandatory collection of monitoring data on all consumer, small business and small farm loans is a way to ensure that lenders and regulators are able to detect and modify discriminatory lending practices. A voluntary program may not be sufficient to induce lenders with uncertain or discriminatory credit practices to collect data. Mandatory reporting of this data is a way to introduce transparency and market discipline into the lending process. A reporting program would provide a greater degree of public oversight into lending patterns and compliment the federal agencies' fair lending examination programs. Clearly, we recognize that there are costs associated with a mandatory program, primarily one expanded to include a reporting component. We discuss the benefits and costs of both mandatory collection and reporting and offer two cases in particular wherein mandatory data collection warrants further study.

Benefits

Mandatory data collection is beneficial for regulatory staff as a tool for fair lending examinations and complaint resolution. Federal agency compliance staff are currently unable to conduct thorough fair lending examinations or review of consumer complaints alleging discrimination for any but HMDA products, due to lack of monitoring information on non-HMDA consumer, small business and small farm loan applicants. Agency guidance suggests that examiners use surrogate information, such as ethnicity of last names, gender of first names, and census tracts or zip codes of residence. Generally, this results in inadequate bases for conducting responsible examinations and complaint investigations, as reflected by years of experience by field examiners, Reserve Bank management and Board staff.

It is this Reserve Bank's experience that while some application information or surrogate information can assist examiners in identifying many of the protected class categories, it is very difficult to assume African-American status from given names or surnames.

Research and anecdotal data suggests that African-American applicants may be among the most disadvantaged in the credit application process. Census tract of residence is helpful in identifying African-American applicants only if that group comprises a predominant portion of the tract's residents. Even this data is questionable in certain markets, depending on the age of the data and the residential market dynamics in the area. In addition, we question the evidentiary value of surrogate information in any judicial proceeding that might result from an agency enforcement action. Mandatory data collection could resolve these issues by providing a basis for meaningful and efficient fair lending compliance and self-assessment exams and complaint investigations.

There are also a number of benefits associated with a mandatory program that includes a public reporting component. We suggest that the market itself could play an important role in deterring and ending discriminatory lending practices by disciplining noncompliant credit providers. Transparency of a lenders credit portfolio is the key to this market solution, and would require that the data be made available for public scrutiny. In this scenario, lenders would have additional incentives, beyond traditional regulatory oversight, to adhere to ECOA guidelines. This may be an especially useful compliance mechanism for firms that are not subject to regulatory exams.

In addition, a mandatory reporting program would provide data for research. Such a data set would provide federal regulators, the lending industry, public interest groups and researchers with a body of data for various types of analysis that could improve the understanding of the dynamics of consumer lending. This may be especially important given the rapid growth of subprime lending, unsolicited pre-approved loans, and lending through the Internet.

Costs

The cost of mandatory data collection and reporting must be weighed against the economic and societal benefits of improved fair lending compliance. In order to perform that assessment, it is important to recognize that burden on lenders for data reporting will be greater than the burden for data collection, and that cost will differ between categories of lenders. A third major cost consideration is the cost to lenders and federal agencies to consolidate the information, ensure its reliability and validity and make it available to the public. A discussion of each of these considerations follows.

First, it is important to consider the differences in costs, both explicit and implicit, that are associated with a data collection requirement and a public reporting requirement. A requirement limited to data collection, involving the recording of a consumer, small business or small farm applicant's race, ethnicity and gender on the loan application form, would be less burdensome to lenders, whether banks or loan companies[4]. Two

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[4]We refer to federally insured depositories and their subsidiaries as "banks" and private sector lending companies and other creditors, whether or not owned by bank holding companies as "loan companies". The difference between these two groups is that lenders in the "bank" category are subject to regularly-scheduled, comprehensive fair lending compliance examinations, while lenders in the "loan company" category are not routinely and comprehensively reviewed for compliance to fair lending or other consumer protection laws and regulations. Many loan companies, in fact, have never been subject to any level of

questions or fields, similar to those mandated on housing applications, indicating gender and race or ethnicity, could be added to each file or electronic form.

The costs associated with implementing a data reporting program clearly would be greater than those associated with a simple data collection program. Current HMDA reporters, and those lenders with access to the federal regulatory agencies' HMDA support services (i.e. banks), would face lower costs and burden than non-HMDA reporting loan companies. This is especially true if the HMDA model is utilized.

The initial costs of reporting will differ between categories of lenders. For the purposes of this discussion, we have considered three categories of lenders: 1) current HMDA reporters, 2) banks that are not HMDA reporters, and 3) loan companies that are not HMDA reporters. The first category, all HMDA reporters, is already familiar with the general requirements for a mandatory data collection and reporting program. Current reporters would likely experience lower start-up costs in implementing a new reporting program, especially if it was based on the HMDA model. It is less likely that the second lender category, non-HMDA reporting banks, would have the prior reporting experience or the existing infrastructure. However, these banks would have access to a significant level of federal agency and trade group assistance in setting up their programs. The third category, loan companies with no HMDA experience, is likely to face the most significant start-up costs if mandatory data collection and reporting are adopted. Organizations and agencies associated with the banking industry could provide these loan companies and their federal regulators with access to the necessary software and technical expertise related to collection and reporting.

Lastly, there are significant lender and agency costs associated with reporting. Lenders would have to compile, verify and transmit data to their regulator. The regulatory agencies would have to consolidate the data, perform additional basic data verification, and make it available to the public. In addition, the agencies would have to consider whether to institute on-site examinations to ensure data reliability at the loan file level; it is only after the Reserve Banks have instituted this process for high volume reporters that examination teams have been able to use HMDA data with confidence. These procedures require considerable infrastructure, staffing and operations costs for lenders and agencies alike.

The federal financial supervisory agencies are well aware of the data problems that plague HMDA reports submitted by lending entities that are not subject to routine data verification reviews by their primary federal regulator. Error rates in HMDA reports submitted to the Department of Housing and Urban Development (HUD) by private mortgage companies, for example, are substantial and affect reliable usage. The recently mandated "CRA Data" on small business and small farm loans, reported annually in the mid-year bank Call Reports[5], is another example of a dataset with serious quality problems. In light of these unresolved issues, the question of how data validity and

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supervisory review of their fair lending practices by either their primary federal regulator or by state or other local regulators.

[5] Consolidated Reports of Condition and Income

reliability could be ensured under a mandatory program requires serious consideration. Furthermore, this undertaking would require the commitment of numerous federal regulatory agencies to provide adequate resources.

Two Cases for Further Study of Mandatory Data Collection
There are two cases in particular that are high priority for study by the Board wherein the benefits of mandatory collection may outweigh the costs. The first is for home equity loans. Mandatory collection of monitoring data for all home equity loans could reduce lender confusion, reconcile differences between ECOA's Regulation B and HMDA's Regulation C, and provide fair lending compliance examiners with concrete data that is currently unavailable. Specifically, monitoring data for all home equity applications, including both open- and close-ended products could be mandated. Mandatory data collection on home equity applications and lines of credit could both reduce regulatory confusion and burden for lenders, and provide much-needed information to the agencies for conducting fair lending compliance examinations and complaint investigations.

Requiring monitoring data for all loans that are secured by the applicant's principal dwelling, regardless of the purpose of the loan, would eliminate some of the apparent contradictions between regulations. In one part of Regulation B and its related commentaries, it states that data collection is required for loans "... secured by an applicant's dwelling". In other parts, it states that it is required for any "application for...purchase or refinance of a dwelling...secured by the dwelling". Regulation C states that monitoring data is required for home purchase and home improvement loans only, including refinancings of home purchase and home improvement loans. By requiring monitoring data for all home equity loans, these differences between the regulations would be reconciled and, for the reasons discussed below, both reduce regulatory burden and more directly address the intent of Regulation B and ECOA.

Many lenders have stated to Reserve Bank staff that the inconsistency of reporting rules between open-ended and close-ended home equity loans contributes to their incurring of Reg. C violations[6]. In addition, lenders report that they feel burdened by the necessity to question customers' uses of home equity loan funds, and that many of their customers dislike having to predict the use to which they may put the loan proceeds offered through lines of credit. For these reasons, mandatory home equity data collection would likely reduce confusion and burden for lenders.

The Reserve Bank's fair lending examination and complaint functions have been significantly hampered by the lack of these data. While mindful that Regulation C requires data collection only for dwelling purchase and rehabilitation purposes, the current realities of consumer lending are such that an increasing number of consumers

[6] For open-ended home equity lines of credit, reporting is optional, even if some or all loan proceeds will be used for home improvement. If the lender opts to report on these lines of credit, then only the dollar amount that will be used for home improvement should be reported. For close-ended home equity loans, it is mandatory to report on all home equity loans for which any part of the proceeds will be used for home improvement. For these loans, the entire loan amount is reported, regardless of the portion of the loan that will be used for home improvement.

realize significant debt pricing and tax advantages by using home equity loans to finance a variety of goods and services. Typical uses include school tuition, auto purchases, and medical services. We feel that it is in the public interest to ensure that protected classes of consumers have equal access to this important consumer-financing vehicle. While the intended uses of home equity proceeds may not be housing related, the bases for home equity loan discrimination are similar to that for dwelling purchase and rehabilitation loans. Discrimination issues raised by examination data, community contacts, and consumer complainants all support the need for comprehensive home equity data collection in order to adequately address these issues.

These new data on home equity loans could be included in lenders' Loan Application Registers ("LARs") and HMDA reports, in an effort to facilitate HMDA compliance and market discipline. HMDA reporters may prefer that these loans be added to HMDA reporting requirements as this would result in less confusion (and lower the potential for Regulation C violations) when preparing LAR and HMDA reports.

Another case that merits further study by the Board, where the benefits of mandatory reporting may outweigh the costs, relates to loan categories for which banks seek CRA credit. When a bank elects to include other non-HMDA categories of consumer loans for CRA credit, it could also be required to add monitoring data to the existing list of data already required for CRA purposes (loan amount, census tract, applicant income and loan identification number). Currently, examiners use the monitoring data collected as part of the HMDA data set to provide reasonable assurance that consumer real estate loans included in the CRA "lending test" have been offered in a manner consistent with fair lending requirements. However, when additional categories of consumer loans are included, at the bank's option, into the "lending test" assessment, monitoring data is not available. Thus, these loans cannot be adequately reviewed for fair lending compliance. The surrogate data currently used to simulate fair lending review of these loans is inadequate to provide the basis for a reliable review. Addition of monitoring data to the bank's existing data collection requirement for these voluntarily elected loans would provide examiners with the data they need to perform the fair lending review, and add minimal additional regulatory burden.

Other recommendations for voluntary and mandatory data collection programs

First, we strongly recommend that relevant federal agencies consider implementing a consumer education campaign if either voluntary, or some level of mandatory data collection, is approved. It can be expected that many consumers will question why information on their race, ethnicity and gender is being requested for non-housing loans, and will need to be informed regarding the reason why and to be reassured that the information will not play a role in the credit approval decision. In addition, without public recognition of the importance of monitoring data collection, applicants may become unwilling to provide this data on electronically-generated loan applications. Given the likely growth in this type of application over the Internet, the importance of a significant public education effort is clear.[7] We also recommend that the federal agencies

[7] The availability of monitoring data on HMDA-reportable applications is already being effected by the growth in electronically-generated applications. When an applicant declines or neglects to provide the

provide guidance to lenders regarding their responsibilities for adequately informing consumers about the purpose and uses for the data collection.

Second, it appears that the proposal for voluntary data collection does not include a provision for visual observation or use of surname to determine an applicant's race, ethnicity and gender in the event that the applicant declines to provide the information. We assume that since the proposed data collection is not mandated by federal regulation, the Board deems it inappropriate for a lender engaged in a voluntary program to note these characteristics independently, once the applicant has declined to do so. We support this position because, under the voluntary proposal described in the RFC, there are no HMDA-like provisions that would assist examiners in reviewing the data to ensure that the data has not been misused. Absent these consumer protections, we support prohibitions against visual observation, surname analysis, or use of other means by the lender to note an applicant's prohibited bases characteristics once the applicant has declined to provide the data. In addition, we recommend revisions to Regulation B explicitly state this.

Finally, we recommend that the requirements for lenders to provide information on how to file a complaint be expanded. Approval of voluntary data collection should be accompanied by enhanced requirements for providing the consumer with information (e.g., the name, address, and phone number of the federal regulatory agency supervising the institution in question) on how and where to file consumer complaints about discriminatory treatment. This recommendation may be particularly useful as a protection for applicants to loan companies, since these lenders do not receive the same level of fair lending supervision as federally insured depositories.

Clarification of existing provision for mandating collection of monitoring data under "Administrative Enforcement"

In preparing this response to the Board's RFC, we have engaged in significant in-house discussions regarding the potential uses, benefits and detriments of monitoring data collection, whether voluntary or mandatory. One seldom-discussed application of monitoring data collection is a provision whereby a regulator might mandate a lender to collect monitoring data as provided for under Section 202.14, "Administrative Enforcement", and what additional administrative and/or legal procedures would be required to effectuate a lender's compliance with such a mandate issued under 202.14. Since part of the rationale presented for permitting voluntary monitoring data collection is that it might assist fair lending compliance examiners, we feel that it is also appropriate at this time to revisit the provisions of Section 202.14, and to clarify the circumstances under which data collection might be mandated. To our knowledge, the Board and Reserve Banks have not routinely used this provision as a method either for investigating suspected illegal use of prohibited bases or as a monitoring tool to ensure that a lender has ceased to use illegal lending practices. In the event that mandatory data collection provisions are not adopted, this enforcement and remedy tool should be revisited and clarified.

information, visual observation is not a method available to the lender taking the application, leaving only surname analysis as a method for providing the data.

Response to Item #2: Require creditors to retain certain records for preapproved credit solicitations

We agree with the Board's proposal to use the exception authority contained in Section 703(a)(1) of ECOA to require creditors to keep records related to preapproved credit solicitations, for the reasons stated in the RFC. Regarding the Board's request for comment on the regulatory burden posed by this proposal, it is our opinion that the proposal merely provides a greater degree of specificity regarding what materials comprise the criteria used to select consumers for a preapproved solicitation, as currently required under the Fair Credit Reporting Act. Therefore, we feel that very little if any additional burden is created by this proposal.

Upon approval of this proposal, the Reserve Bank would welcome additional examiner guidance regarding the role such data should play under the new Risk-Based Fair Lending Examination Procedures; for example, should the data be reviewed as a routine part of the "scoping" process, and to what extent might preapproved credit solicitations be identified as examination focal points?

See also our related comments under Item #4.e.

Response to Item #3: Expand from 12 to 25 months the record retention period for most business credit applications

The Reserve Bank supports the Board's proposal to extend the required record-keeping period for small business loans (businesses with annual gross revenues of $1million or less) from 12 months to 25 months for the reasons stated by the Board in the RFC. We do not feel that this proposal would unduly burden banks, given, as noted by the Board, technological advances and electronic storage methods.

In light of the new CRA examination schedules mandated by the Gramm-Leach-Bliley Act of 1999, record retention for consumer, small business and small farm loans may also require another review. While the records are used primarily for consumer compliance examinations, for which the frequency is unchanged by the Act, the records are also used for CRA examinations. For insured depositories with "outstanding" ratings, the frequency of exams will reduce to every 5 years. Insured depositories with "satisfactory" ratings will be subject to review every 4 years. This leaves a considerable data gap that may warrant the Board's review.

Response to Item #4: Various revisions to official staff commentary on Regulation B

The Reserve Bank has reviewed the Board's other proposed changes to both Regulation B and to the Staff Commentary. Our comments on the remaining changes are as follows:

a) 202.2(c)(1) We support the Board's proposal that "substantial portion" should be changed to "substantially all" when determining the trigger for provision of adverse action notices when a creditor terminates or unfavorably changes the provisions of a class of accounts.

b) 202.2(f) We support the Board's proposal that a request for a preapproved loan under procedures in which a creditor issues a "written commitment to extend credit up to a designated amount that is valid for a designated period of time, even if subject to conditions" constitutes an application, and that a "preapproval" without procedures involving a written commitment would be treated as a "prequalification."

c) 202.2(l) We strongly support the Board's proposal to expand the definition of "creditor" to include those who participate in setting terms for the loan as well as those who participate in the approve/deny decision. We note that this could have the potential to include as "creditors" independent mortgage brokers, other types of loan brokers, and also auto, home improvement and other dealers who "price" the loans they deliver to a lender for origination or purchase. This proposal may have the added benefit of giving federally insured depositories some leverage over the policies, practices and conduct of the brokers and dealers with whom they do business, and level the playing field between insured depositories and private sector loan intermediaries.

With respect to the revisions to Staff Commentary, we support the Board's approach regarding retaining the general language regarding "reasonable notice" and the expectations for exercise of "due diligence." However, we encourage the Board to develop a systematic program for assembling exam-based information regarding the variety of relationships between multiple creditor programs in which state member banks participate. This information would add to the System's understanding of multiple creditor arrangements, and provide a knowledge base against which to assess when "reasonable notice" really occurs and when "due diligence" by state member banks could be reasonably expected.

d) 202.3 We support the Board's proposals in all three categories (public utilities credit, securities credit, and incidental credit) regarding the retention or modification of certain exceptions to Regulation B with respect to record retention, inquiries about marital status and spousal information, and furnishing credit information.

e) 202.4 (See Item #2, regarding new proposal for creditors to retain records for preapproved credit solicitations) While under Item #2 of this memorandum we support the Board's proposal for creditors to retain records regarding preapproved credit solicitations, the Reserve Bank feels that significant potential for illegal discouragement of applications from protected classes exists within the full range of prescreened application marketing. We too note the inconsistency with FHA on this issue. We have developed, through our field experience and also from discussion with industry experts, bankers and consumers, a growing concern that increasing use of technology-driven, targeted marketing campaigns can result in widely differing levels of credit availability and credit terms between the general population and protected class groups. We recommend that the Board consider what additional regulatory responses might be appropriate to prescreened credit marketing programs in general, under which products or terms are marketed and made available to the target group, that are not generally made available through other marketing or other means to nontargeted consumers. We also support the Board's proposal to consolidate various related provisions that are scattered throughout the regulation and commentary under this section, and the proposal to include in Regulation B the requirements that electronically delivered disclosures be "clear and conspicuous" and have a "retainability" feature.

f) 202.5 (See Item "1, regarding voluntary data collection) In addition to our more extensive discussion under Item #1 of this memorandum, we recommend that the sample consumer disclosure form in Appendix C-10 be expanded to provide clear information on how a consumer may file a discrimination complaint. Given that non-bank subsidiaries, private credit companies, dealers and loan brokers will also have the option to utilize the voluntary data collection provision, and that these types of creditors receive little to no supervision of their fair lending compliance practices, we feel that such a statement will provide some additional level of consumer protection against improper use of the information.

g) 202.7(d)(4) We support the Board's proposal to clarify that a spouse's signatures on financial statements and other documents necessary to secure the creditor's interest in jointly held or otherwise pledged collateral does not constitute a basis for the lender assuming or requiring a joint application for credit, or justify requiring the spouse's signature on the promissory note to the loan or otherwise obligating the spouse for repayment of the loan. During the examination process we encounter this issue with many smaller banks that make farm loans; they state that they "need" the spouse to sign the note in order to access the collateral if needed. It is sometimes not clear from discussion with the banker or the bank's attorney whether they feel it is necessary to obligate the spouse on the note to ensure access to collateral, or whether it simply provides an easier and quicker route to claim collateral. Given our experience in the field, this additional guidance is welcome.

h) 202.8 We support the Board's proposal to eliminate the phrase "special social needs", as it is unnecessary given the detailed criteria provided in the section for establishing a special credit program.

i) 202.9 We support the Board's proposal to retain the current exceptions regarding the different criteria for notifying businesses of varying sizes regarding adverse action on credit applications. We also support the proposal to add the requirement that creditors disclose to businesses over $1 million in annual gross revenues the right to a written statement of reasons for adverse action on a credit application; we concur that creditors would not be unduly burdened, and that without such disclosure some businesses may be unaware of their right to request this information.

j) 202.9(b)(2) We support the Board's proposal to require that creditors provide specific reasons for denial of joint applications for credit, and that the reasons indicate the party to which they apply.

k) Various revisions to Staff Commentary not already discussed: We support the various revisions as stated in the RFC.

QUANTITATIVE ANALYSIS UNIT

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CREDIT CARD REDLINING

Working Paper No. QAU08-1

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Credit Card Redlining

Ethan Cohen-Cole*

February 26, 2008

Abstract

This paper evaluates the presence of racial disparities in the issuance of consumer credit. Using a unique and proprietary database of credit histories from a major credit bureau, this paper links location-based information on race with individual credit files. After controlling for the influence of such other place-specific factors as crime, housing vacancy rates, and general population demographics, the paper finds qualitatively large differences in the amount of credit offered to similarly qualified applicants living in Black versus White areas. An instrumental variables approach allows the paper to distinguish between issuer-provided credit (supply) and utilization of credit (demand), where instruments for demand are derived from social theory à la Veblen (i.e., 'keeping up with the Joneses'). The results suggest that the observed differences in credit lines by racial composition of neighborhood are largely driven by issuer decisions rather than by demand.

JEL codes: J15, G21

Keywords: Credit cards, racial disparities, access to credit, keeping up with the Joneses, African American, redlining

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1 Introduction

This paper evaluates the presence of racial disparities in the supply of revolving consumer credit. Disparities in access to such consumer credit as credit cards are critical to assess because this form of credit is generally the first form of credit accessed by consumers. In order to qualify for a mortgage, one typically has to "build" a credit history. This marks a significant change that has taken place over the past few decades. In the 1960s, borrowing was predominantly related to home purchases. However, households now have more access to personal loans, auto loans, educational loans, and, significantly, credit cards; building credit involves using one or more of these products to incur debt and successfully repay it. As a result, disparities in access at this stage will be magnified when consumers seek access to such products as mortgages.

To frame the research for this paper, it is useful to consider a couple of borrowers. Consider two individuals, each of whom is the same age and earns a similar salary. Our two individuals have similar credit histories in the sense that they have both obtained and used credit with similar patterns of delinquency and repayment. Thus, the two have identical credit scores. The only characteristic that will distinguish our borrowers is the racial composition of the neighborhood in which they live. Individual A lives in a predominantly White neighborhood and individual B lives in a majority Black one.[1]

This paper's principal observation is that remarkably, in spite of identical scores and identical community characteristics, our individual in the Black neighborhood receives less consumer credit (e.g. fewer scredit cards) than the individual in the White area. That is, in spite of the fact that both have been assessed to have similar risks of nonpayment, as determined by the credit score, the person living in the Black area has less ability to access credit. Notice here that the example does not identify the race of the individuals, only the neighborhoods in which they live.

As is well known, there are large correlations between racial compositions and other socioeconomic factors that may be related to an individual's ability to repay debt. For example, high vacancy rates may impact home equity appreciation rates, and thus in areas with low growth, individuals may not be able to subsidize consumer spending with equity financing. Many factors indeed show a correlation between credit quality and neighborhood racial composition. For example, Panel A of Table 1 shows the results of a series of univariate regressions of "months since last delinquency" on a handful of demographic characteristics.[2] Notice that, given the results of this table, the process of an issuer implementing some simple marketing differentiation by such location-based characteristics as crime rates could appear to an outsider as race-based outcome differences even when race is explicitly excluded from consideration.[3] That is, the stylized fact above that individual B received less credit may simply be due to issuers avoiding lending in areas with

[1]This paper uses Black throughout to refer to the self-reported race from the U.S. Census 2000 Summary File.

[2]Li and Rosenblatt (1997) find no relationship between nine census variables and home prices. If one believes that the causal relationship between the use of location-based demographics and credit quality is collateral values, this study is strong evidence of the implausibility of the argument. However, it seems that environmental factors such as neighborhood crime can have an influence on the ability to repay debt without a causal chain that passes through housing collateral values.

[3]The legal term for the appearance of outcome differences is "disparate impact." This paper goes to great length to avoid taking a legal stand on this topic; in fact, it is not clear from existing legal precendent how the results of this paper should be treated. Some discussion is available below.

endemic crime, vacancy, etc. That is, an issuer could argue that using race, or one of a number of other factors correlated with race and delinquency, provides information related to profitability: those living in communities with more African Americans appear to have higher default and delinquency rates than those outside. To support this type of argument, panel B of the same table shows a correlation matrix of these variables with the percentage of African Americans in a census block.

This takes us to the second stylized fact: the disparity in credit access persists even after one accounts for the socioeconomic characteristics that one might suspect are correlated with ability repay debt. In fact, it appears to survive the inclusion of numerous demographic and socioeconomic variables available in the census report.

The broad goal of this paper is to distinguish between the two stylized facts above. The first found that there are race-based differences in access at an average level, conditional on credit score. The latter found race-based differences even after conditioning on additional information potentially useful in a credit decision. That is, one wants to know whether race-based differences in credit issuance are present, even after conditioning on non–race-based profitability measures.

To answer the broad question of the presence of a location-based race coefficient, this paper uses a set of data that has not previously been applied to this topic: that is, data from a nationwide representative sample of credit reports. Used in conjunction with publicly available census and crime information, this data gives one a potential window into the methods of issuers. The paper accomplishes this in three ways. One, the data used are new to this literature and provide a number of advantages: (i) the data include individual-level credit reports for a nationally representative and very large sample of individuals; (ii) the reports include information on total credit available and on credit used; and (iii) credit limits provide a logical proxy for supply, while the amount of credit used offers a clear interpretation for demand. This allows one to avoid the simultaneity questions that have confronted some of the mortgage literature. Two, though the quality of the supply proxy is very good and the reduced form may be sufficient for inference, the paper also uses an instrumental variables approach to account for the simultaneous determination of credit limits and utilization. And three, the instruments chosen are based on phenomena related to the correlation of consumer behavior (demand for credit) across individuals in social proximity.

Drawing on these methods, the paper finds evidence of race-based differences in the availability of credit. Though issuers' marketing and underwriting decisions are not fully known, it appears likely that a race variable is included somewhere in the determination of credit availability.

The remainder of this paper is organized as follows. Section 2 provides a review of related methodology and concepts from the mortgage literature. Section 3 discusses the data and section 4 describes the methodology of this paper. The results are presented in section 5, a discussion of potential confounding issues are addressed in section 6, and a conclusion is provided in section 7.

2 Literature Review

The issue of race-based differences in access to credit has received ongoing national attention since it was highlighted decades ago when mortgage disparities were believed to have contributed to urban blight. More recently, Edelberg has found that minorities have systematically worse terms of credit (Edelberg 2007). Following the Second World War, many U.S. cities experienced dramatic disinvestment in urban areas, in part as a consequence of newly forming suburbs. As is well known, these now-poor urban areas are predominantly African American and characterized by low job growth, high crime, and other varieties of social and economic malaise. Among the contributing factors for this poverty was the differential access to credit; specifically, the practice of mortgage "redlining." Broadly speaking, this term refers to a process by which financial institutions avoid mortgage lending in specific geographic areas, typically minority ones. As individuals in these areas were denied loans to buy or build houses, a process of slow deterioration took root. The ensuing conceptual link between credit access and growth has fostered a large literature seeking to evaluate theoretically and empirically the presence of disparities in access to mortgage credit. Ross and Yinger (2002) and Hillier (2002) provide excellent overviews of this line of research.

To date, many empirical studies of supply differentiation have focused on estimating the coefficient of a race variable in a regression of individual mortgage approval decisions. While most studies of these have concentrated on mortgages, the methodological issues faced are instructive for this paper's focus on consumer credit. For example, one specifies:

$$approval_i = \beta_0 + \beta_1 black_i + \beta_2 X_i + \beta_3 percentblack_j + \beta_4 Y_j + \varepsilon_i, \tag{1}$$

where X_i is a vector of such individual characteristics as credit history and income, where i indexes individuals, and Y_j is a set of regional or local characteristics, with j an index of some geographic area. The variables $black_i$ and $percentblack_j$ refer to a variable indicating a Black applicant and a variable measuring the percentage of Black individuals in neighborhood j, respectively. Then, one typically evaluates the significance of the β_1 or β_3 coefficients. Probably the most prominent of these analyses, Munnell et al. (1996), later dubbed the "Boston Fed Study," found a negative coefficient on β_1 that was robust to a myriad of specifications. This paper (as well as Tootell 1996) used individual-level transaction data from the Home Mortgage Disclosure Act (HMDA) along with census tract information and credit histories to show evidence of disparities in access to mortgages.[4] The study finds that, conditional on applying for a mortgage, the probability of receiving credit is lower for Blacks than for Whites.

Though the negative coefficient has often been viewed as evidence of discrimination, it has several other possible interpretations. The first is based on Becker's (1971) argument that some individuals have a "taste" for discrimination. In Becker's formulation, this is costly to the individual and is minimized by competition. The second is the argument that equilibrium phenomena (such as supply differences by group or location) may occur even with ex ante identical groups. Asymmetries can arise based on very minor differences in

[4] Holloway and Wyly (2001) use similar methods, and in a close antecedent to this paper, Duca and Rosenthal (1993) find evidence in the Survey of Consumer Finances of borrowing constraints that are tighter for minorities than for Whites.

preferences (Schelling 1972), based on incentives to specialize (Moro and Norman 2004, Coate and Loury 1993), or based on differences in information precision related to collateral valuation (Lang and Nakamura 1993). One can explain this type of phenomena in the mortgage context as follows: If applicant choices (e.g., whether to apply) are correlated with their own credit quality and with race, then this can lead to correlations in the lender's applicant pool between race and creditworthiness. Applicant actions serve as an informative signal to lenders that can then be used for credit decisions. As a result, one could observe disparities in approval rates across races even if each lending decision is unbiased with respect to race. Notice that this can occur even in the absence of an omitted variables problem.[5] These phenomena reflect the presence of profit-seeking–based statistical lending or marketing criteria that lead, ex-post, to differences in access by race.[6]

In addition to the possibility that the Boston Fed Study's results could be explained by equilibrium disparities arising from sources other than discrimination, Yezer et al. (1994) highlight another potential issue with the study. The authors argue that the loan-to-value ratio (LTV) of a house is simultaneously determined with the accept/reject decision of a lender.[7] Using simulation evidence, they show that their system, which also includes an equation for default, explains how single-equation models can lead to incorrect inference. Though they highlight an important issue with single-equation systems, it appears unlikely to be a problem in the mortgage case: the structure of mortgage loan decisions leads to the ability to ignore the loan-to-value ratio as a simultaneity issue since LTVs are known prior to the time of a credit decision.[8]

Despite the large volume of studies on access to mortgages, little has been researched on other forms of credit.[9] By looking at consumer credit, it's possible to evaluate a potentially unresolved issue in the mortgage literature, namely the determinants of credit quality at the time of a mortgage application. That is, existing mortgage studies take as given the quality of an individual's credit history at the time of the mortgage. If applicants have faced disparities in access to previous forms of credit, the assumption of similar performance conditional on credit history may be inaccurate. Failure to account for prior history would lead to attenuation bias in mortgage studies, strengthening claims of discrimination and calling into question findings of no discrimination. Detailed credit bureau data on individual credit histories allow one to explore the acquisition of credit that can contribute to, or hamper, the ability to obtain a mortgage.

Moreover, the nature of consumer credit allows one to side-step an additional issue in mortgage studies. By their nature, mortgage applications are binary events; agents apply for one (on occasion two or three) or none. Most individual-level studies have used information provided by HMDA, which reveals the loan

[5]The common counter-argument to the signaling case is simply that a similar phenomena could be observed based on an omitted variable. The full argument is articulated in the mortgage case by Longhofer and Peters (2005).

[6]The literature on mortgage lending disparities is very long and a full review is beyond the scope of this paper. Some references on the use of statistical methods to ration supply include Zenou and Boccard (2000), Holloway and Wyly (2001), Ross and Tootell (2004), and Ferguson and Peters (1995). See Ross and Yinger (2002) for a comprehensive review.

[7]The situation suggested by Yezer et al. is that of a borrower with perfect foresight. This enables them to form expectations about the functional form of the lenders' accept/reject decision and essentially make an LTV decision simultaneously with an acceptance probability. Lenders are thus modeled as passive implementers of functional lending criteria.

[8]Phillips-Patrick and Rossi (1996) point out a different endogeneity problem. They note that the credit supply-and-demand functions are simultaneously determined.

[9]There have been studies on redlining in insurance markets. See Squires (1997) for a series of articles on the topic.

approval decision for each application. It has been well acknowledged that this only allows insight into a portion of the possible avenues for disparities in access and does not capture the full supply/demand characteristics of the market. For example, a lender that is potentially willing to issue additional mortgages in an area to individuals of a specific race will not be fully revealed in the database, and individuals who may want a mortgage may thus be discouraged directly or indirectly from applying. Essentially, portions of the supply curve may be unidentified. Though using credit lines as a proxy brings some identification challenges, they provide (nearly) continuous information on credit availability in the form of credit lines.

3 Data

The principal data for the study is drawn from a unique, proprietary panel dataset from one of the three major credit bureaus. It draws information from 285,780 individuals at two points in time (June 2003 and December 2004).[10] The data are from a geographically stratified random sample of individuals. The credit file has information on all data commonly available in a personal credit report. This includes such personal information as individual address up to the location of the census block group, age, and date of birth. It also includes such account information as the number of open accounts, defaulted accounts, etc. Each account file also includes such credit quality variables as current and past delinquencies, size of missed payments, etc. As well, information spans and itemizes account type from mortgages, bank cards, and installment loans to department store accounts. Finally, the credit bureau provides information on individuals' internal credit score.[11] Account files have been purged of names, social security numbers, and addresses to ensure individual confidentiality.

Of the original sample of 586,800 observations, a certain number cannot enter the analysis due to missing data. For example, the *availcredit* measure is missing in 135,355 observations, *percentblack* is missing in 48,065, and the credit score measure is missing in 90,865. Once these are removed, there are 401,009 observations.[12] As controls are added in the various tables below, sample sizes fall a bit more.

In order to draw inferences about location-based decision making of lenders, the study exploits the information from the credit file on the locations of residence of the borrowers. With an individual's geocoded census block group, one is able to link a wide variety of information on location characteristics. This paper draws on a set of four external data sources. The first of these is the publicly available U.S. Census 2000.

[10]Specifically, there are 568,000 total observations, including 300,992 drawn in the second quarter of 2003 and 285,808 drawn in the fourth quarter of 2004. Of these, 285,780 overlap and have information available in both time periods.

[11]In order to protect the confidentiality of the data provider, we cannot provide much additional information on the construction of the score. Credit scores in general are inverse rankings of default probability for an individual. Thus, a system that grants one individual a score of 10 and another an 11 has found that the 11 poses a lower risk of nonpayment. To create a score, one regresses default probability on a variety of such credit characteristics as time since last delinquency, amount borrowed, number of accounts, etc. The coefficient of the regressors are then used as weights in determining a "score "

[12]Missing information on credit file information comes from gaps in the original data Missing information from the demographic files is due to discrepancies between the geocodes from the credit bureau and the census When a geocode from the credit bureau lies more than a mile from the closest census block group centroid from the census, the data point is excluded. One can also match these remaining points by associating the individual with the closest centroid and run the risk of connecting the individual with an incorrect neighborhood. Nonetheless, the key coefficients on a regression using this methodology are substantively unchanged from the baselines below.

Using the 2000 national summary files, one can link information on block- or tract-level averages of all information drawn from the census long form, including income decompositions, average education levels, country of origin, mobility rates, and more.

The second dataset is the *Uniform Crime Reports* (UCR) of the Federal Bureau of Investigation (FBI). This collects, according to a common standard, information on reported crimes in various categories at a county level. The information is collected on an annual basis, enabling the matching of two sets of crime data to the credit file. Both this and the census file enable one to control for community-level effects that might impact credit issuance decisions.

To capture the role of less regulated consumer credit providers, this study also incorporates information on the prevalence of payday lenders. The data includes geocoded information on the location of more than 25,000 payday lenders across the country. Geocoded files have been provided courtesy of Professor Steven Graves of California State University at Northridge.

The study will exploit a wide range of this information, including the census block group of residence of the card (or other debt) holder.[13] These data have a number of advantages that mirror other studies using individual-level credit card data (e.g., Gross and Souleles 2002). One, this paper can look at various features of borrowing behavior without concern for measurement error common in surveys. Two, it is possible to evaluate fixed effects at the consumer level. To distinguish the data from the Gross and Souleles data, this dataset also has individual location information that allows investigation of differences in credit availability based on local racial compositions.

The variety of data used is reflective of the effort taken to include as many potential location covariates as possible. This allows one to cover a wide range of hypothetical lender practices involving location-based evaluation other than race. Once these other factors are included, one can interpret the race coefficient in a regression with less concern.

To evaluate the issue, one needs both a set of information on individuals' credit and on the neighborhood in which they live. Facilitating this, the credit database includes individual level-geocodes for the census block group of residence. For each of the individuals, this paper matches census and other data based on the provided geocode. This allows one to integrate census block group–level information[14] on population characteristics to determine the racial composition of each of the borrowers' neighborhood. Using census-based geographic areas has some difficulties. For example, an individual who lives on the edge of a census block group may have more in common with the individuals "across the line" than those within the geographic area. Furthermore, a lender may use population characteristics that correspond to areas different than the census definition. The size of the cross section ensures that unless there are systematic tendencies to live at the edge of a census block group, these errors are equivalent to small, normally distributed measurement error, and as such will not impact inference.

[13] A census block group is a cluster of census blocks having the same first digit of their four-digit identifying numbers within a census tract. For example, block group 3 within a census tract includes all blocks numbered from 3000 to 3999. Block groups generally contain between 600 and 3,000 people, with an optimum size of 1,500 people. (Definition from www.census.gov)

[14] In some cases, census data are available only at the tract level. For those cases, we include data at the lower level.

4 Methodology

Since the study is focused on evaluating the role of location-based criteria in the provision of credit, this paper uses census, UCR, and payday lender information to include demographic and location-based information. The method is motivated both by the structure of the credit market and by the nature of the dataset. As most adults know, consumer credit has become increasingly easy to obtain. As a case in point, credit card issuance is commonly done via a (sometimes pre-approved) mail solicitation. Issuers typically use information from credit registries to pre-screen applicants and provide these offers. An example of a possible initial evaluation would be to use credit score alone as a tool for determining which individuals will receive offers for a card of a given type. Once information on the application is returned, issuers evaluate both the information provided on the form as well as the individual's credit history. The underlying question is whether community-level information, in particular on race, is used during either the pre-screen or the credit issuance decision.

What if lenders used information on a potential borrower's neighborhood as a way to determine lending, but used data other than racial composition? One wants to exploit information not only on the individual but also on the area itself. Essentially, the individual is the unit of observation, but acts as a control in the evaluation of an aggregate phenomenon. That is, one wants to understand whether credit issuance in a location (geographically defined) is impacted by race-based criteria. To do this, looking at average lending by demographic characteristics in a location would be inconclusive; a lender could simply provide excess funds to select individuals within a location such that the averages appear to be non–race-based. In this sense, the individual's data serve as a control; based on individual-level credit characteristics, one can evaluate whether lending varies based on the racial composition of a given location.

Notice that the relevance of distinguishing between mean and individual-level differences becomes important here. Consider as a case in point two specific regions. One is predominantly Black and the other predominantly White. These regions also exhibit distributions of socioeconomic characteristics that match current national levels. Thus, the Black area will be poorer and have lower credit quality on average. An issuer that uses mean characteristics to determine whether to market to the entire area could decide to exclude the Black area for purely financial reasons. Changing focus to address individuals, consider figure 1. Notice that the distribution of scores on the X-axis overlaps; there exist some individuals in each area that are nonrepresentative vis-a-vis the means used above. Thus, a purely financial incentive that leads to disparities in access at the community level may not be justifiable at the individual level. An issuer that used the mean criteria simply used profitability characteristics; but in this example it has treated the two individuals of similar characteristics differently based on the racial composition of where they live.[15]

Thus there are two questions. One, once the distributions in figure 1 have been conditioned on demographic characteristics, are there still distributional differences in performance based exclusively on the racial composition of the neighborhood?[16] Two, after accounting for possible individual-level performance

[15] This point is similar in theme to Ferguson and Peters (1995).

[16] A recent Congressional report found systematic performance differences by race. Notably for this study, the report found that Black individuals, conditional on credit score, performed worse than others. Hence, without controls, one will continue to observe

differences, are there still individual-level access differences as illustrated in the figure?

4.1 Single-Equation Systems and Credit Availability

Endogeneity is a well-known problem in the study of credit availability. As mentioned above, it has been a contentious issue in prior work on disparities in lending. In the case here, the problem emerges if issuers adjust credit lines when they expect utilization to change. Then a portion of the observed credit availability change could reflect underlying changes in utilization of credit. Evaluating this behavior can be handled both through use of a particularly rich dataset and through an appropriate instrument.

The data used in the study offer a particularly rare depth of variation in controls. The data section above discusses some of the exceptional information available. Local demographic information from marriage rates to education levels account for systematic differences in utilization driven by life-cycle concerns. Extensive information on local income levels, unemployment rates, and vacancy rates provides proxies for local utilization shocks.[17] Social-environmental factors such as property and violent crime account for additional variation in utilization. The methodology also controls for individual account risk using the credit registry's own measure of credit risk. If issuers attempt to match credit availability to utilization changes, this control strategy should be a strong check against endogeneity.

Although the data in the study provide ample detail, credit issuers themselves must trade off parsimony, essentially cost savings, for the benefit of using additional variables to determine availability. When credit applications are taken, using credit cards as an example, the issuer has direct information on the borrower's age, self-reported income, employment status, household location, and social security number, which is used to acquire credit agency information on the performance and quantity of other credits. In attempting to answer the question of whether issuers use a race variable, one should find evidence across the range of possible specification choices chosen by the issuer. The data available for this study include most of the information contained in the issuer information set,[18] enabling one to check whether racial composition coefficients vary across the range of possible specifications.

The supply proxy itself is potentially an issue. The mortgage literature has used individual accept/reject decisions (see equation 1, above) as its proxy for supply. Of course, this has left open questions regarding both unmeasured demand, in the form of potential applicants who never make it through an application, and unmeasured availability, in the form of willingness to provide loans that were never requested. Consumer revolving credit avoids many of these problems. For example, Gross and Souleles (2002) use the credit limit from individual card accounts as their supply proxy and the utilization on the account as the demand proxy. The basic argument is that these reflect both the willingness of the issuer to provide credit and the actual demand of the consumer. While in principal the issuer may be willing to provide additional credit

distributional differences by neighborhood The Congressional report, however, did not directly evaluate the question in this paper, nor did it assess whether the distributional differences could be accounted for with non-race factors. The appendix to this paper includes an analysis of individual-level performance measures and finds no qualitative difference in results.

[17]The appendix includes information on a range of additional proxies.

[18]The data being used do not include individual-level information on employment status or income. In their place, block group level information on employment and income is used as a proxy.

and the user may wish to use more debt, for analysis of these issues these proxies are far superior to those used in the mortgage literature. This study uses the sum of credit lines, along with the residual available credit, as a measure of supply, and uses utilization to reflect demand. By using the sum of credit lines, we sidestep issues of substitutability across lines that would occur with individual account analysis. Residual available credit measures willingness to supply credit conditional on current conditions – including existing debt stock. To understand why this is a valuable measure, consider two individuals with identical credit histories, ages, etc. who have $10,000 credit lines. One of these uses $2000/month on a credit card for company travel purposes. A rational issuer would increase the credit line of the individual with the expense account charges; otherwise, her effective credit limit for personal expenditures would be only $8000. As well, many individuals experience growth in earnings, and thus ability to carry debt, over time. Issuers can thus use successful payment of prior debts as evidence of ability to carry higher debt levels. Most likely, both the limit and available credit variables are "supply" variables. This paper uses both as potential proxies.

Single-Equation Systems

First, this paper looks at patterns on revolving credit usage. As discussed, credit can be extended (supply) through card offers and through increases in existing credit lines.

$$availcredit = totalcreditline * (1 - utilizationrate).$$

This paper evaluates the relationship between race characteristics of a neighborhood and credit availability.

Here it looks at some other social factors of available credit with one of the following specifications:

$$availcredit_i = \beta_0 + \beta_1 percentblack_j + \beta_2 X_i + \beta_3 percentblack_j * X_i + \beta_4 Y_j + \varepsilon_i, \tag{2}$$

$$Limit_i = \beta_0 + \beta_1 percentblack_j + \beta_2 X_i + \beta_3 percentblack_j * X_i + \beta_4 Y_j + \varepsilon_i, \tag{3}$$

where X includes various components of credit history as well as an individual's age, and Y includes census block–level income, square of income, racial composition, and other demographic variables. This paper also includes interaction terms for credit history and community-level race variables. Recalling that data are available at different levels of aggregation, with counties the largest aggregation in most cases, the regression includes county-level fixed effects where possible. Errors are clustered at the block group level. One can interpret the coefficients as the responsiveness of available credit to a change in the independent variables. Thus, excluding any view of the demand side, one can view β_1 as the change in available credit due to a 1% change in the Black population in area j. In the results section below, this paper will discuss a number of specification variations — primarily modifications of the vectors X and Y.

Notice that an individual's credit score variable appears on the right-hand side of the equation above. That is, the effort is not to identify disparities in the calculation of the score itself. Credit scores are calculated by many entities, and while one cannot rule out the use of race in the determination of a score, scoring systems are well-known aggregations of individual credit histories. This paper focuses instead on the provision of credit, conditional on given credit quality. There are, of course, some issues of endogeneity here.

In addition to the causal chain implied by equation 2, one could imagine argument for an impact on credit scores as a result of an increase in individuals' credit lines. Thus, the single-equation approaches could very well be subject to the critique that the specification is simply picking up systematic social differences in credit demand. If African Americans systematically use a greater proportion of (evenly provided) credit, one could generate negative coefficients on β_1 and β_3, above. The results here will only be as good as the quality of the supply proxy. To the extent that they represent the supply curve, magnitudes will not differ much from a correctly specified simultaneous system.

4.2 Multi-Equation Systems and Instrumenting with Social Factors

In addition to relying on a large set of controls, this paper uses an instrumental variables approach incorporating instruments that encompass plausible demand variation via "keeping up with the Joneses" effects. These instruments are discussed at greater length below. As a number of authors have emphasized, credit access is a function of both issuer's decisions on availability of credit and individual's choices on quantities to use. There is anecdotal evidence that increased credit lines, even for individuals without notable constraints, leads to increased use. This might be due to shifting from existing credit lines to others, or may reflect actual increases in use. Including a simultaneous system allows one to incorporate this possible effect. Similarly, increases in use may signal to issuers increased willingness or capacity to take on credit, and thus may lead to larger lines. Issuers can increase credit lines or offer new cards to encourage use and individuals can request line increases or order new cards. As above, one could look at the utilization as follows:

$$utilization_i = \gamma_0 + \gamma_1 percentblack_j + \gamma_2 X_i + \gamma_2 Y_j + \gamma_3 Z_j + \varepsilon_2. \tag{4}$$

One can look here at both components using the follow system of equations:

$$\begin{aligned} Limit_i &= \beta_0 + \beta_1 percentblack_j + \beta_2 X_i + \beta_3 Y_j + \beta_4 utilization_i + \varepsilon_1 & (5) \\ utilization_i &= \gamma_0 + \gamma_1 percentblack_j + \gamma_2 X_i + \gamma_3 Y_j + \gamma_4 Z_j + \gamma_5 availcredit_i + \varepsilon_2. & (6) \end{aligned}$$

Equation 4 and the system (5-6) mirror those that have been used in the literature to date.[19] Conditional on an appropriate choice of instruments, one can get an unbiased estimate of β_1, as desired, using two-stage least squares. To obtain this desired result, the standard challenge is to find a suitable candidate for Z.

Instrumenting with Social Factors

Central to two-stage estimation is the specification of appropriate instruments. In this case, one is looking for an unbiased measure of an influence on credit supply. To obtain this, one must specify a set of excluded instruments that are plausibly correlated with utilization but not with availability of credit.

[19]See Phillips-Patrick and Rossi (1996) and Yezer et al. (1993). The argument for including quantities as independent variables is broadly that issuers may include their expectations of utilization changes, as proxied by current levels, in their credit decisions. This may not be fully captured by the set of other covariates. Similarly, borrowers who desire a particular buffer stock of available credit may adjust utilization as available credit changes. While there are relatively straightforward interpretations of the two variables as 'supply' and 'demand,' this paper uses the variables themselves to maintain clarity that the variables are proxies and the system, lacking price information, is not a classic supply and demand one.

First, this paper points to the literature originating with Veblen (1899) and continued in mid-century by Duesenberry (1949). Their well-known works argue that individuals look not only internally to make consumption decisions but also at the consumption behavior of others around them. In modern economics, this has been somewhat formalized as "keeping up with the Joneses" preferences. Under this type of preference structure, agents care not only about their own consumption, but also about some function of the consumption of others.[20] Among others, Dybvig (1995) and Harbaugh (1996) have looked at variations of the same theme with respect to consumption habits. Formalization of preferences that incorporate actions of others is now quite widespread. Surveys of the literature are available in Durlauf (2004) and Soetevent (2006). Focusing on the component of the literature that relates social factors and spending decisions, recent examples include a variety of works: Basmann et al. (1988) show that utility maximization formulations work quite well in describing patterns of commodity expenditures in the U.S. after the Second World War as long as Veblen-style consumption is accounted for. Bagwell and Bernheim (1996) explore theory to explain when Veblen effects can exist and suggest criteria to test for its existence. Bowles and Park (2005) argue that Veblen effects are present in data on patterns of work; they find work hours to be greater in countries with higher inequality.

Based on the claims of this literature, one would want an instrument that is a measure of the income of others in one's reference set. Broadly, one might want to capture the influence of seeing someone from the neighboring town pull into the mall in a luxury car, or of passing someone at work carrying a designer bag. In the case of this paper, one wants to be particularly careful not to include income of others that may be used by credit suppliers. In particular, it is possible that a lender uses the income profile of the neighborhood in establishing credit limits. Akin to using community-level mean statistics on other types of traits, a lender may decide that the wealthy areas confer such benefits as increases in home values that transfer to an increased ability to repay debt. In order to account for the lender's desire to control for local income characteristics, an appropriate instrument may be the income of *surrounding* areas. A pure evaluation of the keeping-up-with-the-Joneses– type effect looks at the role of the relatively-richer on an individual's decisions. Thus, the paper uses mean income of surrounding areas for those areas that have higher earnings than the borrower's own area.

Specifically, the paper uses two measures. Given an individual's census block group, one references only the relatively higher incomes of the block groups living 1-4 miles from the individual. The second instrument uses the same feature 4-20 miles from the individual. The paper uses two measures of distance to allow for different effects of communities that are "close to home" and for those that are further away, but still within a range that can lead to some degree of regular interaction. For example, the first area may correspond to communities with whom an individual interacts at the local school, and the latter, groups that can be observed in the workplace or in a nearby mall or shopping venue. Whether a close neighbor owns a Lexus or a stranger in the mall drives a Mercedes may impact individuals differently. An additional benefit

[20]Recent research in sociology also supports the ideas of Veblen and Duesenberry. Some (see Marmot 2004) even find that health and lifespan are impacted by social standing. See Gali (1994) for a formalization of "keeping up with the Joneses' preferences." He posits that individuals use a utility function: $U(c, C) = (1-\alpha)^{-1} c^{1-\alpha} C^{\gamma\alpha}$, where c is individual consumption and C is average community consumption.

to using the two measures is that the paper can take advantage of common overidentification tests.

This measure proxies for the Veblenesque consumption behavior— i.e., an individual's own consumption is some function of the consumption of others — but without the influences of the immediate proximity areas.[21] Defining a reference space, however, is nontrivial. An argument below is that the precision is not critical once one excludes the area that may be used for supply choices. This argument is buttressed by the fact that this paper does not use this type of social theory to estimate the specifics of individual spending behavior as a function of others (the econometrics for this type of estimation are explained in Manski 1993 and Brock and Durlauf 2001). Instead, it uses the now-well-established connection between the actions of others and human behavior as justification for the excluded instruments.[22] This literature has found, in a myriad of contexts, that individuals base their decisions on the behavior of others.

With both instruments, the exclusion restriction is that they are uncorrelated with issuers' decisions on credit lines. While Veblen, Duesenberry and others have suggested that individuals are influenced by the behavior of those in their reference set, it does not appear that a credit issuer would care about the income levels of neighboring areas or the country of origin of individuals in an area. However, a credit issuer may use information about the community if it impacts default rates. In fact, in June of 2007, New York's attorney general, Andrew Cuomo, accused a "significant number" of lenders of setting loan rates based on the school of a borrower.[23] The null hypothesis is that credit issuers use individual- as well as some community-level information to determine the provision of credit but do *not* use racial information.[24] The assumption that issuers use some community information makes the instrument choice more difficult. Had one specified that the issuer used *no* information on communities, it would be simple to select any community-level variables as instruments.

Along with determining the role of race, one can assume that credit issuers may be using a range of other such location-based factors as crime rates, income levels, and vacancy rates. As such, this paper takes these to be included instruments. Essentially, the claim is that credit issuers that might consider neighborhood characteristics of an individual (e.g., percent Black) would not consider the context of individuals who live in other areas. That is, the percentage of minorities who live a mile away from the card applicant would not be a factor in the credit issuance decision. However, demand, based on the sociological arguments above, will be correlated.

[21] In measuring Veblenesque consumption behavior, one needs to know the consumption patterns of people in a reference group. In this paper, information on income and other factors from an individual's own immediate area are used in the evaluation of discrimination. One would want the information on the keeping-up-with-the-Joneses effect to be drawn from a different area By choosing the surrounding areas, one can nonetheless assume that an individual references her spending off of those in nearby areas as well.

[22] In the nomenclature of the social interactions literature, we will be using contextual effects defined by the geography of individual's home as excluded instruments.

[23] *New York Times*, June 19, 2007.

[24] In fact, the paper evaluates a number of nulls. The first column of a number of the tables is essentially the null that the lenders uses no information on community-level factors. A rejection of the null of no factors at all allows us to move to the more realistic setting described here. To be clear, evaluation of the hypothesis is reliant on the instruments being valid — this is addressed below.

5 Interpretation of Results

Broadly, the attached tables find a significant positive coefficient on the $percentblack$ variable and a significant negative coefficient on the $percentblack * creditscore$ variable. The net effect is uniformly lower access to credit in Black communities. A few comments are useful at the outset. One, the coefficients are largely unchanged across a very wide range of specifications, and across both single and multi-equation systems. The consistency of results across the range of specifications addresses the concern that since racial fractions are highly correlated with many other tract characteristics, multicollinearity issues can infect the regressions and lead to spurious inference on a single regressor. Thus, a study which found only limited specifications with a significant race coefficient would be particularly weak evidence. Two, while the study includes many variations of a baseline specification, the parsimonious ones are more likely representative of the information used by issuers in the credit decision. Given cost constraints, using all possible variables seems an unlikely method. Three, the similarly of results across single and multi-equation systems suggests that the supply proxy is a good one; that is, it does not appear to be biased due to simultaneity. This marks a distinction from the simultaneity debate in the mortgage literature in that there is clear evidence here that the supply proxy is a good one.[25]

Numerous studies on mortgage lending have found negative correlations between access to credit and race/neighborhood racial composition; this study takes advantage of a unique dataset and finds similar patterns in consumer lending.

5.1 Single-Equation Results

Table 6 shows results from equation (2) above. Column 1 regresses available credit on percentage Black and the individual's credit score. As expected, credit score is positively and very strongly related to the amount of available credit. The race variable is negatively related to the amount of available credit; a 1% increase in the percentage of African Americans in an area corresponds to a reduction in available credit of \$123. Moving from an 80% majority White to 80% majority Black area reduces credit by an average of \$7,357. Moving to column 2, one can see the interaction of the race and credit score variables, $percentblack_j * creditscore_i$. This allows the inspection of the nonlinearity in credit availability (for the time being, ignoring utilization decisions). The percentage Black variable becomes positive and the interaction term is negative in this case. To interpret the magnitude here, consider a credit score of about 600; each unit change in the percentage of African-Americans leads to an increase in credit of \$131 from the percentage Black variable and a reduction of \$246 from the interaction term — a similar net magnitude found in column 1. The nonlinear term suggests that the race "penalty" is greater for individuals with better credit histories. A plausible interpretation of this effect is that issuers consider "bad" credits to be universally "bad," independent of race. As credit quality increases, Black individuals with "good" credit receive relatively smaller advantages for the improved performance. The remaining columns explore the

[25] While the empirical results from the Boston Fed Study were not overturned based on the endogeneity concerns, the nature of the data available at the time (and of mortgages) simply did not allow the type of analysis presented here.

robustness of these findings to the inclusion of other community-level variables from education and marital status to language use and crime rates. Key coefficients remain essentially unchanged. Column 3 introduces an age variable, which has a significant and positive impact on available credit.

To address the possible concern that the coefficient on the *percentblack* variable is biased due to an omitted variable, moving from columns 4 to 8 progressively adds control variables of various types. The per capita incidence of violent crime (column 4) is negatively associated with credit availability, although insignificant. Column 5 shows the percentage of male and females who have obtained more than a high school diploma; both are positively related to credit availability. A higher percentage of married men and women is also correlated with available credit (column 5). Column 6 shows the percentage of foreign-born in the neighborhood is statistically significant and is correlated with reduced available credit. Finally, the percentage of high income individuals positively correlates with available credit, while the percentage of low income individuals is not significant.[26] As mentioned above, the study includes essentially the same data used by issuers in the determination of credit, and while marketing departments may draw on additional external information, the range of variables included here show that the *percentblack* coefficient is highly robust to specification choice.[27]

Limits

Looking at an alternate view of credit provision, total credit limit produces similar insights (see table 7). The first column again shows only the racial percentage variable and the credit score, finding a drop of $134 in limit for each percentage point drop. Results are analogous when one moves to column 2. Here again one finds a similar penalty in the nonlinear term; an individual with a 600 credit score suffers a $222 drop for each percentage increase in the composition of Blacks, which is then offset by a $70 increase. The implication is that even predominantly non-Black areas see individuals facing large changes in credit limit for small increases in minority populations. As other controls are included, the percentage Black variable increases in size, while the interaction term's magnitude is reduced. The best intuition for this is that the various community-level controls both reduce the influence of the nonlinearity (the "rate of change") and affect the average levels of total credit. Control variables in this table have similar coefficients as in the prior table.

5.2 Instrumental Variables Results

As discussed in the above section, this paper analyzes the role of race in credit limits using a two-stage least squares approach (see equations 5 and 6 above). This paper subdivides the results in table 8 as follows. The first six columns include the two Veblen-Duesenberry instruments discussed above. Both are an interaction of aggregate income in the surrounding census blocks, with an indicator for the surrounding blocks having higher income than the immediate area. The first includes areas 1-4 miles from the individual, and the second, areas 4-20 miles. The final two columns include each instrument in isolation. All specifications

[26] These results are suppressed for space considerations, but are available in an unpublished appendix, on request from the author.

[27] An appendix, available on request from the author, adds specification variations to address a range of additional concerns. No significant differences are found from those reported here

include fixed effects at the county level and are estimated with robust standard errors.

In each case, the key variables are the same as above: the percentage of African Americans in a neighborhood and the interaction term $percentblack_j * creditscore_i$.[28] The coefficients on $percentblack_j$ and $percentblack_j * creditscore_i$ are similar in magnitude and sign to those in table 6. Results are illustrated in figure 2. At low levels of credit, credit availability is quite low, but not distinguished greatly by race. As credit quality increases, the gap, controlling for the various characteristics mentioned in the study, grows quickly.

A number of test results are presented below the table. The overidentification test statistic (Hansen J-stat) is well within the do-not-reject ranges. As well, the Kleibergen-Paap LM test strongly rejects the null of underidentification.

6 Discussion

The results here imply a form of differentiation in both the availability-only equations and full simultaneous system. However, since the implication is not a small one, one can look deeper into the data for an understanding of how much this effect matters and for a better appreciation of how sensitive the results may be to various factors. Following a discussion of economic relevance in subsection 6.1, there is a dissection of the population into different score categories in order to understand which groups might be facing the greatest challenges. The second subsection (6.2) investigates the consequences of differences in financial education on estimation results. The next subsection (6.3) looks at issues of alternate sources of finance, continuing in subsection 6.4 with a discussion of the robustness of the instrument choices to variation in geographic area. Subsection 6.5 discusses some limitations of the analysis.

6.1 Economic Relevance

Many owners of credit cards use far less credit than would be allowed by the lender; in fact, for many there may possibly be no foreseeable event for which they would even contemplate using the credit. Given this, can one claim that race-based disparities in lending have a clear economic impact? In the case of mortgages, it has a clear economic harm.

This paper motivates the relevance in two ways. The first is based on the selection involved in creating the data. By definition, the data contain only individuals with a credit history; those without are those that either chose not to obtain credit at all, or made do with credit supplied either by the nonbank sector (payday lenders, etc.), by friends and family, or by some other nonreporting financial institution. Prescott and Tatar (1999) and Rhine et al. (2001) provide evidence that the underbanked, a category broadly encompassing those without checking/savings accounts and/or credit cards, are predominantly from poor and minority

[28]We abstract here from the endogeneity of location choice. One might imagine that individuals choose where to live based on the availability of credit — particularly in the mortgage case. In the credit card case, we hypothesize that the decision process for credit issuance is sufficiently opaque to card users that determination of credit supply functions for potential new residences is difficult or impossible.

areas. Notice that, if true, this will bias the estimates toward zero; including a disproportionately minority group that has poor credit would increase the evidence of disparities in lending. Without emphasizing the econometric difference here, this paper simply notes that there is a documented impetus toward alternate credit sources when traditional ones are unavailable.

Second, one can view the role of differences in lending across the distribution of available credit. For those with very small amounts of credit, availability restrictions could quite plausibly be binding on consumption decisions. Two tables illustrate that credit constraints can be potentially binding. Figure 3 shows two sets of coefficients on the interaction variable, $percentblack_j * creditscore_i$, for quantiles of available credit from 10 to 90. The blue line shows the results for a quantile regression using controls from the specification in table 6, column 6. This line would suggest that the impact is greatest for those with the most credit; perhaps then the economic relevance is small? To investigate, we add the red line, which uses the log of credit limit as the dependent variable.[29] This reverses the slope of the line — suggesting that there is a difference in access bias on a relative basis, and that the bias is potentially important to those in the range of credit access that could bind with respect to consumption decisions.

One's most direct interpretation of the data is that the strongest race-based disparity is found for scores in a middle category and for individuals with relatively low amounts of available credit. It appears to suggest that once individuals with particularly poor chances of obtaining credit have been screened out (including out of the sample altogether), those individuals with acceptable credit but with small amounts of available credit face the greatest relative access impediments. Recall that this conclusion accounts for the endogeneity of credit availability.

6.2 Age and Financial Learning

A 2002 study from the Federal Reserve Board (Braunstein and Welch 2002) argues that many people in underserved populations may be unfamiliar with components of the financial system. A combination of growing complexity, increases in consumer responsibility, as well as the noted changes in the structure of personal finance to include more individual credit, have contributed to differences in financial literacy. For the purposes of this paper, these differences may translate into differences in understanding about how to build individual credit. Thus, one can imagine that if Black communities have less information on the nature of the credit scoring systems, otherwise credit-worthy individuals may have systematically lower scores.[30]

However, this is a phenomenon that will not be captured in the attached analysis by the inclusion of a score variable. Consider two similarly responsible individuals, one of whom knows nothing about credit scoring systems used by credit issuers. The more knowledgeable individual will take out a credit card, even one with a very low limit, use it regularly, and make reliable payments. As many are aware, even low-volume transactions that are paid on time appear on credit histories as timely payments. The less informed individual may use his or her card irregularly, but make payments on time. The latter individual will have

[29]Results for both sets of specifications are available from the author upon request.

[30]Worthington (2006) finds that race and income are both strong determinants of financial literacy. Rhine et al. (2001) and Prescott and Tatar (1999) find similar results

a lower score, even though his/her behavioral characteristics vis-a-vis credit worthiness are identical to the other's. Extending the example, if one compares two individuals with identical scores, but without this noted difference in understanding, the one with less education is the *better* credit risk. Since education levels are unobserved in the data, one cannot fully measure the bias.

To account for the impact of this difference, one can incorporate an aging effect. One expects that there might be systematic differences across communities in financial literacy that correlate with race demographics; however, one expects that these differences are a function of the time needed to accumulate the necessary information, not a difference in the fundamental capacity to understand. As such, this difference will appear in the interaction between the age variable and the percentage Black variable; learning will take place, but the age-controlled amount of information will possibly be different across communities.

Table 10 shows the effects of these age-race interactions, and figure 4 shows predicted values along the age distribution for Blacks and non-Blacks. In column 2 of this table, we find that the interaction of age and percentage Black is strongly significant. However, the effect of this interaction appears to be nonlinear, as shown in column 3 and in the figure. What one can see from the figure is that there are age effects. Non-Blacks show increases in credit limits up to age 40 or so, then a decline.[31] For financial learning to have impacted the results and created the spurious impression of differences in access, one would need a pronounced inverted U for the Black curves seen in the figure; in particular, it would need to lie to the right of the non-Black curve. One does not observe this pattern; even with the aging effect present (and clearly observed), there are still significant race effects in the data.

6.3 Nontraditional Lending

A wide array of recent research has focused on the recent expansion of nonbank lenders. So-called payday lenders[32] are institutions that lend money on a short-term basis. The typical procedure involves leaving a post-dated check, timed to coincide with the subsequent paycheck, in exchange for a loan. When the loan comes due and is repaid, the shop returns the uncashed check. Lenders charge interest rates around 15-20% for a two-week loan; over the course of a year, the rates amount to 300% or more. As the institutions are regulated on a state-level basis, and data collection is sparse, there is incomplete information on the scale of existing business. One estimate (from 2003) is that about 10 million U.S. residents take out such loans each year (Robinson and Wheeler 2003) with a volume of approximately $40 billion. The common statement is that they are now more prevalent than McDonald's. Not-for-profit advocacy groups have claimed that they are targeting minority and poor areas (Center for Responsible Lending) and the debate on their role and potential regulation has become widespread.

Regardless of the motivation for these lenders' location choice, two recent research projects (Prescott and Tatar 1999 and Rhine et al. 2001) provide evidence that the underbanked are predominantly from poor

[31] The most plausible explanation for this decline is a generational effect. Those above 40 became exposed to credit cards much later in their own lives than younger individuals due principally to the relatively recent introduction of cards. As a result, many have shorter credit files and a higher probability of low use.

[32] Other types of lenders exist as well, including pawn shops and rent-to-own establishments. We focus on payday lenders as they are the most direct equivalent to credit cards; that is, both are unsecured lines of credit.

and minority areas. The implication commonly drawn is that lack of access to traditional financial service products, coupled with volatile consumption needs, drives the most risk prone into the arms of high-rate lending options.[33]

This paper includes a short analysis on the relationship between payday lenders' availability and traditional credit patterns. Broadly, this paper has found differences in access to credit that depend on racial composition of a neighborhood. If payday lending were to have an impact here, one would expect that lenders that intended to differentiate credit could offer less in areas with more payday lending. This would draw on the fact that payday lending is a type of credit and serves, for some individuals in some areas, as a potential substitute. If it acted as a pure substitute, one would expect to see a negative coefficient on the payday stores variable. We can see this negative coefficient in table 11, column 2. Column 1 repeats the table 8, column 6 specification from above, and column 2 adds a measure of the number of payday lenders with a three-mile radius of each individual's census block group.

Similarly, credit differentiation should show an increase in the magnitude of the key coefficients once one accounts for the potential placement of payday stores in low-quality credit areas or minority areas. This can be seen in columns 3-5. While the interaction of the payday stores variable and race or payday stores and credit quality is not significant, the payday stores variable interacted with score is significant. Key cofficients remain essentially unchanged and highly significant across specifications.

6.4 Size of Reference Region

Within a Duesenberry/Veblen framework in which individuals base their consumption decisions on those of people around them, one is concerned with the question of whom they base their individual consideration. In much of the social interactions literature, reference groups are assumed to be a relatively small geographic or social sphere. The largest in the literature tends to be a Public Use Microdata Area (PUMA), an area of up to 100,000 individuals. However, it is more common to use school classrooms, places of work, or census blocks as the area of reference; in each case, the assumption is that the particular decision of consequence to the study is mediated by behavior of other people in the reference group.

This paper posits that credit demand is influenced by individuals in the area of reference used. Do individuals decide whether to buy a bigger car, an iPod, a new cell phone, etc., based on whether their next-door neighbor does so, or based on some other criterion? Many advertisers are certainly convinced that product demand is based on TV viewership – not just local word of mouth. As the goal of this paper is somewhat less lofty than a pure identification of the degree of interaction in credit decisions, one can permit a degree of misspecification in the instrument. The key metric in assessing the validity of the instruments is whether they are correlated with utilization but uncorrelated with limits; thus one needs to be confident that the chosen area both captures some of the social influence of one's neighbors and is orthogonal to whatever

[33]Skiba and Tobacman (2007) come to the conclusion that since many payday loans are repeat customers, this volume is unlikely to be driven by temporary shocks to consumption need. However, this is a controversial statement; one could as easily argue that once an individual faces a shock and is forced to take out a loan, this leads to a drop in asset wealth and an increased likelihood that an even smaller shock will lead to future borrowing needs.

spatially based income characteristics that a lender may be using.

The primary metric (as discussed above) is a 1-mile radius around each individual — with the demand-only area of reference being the 1–4- and 4–20-mile bands from the center. This essentially assumes that credit issuers may be using local income characteristics to make lending decisions; however, individuals may be influenced both by those in the immediate vicinity and by those they pass at the mall, on the way to work, etc.

To be confident that the right measures are being used and to fail overidentification tests, one would want that excluded instruments include the immediate vicinity – indicative of the fact that they may be included in the availability function. One can look at using a census block as the unit of reference and at a demand-only reference band encompassing 1–4 and 4–20 miles from the individual.

The results are relatively straightforward; the size of the reference region appears to play a relatively small role. The final two columns of table 8 include reference bands of 4–20 miles and 1–20 miles alone. Mechanically, this amounts to including only a single instrument in each case. Notice that the coefficients remain largely stable across the columns. Using the 4–20-mile radius instrument alone leads to inability to reject the null at the 10% level. One can broadly interpret this as the demand effect becoming somewhat more diffuse.

6.5 Limitations

Any empirical study of this type will have a number of limitations. In the case here, the most notable is the absence of price information. Given the findings of Edelberg (2007) that there are systematic disparities in price correlated with race, it is unlikely that inclusion of price will change the qualitative nature of the results here. Higher prices for minority communities should in theory lead to lower utilization rates, but there is little reason to believe that it would lead to lower credit limits conditional on credit quality. That is, a profit-maximizing firm should be more willing to provide credit at high rates to equally qualified applicants.

The second notable limitation has been discussed throughout the paper. The data, though much more comprehensive than that used in prior studies of this type, do not specify precisely the set of covariates used by lenders in marketing or lending decisions. This makes the econometric task a more challenging one. One must rule out a very wide range of plausible specifications before coming to a conclusion on availability patterns.

Third, given the degree of regulatory scrutiny over the credit decision itself, one suspects that if any disparity exists in the provision of credit, it likely originates in the pre-screening (marketing) efforts. However, the methodology used is not able to distinguish explicitly between these functions. As such, the test used is essentially for the presence of race information in the screening process at one or both stages. This leads naturally to the question of legality, which this paper has explicitly avoided.

Finally, if issuers are simply profit seeking, and race is correlated with profitability, why shouldn't a bank be able to condition credit limits on race? Or if race isn't correlated with profitability directly, why shouldn't issuers be able to use race to proxy for other factors that are related to profit? There are legal precedents that provide some guidance here, though the paper won't address them in detail. The most relevant case is out of the U.S. Supreme Court *Wards Cove Packing v Antonio*, 490 US 642 (1989). This case outlines a three-step criterion for the assessment of disparate impact. "Disparate impact" refers to the ex-post evaluation of differences in credit access; that is, the differences that may arise from any part of the issuance process. There are more strict guidelines for the underwriting decision itself, among which is the documented rationale for any denial of credit. The first criterion in the *Wards Cove* case requires the identification of the presence of a "substantial disparate impact." If met, the second criterion shifts the burden of proof and requires the credit issuer to explain the legitimate business interest motivating its method of credit availability that led to the disparate impact. If the second criterion cannot be met, the third requires that there be an equally effective but less discriminatory option available. Only if the third test is reached and not met could a court find that there had been a problem in the issuance of credit. Whether this holds true in the circumstances examined here is beyond the scope of this paper.

7 Conclusions

The two couple decades have seen a wealth of research on the role of race in mortgage lending decisions. A relatively broad consensus in the literature is that in spite of federal legislation prohibiting discrimination in the home-buying process, minorities nonetheless continue to face significant barriers to buying homes. Contributing to the difficulties faced by minorities are systematically worse credit histories at the time of a home purchase decision; worse credit means higher payments or no loan at all. Enter credit cards. Most adults in the United States are now somewhat familiar with the use of credit cards and the notion that regular payment improves credit scores. Building up the good credit history necessary to buy a house is now almost inextricably connected to the prior reasonable use of credit cards. Credit histories are also now used in determination of auto insurance rates and in job applications.

Access to consumer credit, both in volume and number, is negatively related to the racial composition of an individual's neighborhood. The policy implications are parallel to those in the mortgage literature. Conditional on the finding of differential access to credit cards, long-term differences in home ownership rates is suggested for the reasons discussed above. As well, the lack of access has another, more pernicious effect. While credit card interest rates are exceptionally high compared to collateralized credit such as mortgages, they are nonetheless quite low compared to the growing payday loan market, where borrowers often go when other loan avenues are closed. Payday lenders often charge annual interest rates upward of 300%.

Access to consumer credit, more so than to mortgages, is a starting point on the modern financial ladder.

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Figure 1: Neighborhood credit distributions

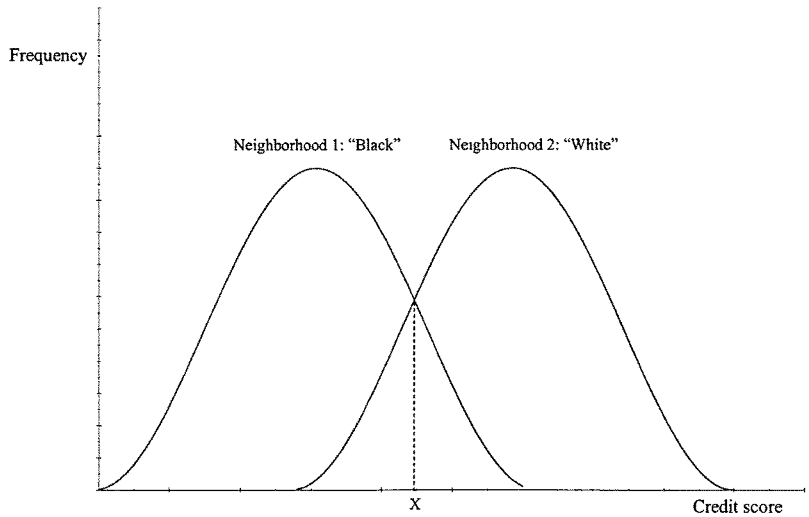
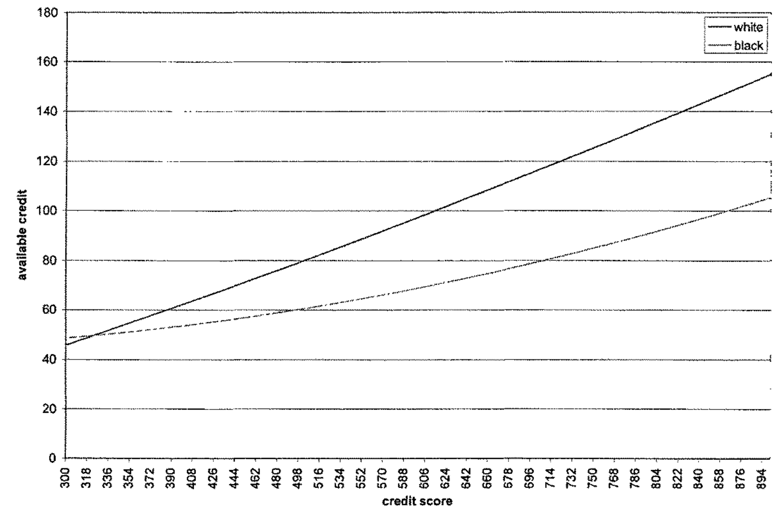


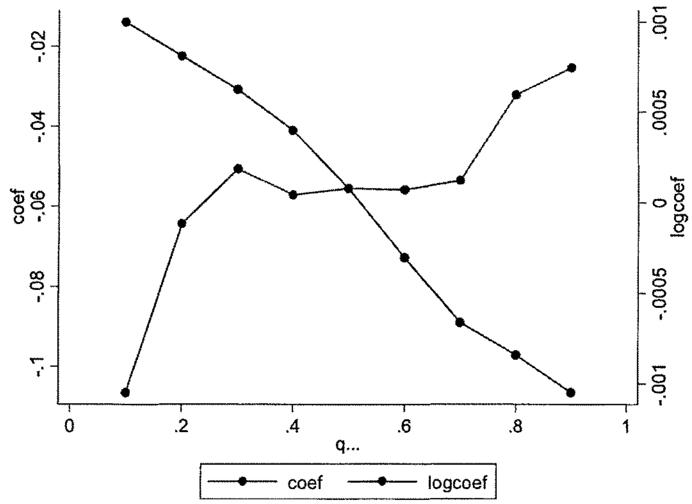
Figure shows two stylized credit score distributions from two neighborhoods that are predominantly "Black" and "White."

Figure 2: Available credit vs. credit score



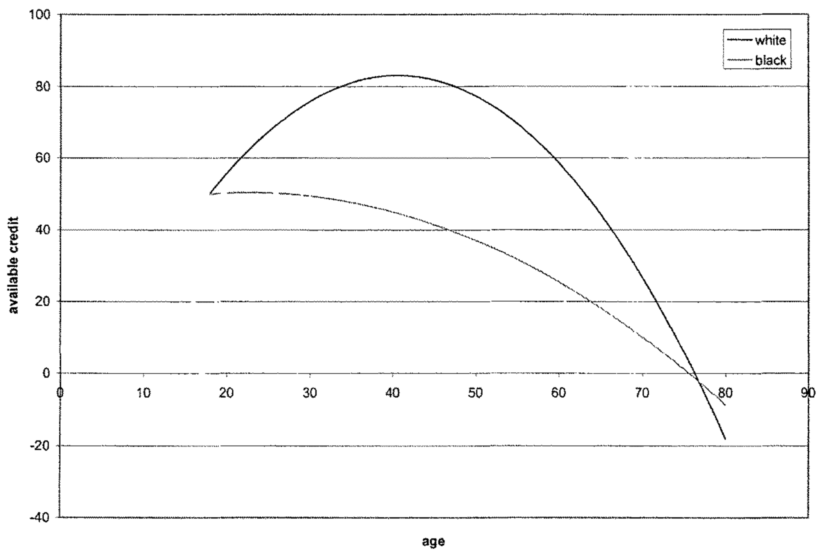
This figure shows a plot of implied available credit by credit score for an individual in a 100% White neighborhood and an individual in a 100% Black neighborhood. Values are calculated based on regression output in column 3 of table 8.

Figure 3: Quantile regressions



Blue line shows the coefficients of a quantile regression of available credit on a range of controls (see column 3 of figure 8 for list) Red line shows the coefficients of a quantile regression of the log of available credit on a range of controls (see column 3 of figure 8 for list)

Figure 4: Credit vs. age



This figure shows a plot of implied available credit by credit score for an individual in a 100% White neighborhood and an individual in a 100% Black neighborhood Values are calculated based on regression output in column 3 of table 11.

Table 1: Introductory data relationships

Panel A - Univariate regressions of months since last delinquency on selected variables						
months	married M	married F	secondary-ed M	secondary-ed F	household inc	% Black
coefficients	5 939	5 625	5 525	5.794	.1226	-4 742
std errs	(.398)***	(382)***	(.231)***	(264)***	(005)***	(192)***

Panel B - Correlations between selected explanatory variables						
	married M	married F	secondary-ed M	secondary-ed F	household inc	% Black
married M	1					
married F	8812	1				
secondary-ed M	2394	2169	1			
secondary-ed F	.2053	202	947	1		
household inc	.3241	.2942	7502	.737	1	
% Black	**-.4465**	**-.5153**	**-.2857**	**-.2199**	**-.2845**	1

Table 2: Credit across race quintiles

availcredit		
Race quintile	Mean	SD
1	67 113	122.399
2	46 052	81 742
3	37.984	76 267
4	32.858	69 262
5	27 460	63 488

score		
Race quintile	Mean	SD
1	662 366	180 616
2	600 261	193 901
3	564.915	195 714
4	538 160	194 637
5	509 338	186 694

# accounts		
Race quintile	Mean	SD
1	13 259	12 126
2	10 779	11.467
3	9 772	11.265
4	9 160	10 984
5	8 284	10.439

limit		
Race quintile	Mean	SD
1	82.064	148 447
2	53 286	100 171
3	42 741	90 731
4	37.060	81.100
5	30 773	76.538

util %		
Race quintile	Mean	SD
1	37 171	35 223
2	44 458	38.233
3	49.485	40.310
4	52 374	43 151
5	56.823	44 536

Note: Quintile 1 consists of areas with <20% African Americans. Quintile 2 consists of areas with between 20% and 40% African Americans Quintile 3 consists of areas with between 40% and 60% African Americans Quintile 4 consists of areas with between 60% and 80% African Americans Quintile 5 consists of areas with >80% African Americans.

Table 3: Variable description and data sources

Variable	Description	Source
	Credit Variables	
limit	Credit limit (in thousands of dollars)	Consumer Credit dataset
util %	Utilization rate	Consumer Credit dataset
# accounts	Number of unique accounts	Consumer Credit dataset
score	Credit score	Consumer Credit dataset
	This is a measure of credit quality largely equivalent to a FICO-score	
availcredit	Available credit (in thousands of dollars)	Author calculations
	Available credit is calculated as total available credit line .	
	minus any current balances: limit * (1-util%)	
util $	Utilized credit (in thousands of dollars)	Author calculations
	Utilization is the product of the utilization rate and total credit lines	
	Demographic Variables	
% Black	Percentage of population with race of Black or African American	Census 2000 Summary File
age	Age of individual	Consumer Credit dataset
age^2	Square of above	Consumer Credit dataset
score * % Black	Interaction of score with percentage Black	Consumer Credit dataset
(score * % Black $)^2$	Square of above	Consumer Credit dataset
public assistance	Percentage of households receiving public assitance	Census 2000 Summary File
foreign-born	Percentage of population born outside the United States	Census 2000 Summary File
income growth (inflation adj)	Inflation-adjusted average income growth by PUMA	2000 & 2005 ACS
% employment	Percentage of population over age 16 listed as employed	Census 2000 Summary File
	Housing Variables	
% vacant	Percentage of housing units that are not occupied	Census 2000 Summary File
% owner-occupied	Percentage of housing units that are occupied by owner	Census 2000 Summary File
% houses w/ mortgage	Percentage of housing units with mortgages	Census 2000 Summary File
median rent	Median rent of specified renter-occupied housing units	Census 2000 Summary File
median house value	Median house value by census block group	Census 2000 Summary File
	Income Variables	
income 10k-15k, etc	Percentage of households with annual income between $10k and $15k, etc	Census 2000 Summary File
inc 150kplus	Percentage of households with annual income greater than $150k	Census 2000 Summary File
	Income groups are also specified for fourteen ranges of income	
	between $15k and $150k. This information is available upon request.	

Table 4: Variable description and data sources

Variable	Description	Source
	Language Variables	
lang Span	Percentage of households where Spanish is the primary language	Census 2000 Summary File
lang Asian	Percentage of households where an Asian language is the primary language	Census 2000 Summary File
	Crime Variables	
violent crime	Violent crime per capita	FBI Uniform Crime Reports
property crime	Property crime per capita	FBI Uniform Crime Reports
	Educational Attainment	
> HS ed - male	Percentage of male population with educational attainment > HS diploma	Census 2000 Summary File
> HS ed - female	Percentage of female population with educational attainment > HS diploma	Census 2000 Summary File
eq HS ed - male	Percentage of male population with educational attainment = HS diploma	Census 2000 Summary File
eq HS ed - female	Percentage of female population with educational attainment = HS diploma	Census 2000 Summary File
	Marital Status	
married - male	Percentage of male population over age 15 listed as married	Census 2000 Summary File
married - female	Percentage of female population over age 15 listed as married	Census 2000 Summary File
nonmarried - male	Percentage of male population over age 15 listed as nonmarried	Census 2000 Summary File
nonmarried - female	Percentage of female population over age 15 listed as nonmarried	Census 2000 Summary File
widowed - male	Percentage of male population over age 15 listed as widowed	Census 2000 Summary File
widowed - female	Percentage of female population over age 15 listed as widowed	Census 2000 Summary File
divorced - male	Percentage of male population over age 15 listed as divorced	Census 2000 Summary File
divorced - female	Percentage of female population over age 15 listed as divorced	Census 2000 Summary File
	Instrumental Variables	
GTagginc 1-4 miles	The average income of the surrounding block groups in a 1–4-mile radius with income greater than the immediate area's average income	Census 2000 Summary File
GTagginc 4-20 miles	The average income of the surrounding block groups in a 4–20-mile radius with income greater than the immediate area's average income	Census 2000 Summary File
	Payday Variables	
PD3mile	Number of payday lenders within 3 miles of the individual	Prof. Richard Graves
PD-Black	Interaction of PD3mile with % Black	Prof. Richard Graves
PD-score	Interaction of PD3mile with score	Prof. Richard Graves

Table 5: Summary statistics

Variable	Median	Mean	SD	Variable	Median	Mean	SD
limit	6.100	23.627	46 302	property crime	0 033	0.036	0.018
util %	11.400	27.770	35 493	> HS ed - male	0 522	0 533	0.193
# accounts	10 000	12 677	12 042	> HS ed - female	0 504	0 515	0 169
score	652.851	606 351	165 835	eq HS ed - male	0 269	0 269	0.106
availcredit	12 506	27 012	45 229	eq HS ed - female	0 289	0 290	0 096
util $	1 574	6 582	15 212	public assistance	0.024	0 036	0 037
% Black	0 036	0 127	0 209	married - male	0.588	0 580	0 112
age	46 000	48 207	17 123	married - female	0 540	0.539	0 115
age^2	2116 000	2617.117	1842 198	nonmarried - male	0 293	0.307	0 103
age * race	1.409	5 384	10 146	nonmarried - female	0.227	0 246	0 098
score * % Black	20 589	67 257	114 231	widowed - male	0 023	0 026	0 016
$score^2$* % Black	12887 640	43426 340	80442 260	widowed - female	0.100	0 105	0 048
income 10k-15k	0.135	0.157	0 102	divorced - male	0 084	0 088	0 036
income 15k-20k	0 058	0 062	0 037	divorced - female	0.110	0 111	0.040
income 20k-25k	0 061	0.062	0 032	income growth (inflation adj)	0 167	0 482	2 610
income 25k-30k	0.066	0 065	0 030	employment	0.817	0.809	0 090
income 30k-35k	0.065	0 064	0 027	% vacant	0.053	0.070	0.067
income 35k-40k	0 064	0 063	0 025	% owner-occupied	0 673	0.650	0 206
income 40k-45k	0 058	0 058	0 022	% houses w/ mortgage	0.708	0 699	0 136
income 45k-50k	0 055	0 056	0 021	median rent	0 615	0 665	0 259
income 50k-60k	0 048	0 049	0 020	median house value	112.200	138 333	98 052
income 60k-75k	0 089	0 090	0 030	foreign-born	0 064	0.116	0 132
income 75k-100k	0 103	0 105	0.042	GTagginc 1-4 miles	26 161	29.642	13.167
income 100k-125k	0 097	0.105	0 056	GTagginc 4-20 miles	28.518	31.438	12 305
income 125k-150k	0 042	0 054	0 042	PD3mile	1 000	5 915	9 182
income 150k-200k	0 017	0 026	0.027	PD-Black	0 024	1 011	2 841
income 200k plus	0.012	0 023	0 029	PD-score	662 868	3202 052	5264 233
DNT avg income	21261 230	21516.480	4573 306				
lang Span	0 053	0 115	0 161				
lang Asian	0 012	0 029	0 054				
violent crime	0 004	0 005	0.003				

Table 6: Credit availability regressions

availcredit	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
% Black	-12.261	13.105	11 316	11.601	20 418	19 059	16 872	18 491
	(516)***	(1.498)***	(1.619)***	(1.675)***	(1 690)***	(1 707)***	(1.758)***	(1 909)***
score	.091	.097	.101	100	095	095	094	093
	(.0005)***	(.0006)***	(.0007)***	(0007)***	(0007)***	(0007)***	(.0007)***	(0008)***
score * % Black		- 041	- 040	- 041	-.031	- 030	- 027	- 027
		(.002)***	(002)***	(003)***	(003)***	(.003)***	(003)***	(.003)***
age			110	.110	.110	110	106	105
			(005)***	(.005)***	(.005)***	(005)***	(.005)***	(.006)***
violent crime				-959 008	-1010.030	-1006.920	-834 330	-577 291
				(602 272)	(599 030)*	(598 999)*	(601.523)	(641 613)
property crime				209 221	203.964	202 923	206 180	189 572
				(98 248)**	(97 721)**	(97.717)**	(97 410)**	(107 503)*
education					included	included	included	included
marital status					included	included	included	included
foreign-born						included	included	included
income							included	included
public assistance							included	included
inc growth (inflation adj)							.093	.140
							(.052)*	(059)**
% employment							116	4 319
							(2.137)	(2 473)*
% vacant								- 416
.								(1 842)
% owner-occupied								3 813
								(1 123)***
% houses w/ mortgage								-1 931
								(1 289)
median rent								.906
								(.567)
median house value								.035
								(003)***
Observations	365092	365092	323622	303235	303179	303179	286427	241451
R-squared	082	.083	094	093	103	.103	108	111
F-Stat	16143.38	10880 39	8329.338	5159.003	2162.98	2037 849	981 131	746.649

Note The symbols *, **, and *** denote significance at the 10, 5, and 1 percent levels, respectively Dependent variable is measured in 000s USD. County-level fixed effects included. For brevity, many coefficients are suppressed "Income" includes percent of population divided into 16 income brackets. "Education" includes percent of population with educational attainment of high school diploma or greater. "Marital status" includes percent of population nonmarried, widowed, or divorced Full results are available in the appendix.

Table 7: Credit limit regressions

credit limit	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
% Black	-13 419	7 070	3.666	3 691	14 291	12 503	10.077	11 991
	(454)***	(1.112)***	(1 297)***	(1 345)***	(1 370)***	(1.391)***	(1.443)***	(1 575)***
score	.089	095	100	099	093	.093	.091	091
	(0004)***	(.0005)***	(.0006)***	(0006)***	(.0006)***	(0006)***	(0007)***	(0007)***
score * % Black		- 037	- 033	- 033	- 022	- 022	- 018	- 018
		(.002)***	(002)***	(.002)***	(002)***	(002)***	(002)***	(002)***
age			.080	082	082	081	077	076
			(005)***	(.005)***	(005)***	(005)***	(005)***	(.006)***
violent crime				-884 869	-904 196	-904 144	-734.297	-539.202
				(581.431)	(578.029)	(577.987)	(583 953)	(622 792)
property crime				200 707	190.789	190.678	190 288	183 436
				(95 638)**	(95.083)**	(95 076)**	(94 916)**	(105 157)*
education					included	included	included	included
marital status					included	included	included	included
foreign-born						included	included	included
income							included	included
public assistance							included	included
inc growth (inflation adj)							043	116
							(053)	(.060)*
% employment							1.218	5 104
							(2 170)	(2 506)**
% vacant								460
								(1.868)
% owner-occupied								3.998
								(1 130)***
% houses w/ mortgage								-1 568
								(1 284)
median rent								1 141
								(592)*
median house value								044
								(.003)***
Observations	454692	454692	377955	353188	353122	353122	333941	281883
R-squared	094	.094	101	1	111	111	116	.119
F-Stat	23300.12	15683.21	10582 17	6510.449	2732 265	2575.023	1240 019	942 784

Note: The symbols *, **, and *** denote significance at the 10, 5, and 1 percent levels, respectively Dependent variable is measured in 000s USD. County-level fixed effects included. For brevity, many coefficients are suppressed. "Education" includes percent of population with educational attainment of high school diploma or greater "Marital status" includes percent of population nonmarried, widowed, or divorced "Income" includes percent of population divided into 16 income brackets. Full results are available in the appendix

Table 8: Instrumental variables regressions

credit limit	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
util $	5.429	5 236	5 223	5 077	2 610	2 148	2.170	1.592
	(354)***	(.324)***	(352)***	(.478)***	(.367)***	(604)***	(611)***	(1 507)
% Black	3.487	68.742	71 427	70 124	37 947	32.941	33 117	25 699
	(1 575)**	(5 303)***	(5 936)***	(6 641)***	(4 888)***	(7 027)***	(7 119)***	(17 940)
score	.116	130	133	132	109	103	.104	098
	(003)***	(.004)***	(004)***	(005)***	(.003)***	(.005)***	(.005)***	(013)***
score * % Black		-.107	- 113	- 110	-.060	-.050	- 050	- 038
		(007)***	(008)***	(.010)***	(008)***	(012)***	(.012)***	(029)
age			143	142	118	.116	.117	110
			(010)***	(010)***	(006)***	(008)***	(008)***	(015)***
violent crime			-305 652	-333 645	-425 323	-362 237	-353.119	-560 986
			(679 717)	(669.331)	(466.236)	(448.922)	(447 087)	(386 289)
property crime			94 066	101 629	141.640	142 102	143.461	182 785
			(111 262)	(108 624)	(69.966)**	(73 179)*	(72 843)**	(59.780)***
education				included	included	included	included	included
marital status				included	included	included	included	included
foreign-born				included	included	included	included	included
income					included	included	included	included
public assistance					included	included	included	included
inc growth (inflation adj)					133	147	.147	131
					(.076)*	(.097)	(097)	(101)
% employment					-2.040	2 088	2 352	3 252
					(2.684)	(3 084)	(3.090)	(3 754)
% vacant						-1 785	-1 441	-1.081
						(2 695)	(2 685)	(2 881)
% owner-occupied						3 498	3 692	3 467
						(1 334)***	(1.328)***	(1 275)***
% houses w/ mortgage						-1 266	-1 254	-1 674
						(1 391)	(1 383)	(1 377)
median rent						.486	441	722
						(.812)	(.811)	(820)
median house value						022	021	029
						(011)*	(011)*	(020)
Observations	334250	334250	276942	276892	260517	219421	220483	239114
R-squared	- 692	-.574	-.608	-.524	33	381	379	381
F-Stat	780.025	628.446	389.536	215 027	278 231	305 401	300 724	367.882
e(Hansen J-stat)	6.791	4 24	5 379	8 275	049	.199	n/a	n/a
e(p-value)	009	039	02	.004	824	655	n/a	n/a
e(Kleibergen-Paap LM-stat)	20 342	21.771	19 582	17.866	17 043	13 877	11.93	2 412
e(p-value)	.00004	.00002	.00006	.0001	0002	001	0006	12
e(Kleibergen-Paap F-stat)	802.641	853 618	783 892	239 979	54 592	22.404	42.977	8.203

Note The symbols *, **, and *** denote significance at the 10, 5, and 1 percent levels, respectively County-level fixed effects included, and standard errors are robust to heteroskedasticity and clustered at the county level Columns 1-6 include average neighboring wealth for the relatively richer within 1-4 miles and 4-20 miles as instruments Column 7 uses only the 1–4-mile radius instrument while column 8 uses only the 4–20-mile radius instrument. Dependent variable and util $ are measured in 000s USD "Education" includes percent of population with educational attainment of high school diploma or greater "Marital status" includes percent of population nonmarried, widowed, or divorced. "Income" includes percent of population divided into 16 income brackets. Refer to Table 3 for description of instruments. Full results are available in the appendix

Table 9: First-stage IV regressions

util $

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
% Black	-1 111	-11.797	-12 694	-11 796	-12 489	-12 015	-12 033	-12.020
	(272)***	(596)***	(.630)***	(599)***	(652)***	(.733)***	(731)***	(700)***
score	-.006	-.009	- 009	-.009	- 009	- 008	-.008	- 008
	(0003)***	(0004)***	(0004)***	(0004)***	(0004)***	(0004)***	(0004)***	(.0004)***
score * % Black		017	019	.020	.020	.019	.019	.019
		(0008)***	(0008)***	(0009)***	(.0009)***	(001)***	(001)***	(.001)***
age			- 009	-.009	-.008	-.009	- 009	- 010
			(003)***	(003)***	(003)***	(003)***	(003)***	(003)***
violent crime			-110 708	-93 703	-115 376	-19 824	-8 682	-72 248
			(141 067)	(144.139)	(145.739)	(162 694)	(162 563)	(135 044)
property crime			10 246	5 581	6 608	.677	1 334	7 278
			(25 914)	(26 314)	(26.350)	(31 433)	(31.259)	(24 117)
education				included	included	included	included	included
marital status				included	included	included	included	included
foreign-born				included	included	included	included	included
income					included	included	included	included
public assistance					included	included	included	included
inc growth (inflation adj)					- 022	.008	009	019
					(.023)	(.027)	(026)	(026)
% employment					2.957	2 445	2.499	1 987
					(.907)***	(.985)**	(953)***	(915)**
% vacant						.717	.653	1.138
						(833)	(.816)	(.789)
% owner-occupied						344	.373	265
						(.526)	(512)	(495)
% houses w/ mortgage						122	138	-.157
						(.487)	(486)	(444)
median rent						.028	025	105
						(283)	(287)	(.267)
median house value						009	.010	.011
						(003)***	(003)***	(.003)***
GTagginc 1-4 miles	.042	.040	051	.064	059	047	.047	
	(010)***	(010)***	(011)***	(012)***	(012)***	(.012)***	(012)***	
GTagginc 4-20 miles	081	088	.089	044	.013	005		029
	(011)***	(011)***	(.012)***	(.013)***	(.018)	(.019)		(.017)*
Observations	334250	334250	276942	276892	260517	219421	220483	239114
R-squared	008	009	01	011	.011	012	012	012
F-Stat	145.241	165 397	101 823	64.681	39 029	30 985	31 76	33 663

Note: The symbols *, **, and *** denote significance at the 10, 5, and 1 percent levels, respectively. County-level fixed effects included, and standard errors are robust to heteroskedasticity and clustered at the county level Dependent variable is measured in 000s USD. For brevity, many coeficients are suppressed "Education" includes percent of population with educational attainment of high school diploma or greater "Marital status" includes percent of population nonmarried, widowed, or divorced "Income and employment" includes percent of population divided into 16 income brackets, as well as the percentage of population receiving public assistance, with earnings, and the inflation-adjusted income growth Full results are available in the appendix

Table 10: Interaction of age with race

credit limit	(1)	(2)	(3)
util $	2 148	2 148	2 058
	(604)***	(.604)***	(621)***
% Black	32.941	33.275	73.045
	(7.027)***	(7 952)***	(7.016)***
score	.103	.103	102
	(005)***	(.005)***	(005)***
score * % Black	- 050	- 049	-.045
	(012)***	(011)***	(.012)***
age	116	117	2 090
	(008)***	(011)***	(.423)***
age^2			-.019
			(.004)***
age * % Black		- 010	-1 807
		(.035)	(183)***
age^2 * % Black			017
			(.002)***
inc growth (inflation adj)	147	.147	.124
	(097)	(.097)	(.097)
% owner-occupied	3 498	3.501	3 447
	(1 334)***	(1 334)***	(1.334)***
% houses w/ mortgage	-1 266	-1 276	-1 342
	(1.391)	(1.393)	(1 377)
median house value	022	022	022
	(011)*	(011)*	(.011)**
crime	included	included	included
education	included	included	included
marital status	included	included	included
foreign-born	included	included	included
income	included	included	included
public assistance	included	included	included
% employment	included	included	included
% vacant	included	included	included
median rent	included	included	included
Observations	219421	219421	219421
R-squared	381	.381	397
F-Stat	305.401	299 025	296 46
e(Hansen J-stat)	.199	.198	135
e(p-value)	655	656	714
e(Kleibergen-Paap LM-stat)	13.877	13.897	13.347
e(p-value)	001	.001	.001
e(Kleibergen-Paap F-stat)	22.404	22 43	21.439

Note The symbols *, **, and *** denote significance at the 10, 5, and 1 percent levels, respectively Results are based on IV regression specification as in Table 8 County-level fixed effects included, and standard errors are robust to heteroskedasticity and clustered at the county level Dependent variable and util $ are measured in 000s USD For brevity, many coefficients are suppressed "Education" includes percent of population with educational attainment of high school diploma or greater. "Marital status" includes percent of population nonmarried, widowed, or divorced "Income" includes percent of population divided into 16 income brackets Full results are available in the appendix.

Table 11: Payday lending

credit limit	(1)	(2)	(3)	(4)	(5)
util $	2.148	2 131	2 126	2.154	2.154
	(.604)***	(605)***	(.604)***	(.608)***	(610)***
% Black	32 941	32.766	31 745	31.422	31 288
	(7 027)***	(7.022)***	(7.167)***	(6 787)***	(7 117)***
score	103	103	103	.108	.108
	(005)***	(005)***	(005)***	(006)***	(.006)***
score * % Black	- 050	- 049	- 049	- 047	-.047
	(012)***	(.012)***	(012)***	(011)***	(.011)***
age	.116	116	.116	.117	.117
	(008)***	(008)***	(008)***	(008)***	(.008)***
inc growth (inflation adj)	147	.147	.149	.148	148
	(.097)	(.098)	(099)	(.099)	(099)
% owner-occupied	3.498	3 387	3 369	3 475	3.472
	(1 334)***	(1 332)**	(1 330)**	(1 323)***	(1.323)***
% houses w/ mortgage	-1.266	-1.338	-1.375	-1 535	-1 539
	(1 391)	(1 383)	(1 381)	(1 393)	(1.391)
median house value	.022	021	021	021	021
	(.011)*	(011)*	(.011)*	(.011)*	(.011)*
PD-3mile		- 026	-.040	387	.384
		(.018)	(.023)*	(.102)***	(.109)***
PD-3mile * % Black			103		014
			(.067)		(071)
PD-3mile * score				-.0007	- 0007
				(0002)***	(0002)***
crime	included	included	included	included	included
education	included	included	included	included	included
marital status	included	included	included	included	included
foreign-born	included	included	included	included	included
income	included	included	included	included	included
public assistance	included	included	included	included	included
% employment	included	included	included	included	included
% vacant	included	included	included	included	included
median rent	included	included	included	included	included
Observations	219421	219421	219421	219421	219421
R-squared	381	.381	382	381	381
F-Stat	305 401	298 509	303 613	326 789	330.797
e(Hansen J-stat)	199	17	174	167	.167
e(p-value)	655	68	677	683	682
e(Kleibergen-Paap LM-stat)	13 877	13 794	13.703	13 854	13 701
e(p-value)	.001	001	001	001	001
e(Kleibergen-Paap F-stat)	22 404	22 075	21 989	21.764	21 594

Note: The symbols *, **, and *** denote significance at the 10, 5, and 1 percent levels, respectively. County-level fixed effects included, and standard errors are robust to heteroskedasticity and clustered at the county level. Instruments as in Table 8. Dependent variable and util $ are measured in 000s USD For brevity, many coefficients are suppressed "Education" includes percent of population with educational attainment of high school diploma or greater. "Marital status" includes percent of population nonmarried, widowed, or divorced. "Income" includes percent of population divided into 16 income brackets. Full results are available in the appendix

Ms. Sandra Braunstein subsequently submitted the following in response to written questions received from Chairman Watt in connection with the July 17, 2008 hearing before the House Oversight and Investigations Subcommittee of the Financial Services Committee.

1. **At the hearing, you testified that you were unsure whether the Board has existing authority under the Equal Credit Opportunity Act (ECOA) to amend Regulation B to require the collection and public reporting of personal characteristic data of applicants for nonmortgage credit. Please elaborate on the Board's interpretation of the scope of its current statutory authority to require collection and reporting of this data without legislative action.**

Under ECOA, the Federal Reserve Board (Board) has broad authority to prescribe regulations to carry out the purposes of the act—to require lenders to make credit equally available to all creditworthy consumers without regard to race, sex, and other prohibited bases. Further, ECOA authorizes the Board to make "such classifications . . . adjustments and exceptions . . . as in the judgment of the Board are necessary or proper to effectuate the purposes of the [act]. . . ." In exercising the broad delegation of authority under ECOA, the Board must ensure that any obligations imposed directly on creditors advance, rather than impede, the purposes of ECOA. ECOA is silent, however, on whether the Board may permit creditors to note personal characteristics that, by law, they cannot consider.

The Board has exercised this broad grant of authority to require creditors to collect applicants' race, national origin, sex, marital status, and age for mortgage loans. The Board adopted this limited data collection requirement in 1977 based on frequent and serious allegations of unlawful discrimination in the home mortgage market. Collection of these data was designed to help enforcement agencies better monitor home mortgage lenders' compliance with the ECOA, thereby advancing antidiscrimination efforts. The Board did not, however, require reporting or public disclosure of applicant characteristic data collected in mortgage transactions at that time.

Rather, in 1989 Congress enacted the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), which, among other things, amended the Home Mortgage Disclosure Act (HMDA) to require reporting and public disclosure of the personal characteristics of applicants for mortgage credit. These 1989 amendments were intended to enhance the utility of HMDA as an antidiscrimination lending tool. *See* H.R. Conf. Rep. No. 222 at 459, 101st Cong., 1st Sess. (1989). Congress determined that the utility of the data collected on mortgage loans would be limited unless additional information on loans was reported and disclosed in a uniform fashion by all pertinent regulatory agencies. However, this entailed imposing additional obligations and requirements not only on creditors, but on agencies.

As a result, FIRREA amended HMDA to require collection, reporting and disclosure of the race, gender, and income characteristics of borrowers and applicants for loans, and transmission of this information "in a form that facilitated the task of identifying discriminatory lending patterns." *Id.* The agencies, acting through the Federal Financial Institutions Examination Council (FFIEC), ensure that the HMDA data are accurate, aggregate the data, and compile tables and reports based on the data for use by the public. The Board, in cooperation with the other agencies, developed regulatory provisions that prescribed the format for the collection and submission of such data, as well as the procedures for disclosing such information to the public.

Under its existing ECOA authority, the Board could require creditors to collect data on applicants' personal characteristics for non-mortgage loans, such as small business loans. However, a collection requirement alone likely may have limited utility in identifying potential discriminatory lending practices. It is unclear whether, without legislative action, the scope of authority granted to the Board by ECOA is sufficiently broad to permit the Board to establish a reporting and public disclosure scheme like HMDA for non-mortgage loans.

2. Assuming that Congress enacted legislation requiring the collection and reporting of personal characteristic data of applicants for nonmortgage credit, what is the Board's position on what types of financial products should be covered?

We believe that Congress is in the best position to decide the proper scope of a mandatory data collection, reporting and disclosure requirement for non-mortgage loans. A key issue is the complexity of the products for which data must be collected. Another key issue is whether the benefits of mandating data collection and public disclosure for some or all non-mortgage loans outweigh the costs.

For example, some studies have noted unexplained disparities which may suggest that discrimination plays a role in certain types of non-mortgage lending, such as small business. Small business lending is much more complex than mortgage lending and varies across lenders much more than mortgage lending. The types of credit and sources of funding for small businesses span a large spectrum. A small business owner can apply for credit from a commercial bank or other traditional lender, or from "informal investors," such as local development corporations, state and local governments, private foundations, and credit unions. There are also a number of credit products available to small business, such as lines of credit, seasonal commercial loans, installment loans, collateralized loans, credit card advances, and term loans. More importantly, the small business lending industry differs significantly from other lending industries, such as mortgage lending, because it is non-homogenous in its underwriting of credit risk. The underwriting and pricing of these loans may vary depending on numerous credit factors (collateral, capital, ability to repay) as well as the nature and size of the business.

Due to the complexity of this lending segment, to obtain useful information lenders may need to collect and report many different types of data, such as data on business attributes and credit products. A broad range of data might be necessary to maximize the use of that data as an effective screen to detect potential discriminatory lending patterns.

On the other hand, some types of credit, such as credit cards, typically are granted using automated underwriting systems and without face-to-face contact between the creditor and the consumer. For this type of lending, the costs of associated with the collection of applicant or borrower characteristic data likely exceed the benefits. The individual taking the credit application typically does not have knowledge of the personal characteristics of the applicant, and therefore discrimination is less likely.

3. **The GAO Report and your testimony highlighted the projected complexities of a collecting and public reporting of personal characteristic data of applicants for small business lending. Assuming that Congress enacted legislation to require mandatory collection and public reporting of personal characteristic data of applicants for small business loans, how should Congress define "small business"? How should Congress define what types of small businesses are classified as "minority-owned" or "women-owned"? Which types of small business lending products should be included (revolving lines of credit, term loans, home equity loans, unsecured personal loans)? Should the type of collateral be reported? Which categories of lenders should report? Please discuss any other issues Congress should consider regarding a collection/public reporting requirement for small business lending.**

At this time, we do not have any suggestions on how to define these terms, or what, if any, specific types of data should be reported. The questions posed involve a broad range of policy issues and considerations that Congress is best suited to make. However, we have identified a few factors that we believe should be considered when evaluating a collection, reporting and disclosure requirement for small business lending.

The collection of data about the race, ethnicity, and gender of small business owners may be useful to regulators for identifying possible discrimination if they are able to access other relevant information as well. To maximize the use of such data as an effective screen for identifying possible discrimination in lending, when used in a public disclosure scheme similar to HMDA, data would need to be collected on a wide range of factors, such as data about the type of business, type of lending product, collateral, if any, pricing information, and age of the business.

To this end, the lessons learned from the HMDA scheme are valuable. HMDA data, including pricing data required by the Board's Regulation C since 2004, have highlighted the racial and ethnic gaps in the availability and price of mortgage credit. The collection and public disclosure of the HMDA data have drawn attention to these gaps and spurred a variety of efforts to address them by lenders, consumer and civil rights advocates, the Board and other federal and state agencies, and the Congress.

Based on cost and privacy concerns, however, HMDA data do not include several factors that lenders routinely use to make credit decisions and set loan prices, such as information about the borrower's creditworthiness and the loan-to-value and debt-to-income ratios. Thus, HMDA data alone cannot prove discrimination, although the data can, and does, facilitate fair lending enforcement by helping regulators identify lenders that warrant further review.

A similar requirement to collect, report, and publicly disclose race, ethnicity, and sex data for other types of lending, such as small business, also could enhance fair lending enforcement. However, such a requirement would be challenging to implement, especially given the complexity of small business lending, and could impose significant costs on lenders. Just as Congress required the collection, reporting, and public disclosure of applicant characteristic data in HMDA for mortgage loans, we believe that a decision about establishing a comparable collection, reporting, and public disclosure requirement for non-mortgage loans is a decision for Congress to make.

4. **Are there special issues related to the mandatory collection and public reporting of personal characteristic data of applicants for automobile financing, credit card lending or any other type of personal unsecured or secured nonmortgage lending that Congress should consider regarding a collection and public reporting requirement of personal characteristic data?**

As outlined above in our response to Question 2, small business lending presents the widest range of issues given the nature of that credit market. Auto finance lending also presents unique issues. Captive finance companies usually are wholly owned by the automobile manufacturer and have a majority share of the auto finance market. To encourage dealers to promote the captive financing option to consumers, many will offer incentives to auto dealers, such as commissions, finders' fees, or dealer participation rates. Auto finance typically involves two factors that potentially increase the risk of discrimination: financial incentives to charge borrowers more and broad discretion in loan pricing.

As noted in Question 2, credit cards typically are granted using automated underwriting systems and without face-to-face contact between the creditor and the consumer. For this type of lending, any value in obtaining such data is likely less than the costs associated with the collection of applicant or borrower characteristic data. The individual taking the credit application typically does not have knowledge of personal characteristic data concerning the applicant, and therefore discrimination is less likely.

5. **Please provide any data the Board has about the costs to lenders when personal characteristic data was originally required to be reported for mortgage loan borrowers under the Home Mortgage Disclosure Act (HMDA), the costs to lenders whenever any new data field is added to the HMDA requirements, and the projected costs to lenders if Congress enacted legislation to require the collection and public reporting of personal characteristic data for borrower applicants for small business loans.**

Board staff does not have information pertaining to actual or projected costs to lenders when personal characteristic data was originally required to be reported under HMDA, or the costs if Congress enacted a collection, reporting and public disclosure scheme for small business loan data.

Board staff has limited cost data regarding the new data field requirements required by HMDA, as implemented through Regulation C, in 2002. The Board staff estimated that lenders annual compliance burden would increase by approximately 20 percent. In addition, lenders incurred a one-time cost to reprogram existing systems to add codes for new data items, update existing systems with the new definitions for current data items, and create an interface between current HMDA and Truth in Lending Systems to enable reporting of pricing data. However, these costs relate to the addition of fields to an existing scheme, and thus would not reflect the start-up costs of implementing a new collection and reporting scheme for small business loans.

6. **Since the Board will be discontinuing the Survey of Small Business Finances (SSBF), please elaborate on the elements from the SSBF that the Board will incorporate into the Survey of Consumer Finances? Please discuss what issues led to the Board's decision to discontinue the SSBF. What accounts for the long period of time it took for the Board to analyze and release to the public the results from the prior SSBFs?**

6(a). Since the Board will be discontinuing the Survey of Small Business Finances (SSBF), please elaborate on the elements from the SSBF that the Board will incorporate into the Survey of Consumer Finances?

The Board decided not to conduct another quinquennial Survey of Small Business Finances (SSBF) and instead, to redirect its efforts to gathering more timely information on small business finances. The Board continues to view small businesses as a critical part of the U.S. economy. Its decision regarding the SSBF does not represent any change in this view, but merely reflects its judgment that the information that the Board and many others need can be collected via more timely and cost effective means.

The Board made the decision to discontinue the quinquennial SSBF in conjunction with a decision both to (a) expand the sample size of the tri-annual Survey of Consumer Finances (SCF), and (b) revise and expand the SCF's existing set of questions about small businesses owned by households. The 2010 SCF would be the first SCF to reflect these changes. This approach will make up for much of the loss of the SSBF, plus give the Board and other users of data on small businesses some important additional advantages. Key benefits of expanding the SCF include more frequent data, better coverage of new and very young firms, and better coverage of the interactions between small business and household finance. All of these benefits should help the Board and others to better understand important issues in the creation of new businesses and entrepreneurial activity in general, and how a variety of issues in these areas are affected by economic cycles.

While the Board's quinquennial Report to Congress on small business finances will be somewhat different from the reports Congress has received in the past, we believe the report Congress will received in 2012 will be at least as useful as those the Board has prepared for Congress in the past. Data from the expanded 2010 SCF will be available for the 2012 Report.

6(b). Please discuss what issues led to the Board's decision to discontinue the SSBF.

In the course of making this decision, Board staff worked with a wide range of users of the SSBF, including staff of the SBA. After working with these users, and after considering the Board's own needs, Board staff and the Board determined that the information needed could be obtained in a more timely and cost effective means. As discussed in our response to 6(a), this included a decision to expand the Board's tri-annual SCF. As we redesign and expand the SCF, the Board and its staff are committed to working with outside users of the SSBF to attempt to meet their needs. This process began in the fall of 2007 and is continuing.

6(c). What accounts for the long period of time it took for the Board to analyze and release to the public the results from the prior SSBFs?

The SSBFs are named for the year for which the data are collected. For example, most firms surveyed for the 2003 SSBF have data collected for the year ending December 31, 2003. Firms must be afforded time to get their records in order and prepare their taxes. Consequently, the interviewing process of these firms for the 2003 survey did not begin until July 2004 and continued through February 2005. The Board received the final raw survey data from the vendor in March 2005. Cleaning, imputing missing values, reviewing records for disclosure concerns, and constructing the public datasets and documentation were conducted between April 2005 and October 2006. Data were released to the public on November 1, 2006. A similar timeline was followed in the 1988, 1993, and 1998 Surveys of Small Business Finances.

Follow-up questions from Chairman Watt:

1. Please provide any research or information you have about (1) the cost to lenders from the original adoption of data required to be reported under the Home Mortgage Disclosure Act (HMDA) and (2) the projected costs to lenders for the mandatory collection and public reporting of personal characteristic data for applicants of nonmortgage credit.

2. Since the Federal Reserve Survey of Small Business Finances (SSBF) was discontinued, what are the current data sources for researchers to study small business lending patterns for possible discrimination? Are these alternative sources of data adequate for your research?

Responses:

Regarding question #1) I have no data on costs to lenders from HMDA, or the projected costs to data collection of nonmortgage credit. I am unaware of any studies that quantify lenders' costs.

Regarding #2) I am not aware of other data sources suitable for addressing small business lending patterns for possible discrimination.

Best regards,

Ken Cavalluzzo

AFSA
American Financial Services Association

August 13, 2008

The Honorable Melvin L.Watt
Chairman
Subcommittee on Oversight and Investigations
Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Watt,

Thank you again for inviting me to testify on July 17th before your subcommittee on whether non-mortgage lenders should be required to collect race and gender data, just as mortgage lenders must do under the Home Mortgage Disclosure Act (HMDA).

As there was considerable interest in knowing more about the compliance cost for collecting and reporting on non-mortgage forms of credit, you invited me to provide you and your colleagues with an estimate. The Financial Services Research Program (FSRP) at George Washington University estimates the costs to collect, compile, organize, clean and report HMDA-like data to be over $2.7 billion, which is about 10 times greater than HMDA. I have attached the FSRP analysis for your review.

As I articulated at the hearing, AFSA remains very concerned about the feasibility and ~~cost associated with such a proposal. For one thing, the increased cost will inevitably be~~ passed along, at least in part, to consumers while providing them with little, if any, benefit.

Today, most non-mortgage credit is underwritten and priced by creditors using objective, risk-based credit criteria, without face-to-face interaction or any information regarding the applicant's race or other prohibited characteristics. We believe that race-blind decisioning systems provide the very best assurance that consumers receive credit based on objective, nondiscriminatory criteria. It is hard to imagine that mandatory collection of racial information will improve this system.

If you have any questions regarding the FSRP analysis or AFSA's concerns about a new data collection and reporting regime of this magnitude, I would welcome the opportunity to discuss them with you.

Sincerely,

Bill Himpler
Executive Vice President, Federal Affairs

THE GEORGE WASHINGTON UNIVERSITY
WASHINGTON DC

FINANCIAL SERVICES RESEARCH PROGRAM

CENTER FOR REAL ESTATE AND URBAN ANALYSIS

Total compliance cost for HMDA

1. Grant Thornton Phase III (survey) estimate for all banks, 1991	$44,193,143
2. All banks, 2006 (row 1 adjusted for changes in the price level using the CPI: 44,193,143*(201.8/137.9)	$64,671,329
3. All mortgage lenders, 2006 (row 2/ bank share of mortgage originations in 2006 [24.7%] from Avery et al.)	$261,827,243

Estimated total compliance cost for HMDA-like disclosures for consumer credit

From TransUnion's TrenData database, 24,997,814 new consumer credit accounts were opened in 2006. The TrenData database is a sample of about 11 percent of TransUnion's marketing services database.

Thus, there were 227,252,855 (24,997,814/0.11) new accounts in 2006.

Avery et al. reported 20 million extensions and purchased mortgage loans in 2006 (p. A78).

Consumer credit accounts = 207,252,855 = 227,252,855 - 20,000,000, which is 10 <u>(207,252,855/20,000,000) times greater than the number of mortgage loans.</u>

We estimate that compliance costs for HMDA-like reporting rules for consumer credit would be about 10 times greater than HMDA, or $2,713,000,000.

Note
Consumer credit is non-mortgage credit.

Sources

Grant Thornton, Regulatory Burden: The Cost to Community Banks, Phase III-National Cost Survey. Study prepared for the IBAA, January 1993.

Avery et al. The 2006 HMDA Data. <u>Federal Reserve Bulletin</u> (2007).

August 13, 2008

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BARNEY FRANK, MA, CHAIRMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

October 6, 2008

Mr. Bill Himpler
Executive Vice President, Federal Affairs
American Financial Services Association
919 18th Street, NW, Suite 300
Washington, DC 20006

Dear Mr. Himpler:

As you will recall, the Oversight & Investigations Subcommittee held a hearing on July 17, 2008 entitled "*GAO Report on Regulation B: Should Lenders Be Required to Collect Race and Gender Data of Borrowers for All Loans?*"

In your written hearing testimony, you stated that the financial services industry would incur "massive costs" if required to collect and process race and gender data for non-mortgage loans. After the hearing, we requested that you provide support for your claim. You recently submitted a letter and a 1-page attachment, based on a George Washington University study, indicating that the expected costs for the collection of race and gender data for non-mortgage loans to be $2.7 billion. However, it is unclear from your letter whether the $2.7 billion represents an annual or one-time cost.

Please provide further analysis and back-up data supporting your cost claim. The 1-page attachment does not provide an adequate means for the Subcommittee to understand the underlying assumptions, analysis and computations for the cost figure. The Subcommittee desires to build a record for any possible future legislative or regulatory actions and your thorough and rigorous analysis is critical to that objective.

Sincerely,

Melvin L. Watt

MELVIN L. WATT
Chairman
Subcommittee on Oversight & Investigations

MLW/sa

AFSA®
American Financial Services Association

October 16, 2008

The Honorable Melvin L.Watt
Chairman
Subcommittee on Oversight and Investigations
Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Watt,

Thank you for giving us the opportunity to provide further analysis and back-up data supporting our cost claim for non-mortgage lenders to collect race and gender data, just as mortgage lenders must do under the Home Mortgage Disclosure Act (HMDA).

In answer to your question in your October 6 letter, the expected costs for the collection of race and gender data for non-mortgage loans of $2.7 billion represents an on-going annual cost. There would of course be an initial one-time start-up cost for any new HMDA-like regulation which would add to our estimate.

Additionally, you asked for the underlying assumptions, analysis and computations for the cost figure. The FSRP estimate of cost HMDA-like reporting requirements for consumer credit is based on a survey-based estimate of the cost of complying with ~~HMDA at banks. The survey-based estimate for banks is from a Grant Thornton (1993)~~ study of the cost of complying with thirteen bank regulations. Each bank reported the number of employee hours spent on specific compliance activities for each of thirteen regulations. The questionnaires listed specific compliance activities for each regulation and asked that compliance hours for each activity be reported by position or department. The listed compliance activities were developed from cost accounting case studies at several banks. Standard salary, benefit, overhead, and ''other direct cost'' rates derived from the case study results (Grant Thornton, 1992) were used to estimate compliance costs from compliance hours. Survey results were weighted by asset-size classes to represent the population of independent banks and all banks. Elliehausen (1998) provides additional information on the Grant Thornton estimates. No more recent estimate is available.

Activities for complying with HMDA-like reporting requirements for consumer credit would be likely be similar to those required for complying with HMDA. They would take place because an application is taken or a loan is approved. They would not occur in the absence of the regulation, since collection of information on race, ethnic origin, and sex is prohibited. The activities required to report such data would not differ significantly by type of lender, type of credit, or loan amount.

The Grant Thornton estimate for banks is adjusted for price level changes using the consumer price index.

The estimate is next adjusted to reflect the cost of HMDA for all mortgage lenders using data from the 2006 HMDA on the number of mortgage originations at banks and all lenders.

The number of consumer (non-mortgage) originations is obtained by subtracting the number of mortgage originations from the total number of credit accounts originated in 2006. The information on the total number of new credit accounts was obtained from a database on consumers' credit use and payment performance that is based on credit reporting data from Trans Union. The number of consumer originations was about ten times larger than the number of mortgage originations. Since compliance costs occur because a loan is originated, compliance costs HMDA-like reporting requirements for consumer credit would also be about ten times greater than compliance costs for HMDA.

There is no more recent detailed, systematic collection of data on the cost of complying with HMDA. Evidence on regulatory compliance suggests that compliance activities are labor intensive. Employees must enter data into information systems, verify accuracy of data, and correct errors. Managers must monitor employees and reporting systems to ensure compliance. This conclusion is probably still true even with advances in information technology since the Grant Thornton study.

Sincerely,

Bill Himpler
Executive Vice President, Federal Affairs

References

Grant Thornton. "Regulatory Burden: The Cost to Community Banks." Study prepared for the Independent Bankers Association of America, January 1993.

Grant Thornton. "Regulatory Burden: Phase II—Field Cost Studies." Study prepared for the Independent Bankers Association of America, August–September 1992.

Gregory Elliehausen. *The Cost of Bank Regulation*. Staff Studies 171. Washington: Board of Governors of the Federal Reserve System, April 1998. http://www.federalreserve.gov/pubs/staffstudies/1990-99/ss171.pdf

Hearing entitled, "The GAO Report on Regulation B: Should Lenders be Required to Collect Race and Gender Data for All Loans?"

July 17, 2008

<u>QUESTIONS FOR THE RECORD</u>

The House Financial Services Committee, Oversight and Investigations Subcommittee appreciates your participation in the hearing entitled, "The GAO Report on Regulation B: Should Lenders be Required to Collect Race and Gender Data for All Loans?" held on July 17, 2008. Please provide written responses to the follow-up questions below within 30 days to be submitted as part of the hearing record.

<u>ANN SULLIVAN</u> – WOMEN IMPACTING PUBLIC POLICY

1. At the hearing, you testified that the U.S. Small Business Administration (SBA) routinely collects and tracks racial and gender data for its loan programs and that Congress could use the SBA program as a model for any potential collection of similar data for all nonmortgage loans:

    a. What particular provisions of the SBA data collection program do you believe are particularly helpful - - or harmful - - to women-owned small businesses?

    b. Please discuss the tangible benefits to women-owned small businesses and organizations like Women Impacting Public Policy as a result of the collection of personal characteristic data for SBA loans.

    c. If the Federal Reserve collected and reported racial and gender data for nonmortgage lending as it does for mortgage lending under HMDA, would this data allow the SBA to focus more on its core mission of helping small businesses secure financing?

U.S. House of Representatives

Committee on Financial Services

Subcommittee on Oversight and Investigations

Hearing entitled, "The GAO Report on Regulation B: Should Lenders be Required to Collect Race and Gender Data for All Loans?"

July 17, 2008

Written Response Submitted September 23, 2008

QUESTIONS FOR THE RECORD

ANN SULLIVAN- WOMEN IMPACTING PUBLIC POLICY

a. The particular provisions of the SBA data collection program that WIPP believes are helpful to women-owned small businesses is the SBA lending data is broken down by African American, Hispanic, Asian, Native American, Other Minorities and Women. Furthermore, SBA collects the number of loans and amount of dollars of loans for the 7(a), 504, and Microloan programs. This classification of data is extremely beneficial to women-owned small business groups, such as WIPP, who track lending to their segment of the industry and allows us to compare the women-owned business loan approval data with that of another group. This gives us a good measure of our members' progress in gaining access to capital.

b. The tangible benefits to women-owned small businesses and organizations like WIPP as a result of the collection of personal characteristic data for SBA loans is that it provides our policymakers, the SBA, WIPP and other small business groups, with hard data as proof to what women business owners have been telling us, that they face hurdles with respect to access to capital. In addition, it helps to combat the problem that the GAO Report echoed which is that race and gender data are limited for nonmortgage lending.

c. WIPP believes that if the Federal Reserve collected and reported racial and gender data for nonmortgage lending as it does for mortgage lending under HMDA, this data would strengthen the SBA's ability to serve the small business communities' need for financing programs.

Question for the Record
Orice Williams, Director, Financial Markets and Community Investment
GAO

- What has your research demonstrated about the effectiveness of "proxies" or "surrogates" called for by the Interagency Examination Procedures (such as for last names of loan applicants or for census tract data) to assess the potential for discrimination in non-mortgage lending?

In our June 2008 report, Fair Lending: Race and Gender Data are Limited for Nonmortgage Lending (GAO-08-698), we found that in the absence of race, gender and other data on personal characteristics for nonmortgage loan applicants, regulators may rely on time-consuming and possibly unreliable techniques, such as established "surrogates" to make educated guesses as to the personal characteristics, such as race or gender, of nonmortgage loan applicants. The use of such techniques is to help determine whether the lenders they regulate are complying with established laws and regulations in extending credit to minority and other individuals targeted for loan applicants.

While the use of surrogates may help identify the racial or gender characteristics of loan applicants, they have potential for error (e.g., certain first names are gender neutral, and not all residents of particular census tract may actually be African-American). Furthermore, as a result of the limitations of the data on personal characteristics for nonmortgage loan applicants, federal oversight of lenders' fair lending law compliance in this area may be less efficient than it is for mortgage lending (due in part to HMDA data availability in mortgage lending). According to a comment letter submitted by a Federal Reserve Bank to FRB as it considered amending Regulation B from 1999 to 2003, its examiners were unable to conduct thorough fair lending examinations or review consumer complaints alleging discrimination for nonmortgage products due to the lack of available data.

We have just begun a comprehensive evaluation of the current state of federal enforcement of the Fair Lending Laws. In this work we will explore, among other things, the consistency and effectiveness of federal regulatory efforts in greater detail, including regulatory agencies' use of surrogates according to the Interagency Fair Lending Examination Procedures.