November 15, 1999

Jennifer J. Johnson
Secretary of the Board
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave., N.W.
Washington, DC 20551

Dear Ms. Johnson:

We are submitting this comment in response to the Board's notice of proposed rulemaking with respect to Regulation B, which implements the Equal Credit Opportunity Act (ECOA).

As we stated in our comment to the Board's advance notice of proposed rulemaking, we strongly support and encourage the Board to amend Regulation B to allow lenders voluntarily to collect information about the race and gender of applicants for non-mortgage credit, as it has proposed.

The current regulatory prohibition inhibits the ability of financial service providers to learn about and respond to market opportunities to provide credit for underserved communities. The prohibition makes it difficult for institutions to know whether products intended to expand access to credit, including to minorities, reach their intended customer base. Allowing creditors to collect race, gender and certain other data for business and consumer loans will likely lead to innovation and increased access to credit, a greater level of voluntary compliance, and more effective fair lending enforcement.

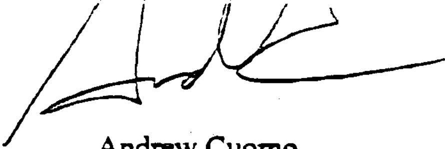
We also support additional changes to Regulation B concerning pre-application marketing practices.

We are enclosing more detailed comments and supporting attachments.

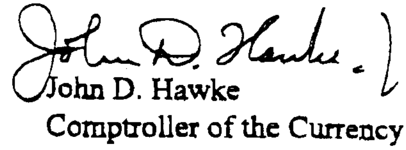
Sincerely,

Lawrence H. Summers
Secretary of the Treasury

Janet Reno
Attorney General

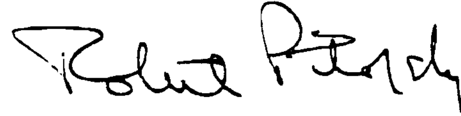


Andrew Cuomo
Secretay of Housing and Urban
Development



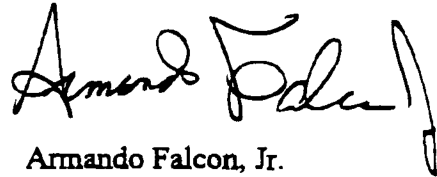
John D. Hawke
Comptroller of the Currency

Ellen Seidman
Director, Office of Thrift Supervision



Roberty Pitofsky
Chairman, by direction of the
Federal Trade Commission

Aida Alvarez
Administrator, Small Business Administration



Armando Falcon, Jr.
Director, Office of Federal
Housing Enterprise Oversight

JOINT AGENCY COMMENTS ON NOTICE OF PROPOSED RULEMAKING UNDER REGULATION B

I. Voluntary Data Collection

The Department of the Treasury, the Department of Justice, the Department of Housing and Urban Development, the Federal Trade Commission, the Comptroller of the Currency, the Office of Thrift Supervision, the Office of Federal Housing Enterprise Oversight, and the Small Business Administration ("the agencies") join in welcoming and supporting the Federal Reserve Board's proposal to amend Regulation B to permit creditors to collect data concerning the race, color, religion, sex, or national origin of loan applicants. Permitting collection of such data will enable creditors to increase credit availability to economically disadvantaged groups and will facilitate private sector and government detection of discriminatory practices.

A. *Experience with Mortgage Loans Shows that Data Collection Has Not Been Used to Discriminate and Has in Fact Increased Access to Credit*

In 1977, the Board revised Regulation B, which implements the Equal Credit Opportunity Act (ECOA), to prohibit creditors from collecting data on the race, sex, marital status, color, religion or national origin of loan applicants, in order to avoid discriminatory use of such data. However, the Board made an exception to this general prohibition by requiring creditors to collect such information on home mortgage loans. At that time, specific detailed information was not known about the nature and scope of ongoing lending discrimination. Since then, much has been learned about mortgage lending discrimination. The fear that race, national origin and gender data collected under the Home Mortgage Disclosure Act (HMDA) would be used for discriminatory purposes has not been realized. Instead, the requirement for recording and reporting applicant data has contributed to increased access to credit for minority loan applicants, assisted creditors in complying with the law and in developing innovative products, and aided federal supervisory and enforcement efforts.

Recent data suggest that HMDA's disclosure requirements play an important role in expanding access to credit. During the 1990s, lending to minorities has increased dramatically relative to non-minorities, and in 1998, total home purchase loans (conventional and government-backed) to both blacks and Hispanics reached record high levels. Between 1993 and 1998, mortgage originations for Hispanics and blacks grew by 87 percent and 72 percent, respectively, more than twice as rapidly as the 31 percent increase registered for the market as a whole. Though minority home ownership rates remain low relative to non-minorities, the gap is diminishing.

B. *Lifting the Prohibition For Other Types of Loans Would Eliminate an*

Unnecessary Regulatory Restriction and Foster Innovation that Would Expand Access to Business and Consumer Credit

In today's competitive financial services market, a creditor cannot afford to be subject to a regulatory prohibition that limits its ability to have the information it needs to be responsive to the demands of its potential customers. The current prohibition in Regulation B on the collection of race, gender, and certain other data of loan applicants for non-mortgage credit results in an unfortunate, and in our view, unnecessary restriction on how a bank, thrift or other creditor conducts its business. The restriction has the unintended consequence of limiting a creditor's ability to expand its customer base because it lacks important information necessary to identify potential new markets or to develop innovative products to serve those markets. In particular, it inhibits the ability of creditors to meet the needs of underserved communities with innovative new financial products and marketing programs, by making it difficult to determine whether new products or marketing programs in fact expand minority access to credit. Collecting, processing, and analyzing race, gender, and other data would help creditors meet the credit needs of particular communities.

Permitting creditors to collect race and gender data from applicants for non-mortgage credit would also enhance access to credit, by enabling creditors to identify gaps in their efforts to serve customers. For example, Regulation B sets out a limited exception to its general prohibition in order to permit creditors to establish "special purpose credit programs" to serve economically disadvantaged persons, including members of a prohibited basis group. However, to adopt such a program under this exception, a creditor must follow a written plan that addresses the credit needs documented by the creditor in establishing the program. Because creditors are currently prohibited from collecting race, gender, and certain other information from applicants for non-mortgage credit, creditors do not have access to data that would enable them to implement appropriate and effective programs that respond to the credit needs of particular applicants. Indeed, our experience has been that the special purpose credit program provision of Regulation B is underused. In our judgment, permitting creditors to collect race, gender, and certain other information from applicants for non-mortgage credit would better fulfill ECOA's goals by increasing the ability of creditors to serve the different credit needs of minorities, women, and other economically disadvantaged persons.

Institutions that have made commitments to lend to underserved markets have expressed a desire to gather information relating to loan applicants that would enable them to determine the number and dollar volume of loans originated to minority or female borrowers.

With voluntary data collection, creditors would have maximum flexibility to collect and use applicant data. The creditor might choose not to collect data on all non-mortgage loan products; creditors could focus data collection, for example, on high-

volume loan products that involve personal dealings with customers or on particular small business product lines. Creditors would also be free to disclose statistical information publicly, if they believed that such disclosure would be useful, or not to disclose such information.

C. *Lifting the Prohibition Would Facilitate Private Sector and Government Monitoring of Creditor Performance as well as Detection and Prevention of Discrimination*

We agree with the Board's assessment that removing the prohibition on data collection for nonmortgage credit would allow issues of credit discrimination to be better addressed.

1. *Evidence Indicates That Discrimination in Business and Consumer Lending Remains a Serious Problem*

There is much evidence that discrimination remains a significant barrier in non-mortgage credit markets, based upon both anecdotal information and studies that indicate disparate treatment in business and consumer lending. *See* Attachment A.

2. *Allowing Voluntary Data Collection Would Permit Creditors to Monitor Their Own Performance*

The supervisory and enforcement agencies consistently have encouraged institutions to conduct self-evaluations of their lending practices. However, creditors cannot conduct fair lending self-evaluations for non-mortgage lending without appropriate monitoring information. Many institutions, therefore, have sought permission from supervisory agencies to collect such information in order to monitor their fair lending compliance. Analyses of monitoring data will permit upper-level managers to assess more accurately whether front-line decision-makers are following non-discrimination policies.

To be fully effective, self-evaluation and subsequent corrective action for problems found require documentation of loan applicant data such as the race, ethnicity, sex, and age of applicants. Without the data that creditors are currently prohibited from collecting under Regulation B, creditors currently have no systematic way to evaluate their own fair lending performance in these markets, or to defend themselves with hard data against any charges of biased lending practices.

3. *Allowing Voluntary Data Collection Would Improve Substantially the Ability of the Agencies to Detect and Deter Unlawful Discrimination*

The prohibition on data collection also inhibits effective government monitoring and enforcement of ECOA. Without the necessary data, enforcement agencies must rely on other investigative techniques that may be less efficient, accurate, or complete. By way of comparison, in the home mortgage area, data collected under HMDA is critical to the decision whether or not to delve deeper into an institution's lending practices when complaints are raised. Indeed, the prohibition has the effect of skewing enforcement efforts toward regulated creditors in the home mortgage market, because the enforcement agencies do not have sufficient information to enforce ECOA effectively with respect to business and consumer loans, particularly those made by non-depository institutions. Moreover, when evidence of discriminatory lending practices is found, self-evaluation -- which could include the voluntary collection of monitoring data -- and prompt corrective actions by the lender, as needed, are considered as substantial mitigating factors by the agencies when they determine appropriate remedies. *See Policy Statement on Discrimination in Lending*, 59 Fed. Reg. 18,266, 18, 270 (April 15, 1994). Yet such voluntary data collection is prohibited.

II. Pre-application Marketing Practices

Citing the potential for discrimination in preapplication marketing practices, the Board's 1998 Advance Notice of Proposed Rulemaking requested comment on the concept of extending Regulation B expressly to prohibit such discrimination. In the discussion accompanying the Board's proposed revisions to the regulation, the Board noted that all of the federal financial regulatory agencies are aware of pre-application marketing practices that could be discriminatory, although not currently in the purview of Regulation B. For example, the Board noted that some creditors, primarily credit card issuers, have at times used age to identify potential recipients of preapproved credit and zip codes to exclude credit solicitations in low-income areas that are predominantly minority neighborhoods. However, the Board suggests that the application of Regulation B's anti-discrimination rules to pre-application marketing practices is not warranted at this time. Instead, the Board proposes to make additional information available to the federal financial regulatory agencies on discriminatory pre-application marketing by requiring creditors to retain certain information about "preapproved" credit solicitations that constitute "firm offers of credit" under the Fair Credit Reporting Act.[1]

While we welcome and support the Board's proposal to enact this information retention

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1 We recommend that the Board replace the term "preapproved" with "prescreened" because use of the term "preapproved" may be deceptive when used by creditors in marketing prescreened offers (or "firm offers of credit") now allowed under the FCRA. Prescreening is the practice by which a creditor may obtain from a credit bureau a list of names of consumers that meet certain criteria for use in making credit offers. Under the 1996 FCRA amendments, Congress permitted prescreening, but also allowed "postscreening" of applicants based on predetermined criteria. Thus, a consumer who receives a credit offer based on a creditor's "prescreening" may not ultimately be approved for the credit offered, and the use of the term "preapproved" therefore may be deceptive when used to describe such credit offers.

requirement, which should improve monitoring of marketing practices without placing a substantial additional burden on creditors, we believe that the proposal should also address discrimination on prohibited bases in pre-application marketing. Although requiring information retention should allow us to determine the extent of prescreening on prohibited bases, unless the Board clarifies that Regulation B covers discriminatory prescreening practices, the federal agencies with enforcement responsibilities under ECOA will not have a clear regulation upon which to rely to require creditors to stop discriminating in prescreening. As we stated in our May 28, 1998 comment in response to the Advance Notice of Proposed Rulemaking, in our opinion, the Regulation would be more effective in addressing discrimination in pre-application solicitations if the Board clarified that the consideration of one or more prohibited bases in deciding to whom solicitations for credit will be sent constitutes discouraging prospective applicants in violation of 12 C.F.R. § 202.5(a) (proposed § 202.4(b)).

The Board has stated concerns about the unintended consequences of broader coverage of credit solicitations. However, we believe that it is feasible to promulgate a rule that would prohibit invidious discrimination that restricts a group's access to credit while permitting benign targeting practices, so long as such practices were not merely an effort to circumvent the purposes of Regulation B and ECOA. We recommend that, at a minimum, the Board alsoclarify that considering one or more prohibited bases in selecting potential applicants in a prescreened solicitation constitutes discouragement of prospective applicants in violation of existing § 202.5(a). Appropriate exceptions could be created for affirmative marketing programs or programs that qualify as special purpose credit programs designed to expand the availability of credit to certain groups.

III. Special Purpose Credit Programs

The Board has proposed a revision to § 202.8 (a)-5 of its commentary to clarify how creditors may determine the need for establishing special purpose credit programs. Specifically, the Board proposes to add that "a creditor might design new products to reach consumers who would not meet, or have not met, its traditional standards of creditworthiness due to such factors as credit inexperience or the use of credit sources that may not report to consumer reporting agencies." We support the addition of this provision. Expressly permitting creditors to establish special purpose credit programs to reach such consumers will encourage the provision of credit to the many consumers who are being adversely affected by their limited credit experience. The provision will also help address concerns raised about the practice of some subprime creditors of not reporting credit information of certain customers.

ATTACHMENT A

STUDIES OF NON-MORTGAGE CREDIT DISCRIMINATION AND EVIDENCE THAT DATA COLLECTION CAN IMPROVE ACCESS TO CREDIT

U.S. Department of the Treasury
November 1999

I. *Discrimination remains a significant barrier in non-mortgage credit markets.*

A. Business credit

Minority-owned businesses continue to be substantially under represented in the economy. Minorities account for one-fourth of the U.S. population but minority-owned businesses represent just 11.4 percent of all firms and receive just 6 percent of total business receipts. These figures from the latest Census survey for 1992 are a little better than representation in 1987, as growth in both firm creation and receipts outpaced population growth, but reveal nevertheless how minority enterprises continue to represent a small share of the business community.

The figures are even more striking for black-owned businesses alone. While African-Americans accounted for about 12 percent of the population in both 1992 and 1987, black-owned businesses represented 3.6 percent of all businesses in 1992 (up from 3.1 percent in 1987) and accounted for just 1.0 percent of all business receipts, unchanged from 1987.

Other sources of information tell a similar story. A study of self-employment trends since 1910 found that the self-employment rate for white workers is approximately three times the rate for black workers, and for men, this 3 to 1 ratio has held roughly constant for the past 80 years (Fairlie and Meyer, 1996).

Reasons cited for the relative absence of black and other minority-owned businesses are varied, ranging from disparities in educational attainment to differential rates of parental self-employment. The most significant and widely recognized, however, are the level of assets of potential entrepreneurs and access to capital. Numerous studies and Congressional hearings have revealed that minority small businesses face greater obstacles in obtaining credit than do white businesses. For example, the Census Bureau's 1992 *Characteristics of Business Owners Survey* found that African American- and Hispanic-owned firms reported stronger negative impacts from credit market conditions and a lack of financial capital than white-owned firms. Further, there is evidence that part of the difference in access to capital is due not only to credit risk factors but also to discrimination, as the following academic studies demonstrate.

Bates (1991) analyzes the relative significance of various financial and other factors in determining commercial bank lending to small businesses owned by blacks and whites. While part of the explanation for lower bank loan amounts awarded to black businesses can be attributed to differences in equity capital (measured by the net worth of the business), human capital (education), and age, the basic finding is that blacks get smaller bank loans than whites who possess identical traits. Further, the

lower loan amounts awarded to black businesses contributed to higher failure rates. After adjusting for the smaller loan size that is associated solely with being black, the predicted number of black firm failures drops to a rate that is close to the failure rate for white firms with otherwise similar characteristics.

Bates extended this research (1997) and found that the reason blacks receive smaller loans is rooted in both lower equity capital investments (due to low household wealth), and to an inability to leverage that equity capital and human capital as well because of discriminatory lending patterns. All other things equal, blacks received an extra $0.92 worth of debt for every dollar of equity, while whites received $1.17. Human capital variables such as education and managerial experience were significant determinants of loan size for whites but not for blacks; in other words, blacks were unable to leverage their college credentials when applying for a loan to finance a small business.

Ando (1988) also found that blacks are less likely than whites to have their loans approved and that loan amounts were smaller. Ando□s analysis of bank loan availability for established businesses found that about two-thirds of the loan applications from black firms were approved, versus almost 90 percent of the loans from white borrowers. When the credit risk of borrowers was statistically controlled for, black-owned businesses were more likely to be denied bank loans than white-owned businesses. The study, based on a survey of business owners for 1983 from the Small Business Administration data files, also found that blacks appeared to compensate for the lack of adequate bank capital by acquiring large dollar loans from the Small Business Administration. Even after taking these loans into account, though, the capital of a black-owned firm was substantially less than that of a nonminority firm, with outstanding bank loans of $21,387 versus $50,955. Lack of adequate capital affects the survival rate of minority-owned businesses.

- While discrimination affected the ability to secure a loan, in this study it did not appear to play a role in differential loan terms (such as interest rates charged, loan fees, maturity periods, etc.). However, an earlier study, cited in Chen and Cole (1988), found that loan terms were less favorable for blacks than for whites.

Immergluck (1998) uses data from the Community Reinvestment Act (CRA) to support the argument that race-based discrimination in marketing and approving loans is likely and that collecting and disclosing more detailed lending data is warranted. The CRA data are not sufficient to confirm or deny small business lending discrimination, but are used to analyze whether bank lending is consistent with explanations of discrimination or redlining. After controlling for industrial mix, firm size, and firm population, Immergluck finds that lower-income and minority areas (particularly Hispanic) suffer from lower lending rates than higher-income and white neighborhoods.

Wells Fargo Bank (1997) sponsored a study which demonstrated that Hispanic business owners are far less likely than non-Hispanic owners to have the business capital they need. Specifically, Hispanic business owners are more likely than non-Hispanics to have less than $50,000 of credit currently available, while non-Hispanics are more likely to have $50,000 or more of credit available. Moreover, Hispanics have been rejected far more often for financing compared with non-Hispanics. While this study clearly shows that Hispanic business owners are not getting what they need from banks, it does not provide evidence that discrimination is responsible.

Other studies of minority lending do reach that conclusion. Using data from the 1993 *National Survey of Small Business Finances*, Blanchflower et al. (1998) found that African American-owned firms are more than twice as likely to have a loan application rejected than white-owned firms (66 percent versus 27 percent), while the rejection rate for Hispanic-owned firms (36 percent) is about one-third higher. Even after controlling for a large number of characteristics, African American-owned firms in particular are substantially more likely to be denied credit. All other things equal, the likelihood of loan denial is 26 percent higher than for white-owned firms. For African American owners with no history of credit problems the increased likelihood is still 24 percent. In addition, African American-owned businesses pay one percentage point more in interest, even for firms with good credit histories. The authors conclude that African Americans face a significant disadvantage in the market for small business credit that does not appear to be due to differences in creditworthiness or geography.

The study also found that African American- and white-owned firms with similar financial and other characteristics differed widely in only one area when asked about the major business problems they faced, and that was in access to capital. This result mirrors the evidence cited from other surveys.

Blanchflower et al. note that the results of their study may be biased toward finding *too small* a disparity in lending rates, since minority-owned firms that actually apply for credit may represent a selected subsample of the most creditworthy. Some existing firms did not apply for a loan, although credit was needed, for fear that their application would be rejected. African American-owned firms were 44 percentage points more likely to cite this, and Hispanic-owned firms 22 points more likely. After adjusting for credit factors, a gap of 26 and 15 points still remained.

In another study, the Greenlining Institute also found evidence that minority business owners are more likely to be discouraged about obtaining credit.[1] Their survey of minority firms in Orange and Los Angeles counties revealed that three-quarters of minority-owned firms do not even bother to apply for business loans or lines of credit

[1] Lee Romney, "Survey Suggests Need for Reform in Inner-City Lending", *Los Angeles Times*, Business Section, p. 1, December 17, 1998.

because they are convinced that banks have little to offer them or will reject their application.

B. Consumer credit

Several academic studies, as well as investigations by Federal financial regulatory agencies and suits by the Department of Justice, point to the existence of unfair lending practices in the consumer credit market.

Getter (1998) used data on credit rejections from the Federal Reserve Board's 1995 *Survey of Consumer Finances* to show that households with different demographic characteristics are held to different credit standards, even if they have similar economic characteristics. The study found that the probability of being rejected for a loan is 16 percent for white households compared with 40 percent for non-white households. Even adjusting for the wealth of a household, the disparities remain considerable. Among low-wealth households, whites had a 27 percent probability of being rejected while non-whites had a 47 percent probability. For high-wealth households, the probabilities were 11 percent for whites versus 29 percent for blacks or Hispanics.

These data alone do not prove discrimination because of the importance of other factors besides wealth in calculating credit risk, such as credit history and income. However, the study also found that different lending criteria were applied to white and non-white households, and further, the use of these disparate standards prevented non-white households from gaining access to credit.

- When the households were fitted to the lending criteria of their counterparts by race, the probabilities of being rejected for a loan were still far apart. While white households had a 16 percent probability of being rejected for a loan, if they were judged by the non-white lending standards they would have a 27 percent probability of being rejected. Similarly, the rejection rate for black and minority households, which was 40 percent, would fall to 30 percent using the lending criteria applied to white households. Controlling for demographic characteristics indicated that black and Hispanic households were evaluated under stricter lending standards that led to the rejection of relatively more creditworthy households.

In the consumer auto market, blacks and women typically pay higher prices for a new car than do white males (Ayres,1991, June 1995, October 1995). While this is not directly an example of discrimination in lending, higher car prices and loan payments do have an impact on the ability to obtain credit. In these studies, testers of different races and genders negotiated with auto dealers on the purchase of a new car, using identical bargaining strategies and scripts. In the 1991 test, the average dealer profit on the final

offers from white males was $362. Profit on final offers from white women was 40 percent higher than that ($504), the markup for black males was over twice as high ($783), and black females were asked to pay the greatest markup ($1,237), over three times the markup for white men.

An expanded test (October 1995) confirmed that dealers systematically offered lower prices to white males, but the ordering of discrimination was different, with black males faring the worst and white females receiving less disparate treatment than in the first study. There was still a consistent pattern of racial discrimination, with white males receiving substantially lower offers than either black males or black females, even after controlling for exogenous variables such as tester experience or bargaining strategy. In fact, the average initial offer that white males received without any negotiating at all was lower than the final offer that 43 percent of the nonwhite males received after an average of 45 minutes of bargaining.

The cause of the disparate treatment could not be statistically proven. There was some evidence that dealers were using race and sex to draw inferences about a customer's reservation price, rightly or wrongly, and adjusting the offer accordingly. If sellers believe, for example, that women are more averse to bargaining than men, the seller could maximize profits by quoting higher prices to women customers. Animus discrimination also was evident, as testers recorded several instances of overtly sexist and racist language by sellers.

In investigating credit discrimination complaints, the Department of Justice and financial regulatory agencies have found that minority, female, and older borrowers tend to pay more for credit than do younger, white males with similar economic characteristics.

- Two recent consumer lending discrimination suits have been settled by the Justice Department. The Security State Bank of Pecos, Texas, agreed to pay over $500,000 in compensation and penalties and to take corrective actions after the bank allegedly charged Hispanics higher interest rates on consumer loans than non-Hispanic applicants.[2] The First National Bank of Gordon in Nebraska, after allegations that the bank unfairly charged higher interest rates for Native Americans, also compensated victims of the discrimination and set up an education program for residents of the Pine Ridge Indian Reservation on how to obtain and manage credit with the bank.[3]

[2] *United States of America* v. *Security State Bank of Pecos*, W.D. of Texas, Civil Action SA95CA0996 (1995).
[3] *United States of America* v. *First National Bank of Gordon, Nebraska*, D.S.D. Civil Action 96-5035 (1997).

- Numerous other instances of consumer credit discrimination against minorities and women have been found by Federal financial investigative agencies and referred to the Department of Justice. In most of these cases, higher interest rates were being charged for minority and female borrowers for a wide variety of consumer loans such as installment loans, auto loans, single-payment consumer loans, and credit cards. In one case, the average interest rate for auto loans by Native Americans exceeded the normal rate by 1.5 percentage points. In another, a disproportionately high percentage of Native American borrowers was led to purchase costly credit life insurance (93 percent) than non-Native Americans (18 percent). Most of these cases have been resolved by the regulatory agency.

II. *Experience with the Home Mortgage Disclosure Act (HMDA) demonstrates that data collection improves the functioning of credit markets and reduces discrimination.*

A. Summary of findings on mortgage discrimination

In the early 1990s, HMDA data showed higher denial rates for black and Hispanic mortgage applicants than for whites. Based on HMDA data alone, however, it was not possible to determine whether minority applicants were more likely to be turned down because of creditworthiness or because of discrimination on the part of lenders. Some important variables related to loan performance and minority status were not among the data collected, including an applicant's credit history, debt burden, loan-to-value ratio, and employment history.

In order to determine whether discrimination was a factor in the discrepancies between denial rates for whites and minorities, Munnell et al. (1996) augmented HMDA data with additional information relevant to the lender's decision-making process and found that even after controlling for wealth, credit histories, loan-to-value ratios, and other factors affecting the mortgage loan decision, a statistically and economically significant gap between white and minority rejection rates remained. Their results showed that African American and Hispanic mortgage applicants in the Boston area faced a probability of denial that was roughly eight percentage points higher than that facing a white individual with the same economic characteristics.

A number of other studies supported the results from the Munnell et al. study and an earlier version. Carr and Megbolugbe (1993) used adjusted data from Munnell et al., plus supplementary information on credit risk, and found clear statistical evidence of differential treatment, with minorities receiving systematically lower credit ratings. Using a model similar to Munnell et al. to evaluate the Boston and Philadelphia markets, Schill and Wachter (1993) also found that since individual risk characteristics

may be highly correlated with neighborhood risk characteristics, the evidence on individual lending
patterns was consistent with redlining and discrimination.

Tootell (1996) reached similar conclusions about neighborhood discrimination. His study found evidence of discrimination based on the race of the applicant, and noted that the racial composition of the neighborhood is highly correlated with the race of the applicant.

Another report (Canner et al. 1991) concluded that after controlling for default risk, minority households were less likely to obtain conventional financing than white households. Minorities with the same demographic and economic characteristics as white borrowers were approximately three-fifths as likely as their white counterparts to get a conventional loan, while white borrowers with the same characteristics as minority borrowers were 2-1/2 times as likely to obtain such loans.

B. Evidence that mortgage markets opened to minorities after HMDA

Home mortgage lending data show that since improved disclosure of HMDA data first demonstrated a lending gap in the early 1990s, minority borrowers' access to the mortgage market has improved dramatically.

Table 1. Number of Conventional Home Purchase Loans, 1993-1998
Between 1993 and 1998, conventional home purchase loans to low-income and minority borrowers grew more rapidly than to other borrowers

	Percent change
Total U.S. Market	59.0
By race or ethnicity:	
African American	94.6
Hispanic	77.7
By income of borrower (% of MSA median):	
Less than 80	75.1
80-99	55.7
100-119	49.1
120 or more	52.5
By income of census tract:	

Low or moderate	75.0
Middle	57.8
Upper	56.5

Source: Federal Financial Institutions Examination Council, July 29,1999.

As demonstrated in Table 1, there has been a sizable upward shift in the share of loans obtained by low-income and minority borrowers. The total number of conventional home purchase loans in metropolitan areas by financial institutions that are covered by HMDA increased by 59.0 percent between 1993 and 1998. In contrast, loans to census tracts where the median income is less than 80 percent of the median income of the whole metropolitan area increased much more rapidly – by 75.1 percent. Similarly, loans to African Americans and Hispanics also increased much faster than the 59 percent average over the 1993-98 period – by 94.6 percent and 77.7 percent, respectively.

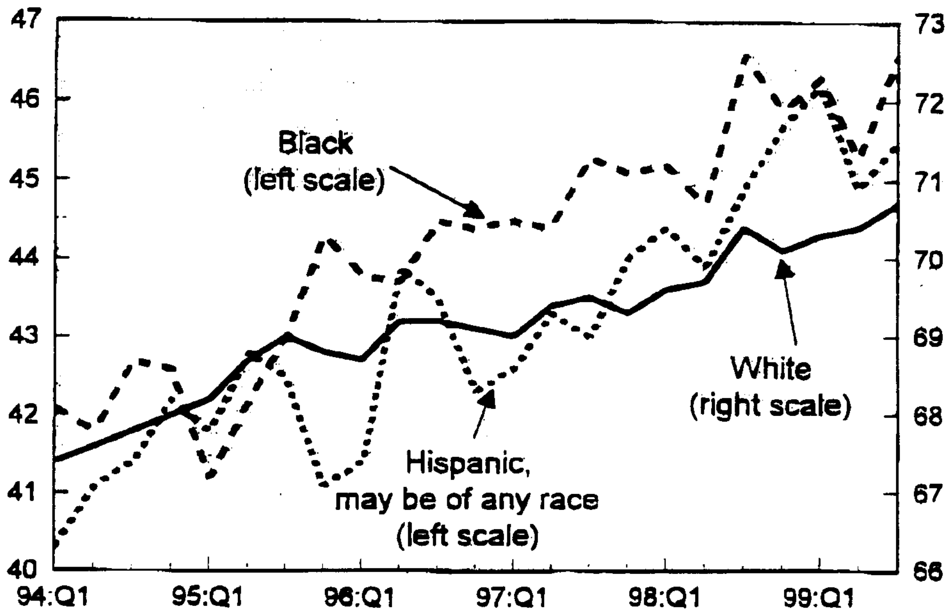
The strong growth in home lending to minorities is effectively demonstrated in the more rapid rise in homeownership rates among minority households than for the population as a whole, as seen in Table 2 and in the chart that follows.

Table 2. Homeownership Rates, 1994-1999
Since the beginning of 1994, the homeownership rate for African Americans, Hispanics and lower income households rose much faster than the U.S. average

	US Total	African American	Hispanic	Households with income less than or equal to the median
1994:Q1	63.8	42.1	40.3	48.1
1999:Q3	67.0	46.6	45.5	51.4
Percentage Point Increase 94:1 to 99:3	3.2	4.5	5.2	3.3

Note: Quarterly data on homeownership by categories shown in table were first tabulated in 1994. Source: U.S. Bureau of the Census.

The homeownership rate for African Americans rose from 42.1 percent at the beginning of 1994 to 46.6 percent by the third quarter of 1999, a 4.5 percentage point gain. That increase was almost one and a half times more than the increase in the average homeownership rate for all households. The rate for Hispanics showed even more improvement. It rose by 5.2 percentage points over that time period, more than one and a half times as much as the average. Growth in the homeownership rate for low-income households also exceeded the average for all households.



There has been some concern as to the quality of the new loans that have been extended, but the Office of the Comptroller of the Currency found that risk management techniques can be successful in reducing delinquency rates of affordable mortgage portfolios to levels that are comparable to conventional residential mortgage portfolios.[4] Delinquencies in affordable mortgage portfolios averaged 4 percent in 1996 compared to 3 percent for residential real estate portfolios as a whole. Most of the disparity was in banks new to the affordable lending market, while banks that had been in the business for several years had developed strategies for reducing delinquencies, such as pre-purchase counseling, rapid response intervention programs, and a limit to the layering of risk factors. The adoption of these techniques helped improve loan performance to a level that was consistent with conventional mortgage loans.

Studies by the Federal Reserve Board and others consistently reaffirm the OCC conclusions. In 1996, a survey of 600 large financial institutions active in the single-family mortgage market found that 98 percent said special lending programs were

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[4] OCC Advisory Letter 97-7, July 23, 1997.

profitable and that credit risk was manageable.[5] Roundtable discussions between the Federal Reserve Board and lenders with affordable home mortgage programs showed that participants viewed costs of origination and servicing of these loans as higher but delinquency and default rates no worse.[6] Statistical analysis did not find any notable relationship between bank profitability and the level of lower-income mortgage lending. The lenders noted that increased risks can be mitigated through the use of flexible underwriting guidelines, buyer education, credit counseling, and early delinquency intervention. Similarly, a study by Bear Stearns found that affordable housing loans had low prepayment risk for investors, and borrower credit scores (and risk) were consistent with conventional financing guidelines.[7]

Banks have also partnered with Community Development Financial Institutions (CDFIs) as an effective way of making profitable loans in low-income neighborhoods. CDFIs are specialized local financial institutions serving low-income communities. CDFIs may include banks, thrifts, credit unions, revolving loan funds, venture capital or micro-enterprise funds that share the mission of serving unmet credit and financial services needs in these communities. According to Marisco (1995), CDFIs have the expertise and local market knowledge necessary to meet community credit needs. They are often well positioned to evaluate the creditworthiness of low-income applicants and to provide loan counseling. These partnerships may lower information costs for banks, enabling them to make profitable and sound loans.

C. Recent increase in lending and homeownership rates for minorities suggests that data collection led to better lending practices.

The tremendous expansion in home lending to borrowers who previously were under represented in the market is the result of many factors. The strong economy, for example, has led to widespread employment opportunities, a reduction in unemployment rates among all demographic groups, and a rise in real income. Very favorable mortgage interest rates have lowered the costs of homeownership and made housing more affordable. Nevertheless, improved collection and disclosure of HMDA data since 1991 was a key in highlighting lending disparities and identifying new untapped sources of profitable lending. That disclosure led to better and more innovative lending practices by financial institutions, better enforcement of fair lending laws, and the creation of new lending initiatives targeted at minority and other under served borrowers. Examples of such initiatives include the National Homeownership Strategy, changes to the FHA home mortgage insurance program, and voluntary best

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[5] Meeker and Meyers, 1996.

[6] Avery et al., 1996.

[7] Bear Stearns, "*Securities Backed by CRA Loans: A New Product for Mortgage and Asset-backed Investors*", October 2, 1997.

practices agreements signed by HUD and real estate industry leaders.

Numerous research studies confirm the role of improved HMDA data disclosure and enforcement under the (CRA) in increasing mortgage lending to low-income individuals and areas. Evanoff and Segal (1996) determined that while growth in mortgage originations in low- and moderate-income groups lagged behind that of other groups throughout the 1980s, there was a significant change in the 1990s. After 1991, growth in mortgage lending was relatively faster in the two lowest-income groups, with the change "overwhelmingly statistically significant." The authors conclude that "this finding suggests that banks have responded to the CRA and have made significantly more loans in the low- and moderate-income markets," consistent with the view that banks were making a significant effort to encourage applications from those neighborhoods.

Evanoff and Segal also tested lenders' objectivity in extending mortgages to minorities. They found that the odds that a minority applicant would be rejected for a mortgage loan over the years 1990-1995 diminished relative to the denial rates for whites. These findings led them to conclude that stricter enforcement of the CRA and fair lending laws since the early 1990s contributed to the surge in credit both to low-income neighborhoods and to minority groups.

Avery et al. (1996) also found that increased lending to low- and moderate-income borrowers relative to other groups (1992 to 1994) meant that affordable home loan programs were having an effect in metropolitan areas. In 1993 the number of conventional home purchase loans to low- and moderate-income borrowers increased by 38 percent. In contrast, the increase that year to upper-income borrowers was only 8 percent. Figures for growth in 1994 showed a similar pattern, with the number of loans extended to the lower-income groups rising by 27 percent while loans to upper-income applicants increased 13 percent. The study notes a number of factors which may have contributed to the relatively rapid increase in such lending on the part of financial institutions. Among them were newly perceived profit opportunities in previously under served markets, newly identified based on HMDA data collection results.

Shlay (1998) determined that a strong CRA in the past few years, brought on by the disclosure of lending disparities in the HMDA data, has led to a climate of more favorable lending patterns to minority and lower-income communities overall. A comparison of lending data in six cities showed that residential loan growth between 1990 and 1995 to low-income borrowers and in low-income census tracts was either comparable to or exceeded overall market trends. Lending patterns improved both for lenders with CRA agreements with communities and for those without, although gains were smaller among the latter group. Shlay attributes the widespread growth in lending to previously under served communities as a general shift in institutional thinking.

spurred by heightened recognition of new profit opportunities identified by the HMDA evidence.

A case study by LaCour-Little, cited by Federal Reserve Governor Edward Gramlich in a 1998 speech,[8] supports the conclusion that CRA has made a significant contribution to the growth in the volume of lending to low- and moderate-income individuals in recent years. LaCour-Little analyzed lending data from 1993-97 for a large mortgage lender that uses credit scoring to screen applicants. He concluded that at least half of the loans made to low-income individuals living in low-income census tracts would not have been made if standard credit-scoring methods were the only screening criteria. He attributed to CRA the fact that loans which scored below the cut-off level were nonetheless made. Further, the data showed that CRA lending was reaching its intended target, as recipients of the low-scoring loans were more likely to have lower income, be members of a minority group, or live in a lower-income area.

In sum, although other factors outlined earlier have contributed to the rise in lending to minorities, research results strongly suggest that the availability of data on the race and ethnicity of potential borrowers has played a critical role in improving the access of minority households to the mortgage market.

[8] Edward M. Gramlich, "*Examining Community Reinvestment*," remarks at Widener University, November 6, 1998; Michael LaCour-Little, unpublished paper, May 1998.

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STATEMENT OF COMMISSIONER ORSON SWINDLE
CONCURRING IN PART AND DISSENTING IN PART
in ECOA and Regulation B, File No. P984808

Today, the Commission has voted to join other federal agencies in filing a comment ("Joint Comment") with the Federal Reserve Board advocating, among other things, that Regulation B be amended to give lenders the option of collecting information on prohibited bases (such as race, national origin, and gender) in connection with credit decisions. I agree that this proposed amendment is worthy of consideration. It would give lenders the flexibility to decide whether it is in their own interest to collect prohibited basis information, while at the same time not limiting the legal protections that are intended to combat the discrimination that continues to plague our society. However, I dissent from the Joint Comment to the extent that this amendment is premised on the rationale that it will cause a significant increase in minority lending and assist the Commission in its law enforcement activities.

As explained in the Joint Comment, the Home Mortgage Disclosure Act ("HMDA") requires lenders to collect and report information concerning race, national origin, and gender of applicants ("prohibited basis information") in connection with mortgage loans. The Joint Comment explains that "the requirement for recording and reporting applicant data has contributed to increased access to credit for minority loan applicants." Joint Comment at 1. The Joint Comment goes on to state:

> Recent data suggest that HMDA's disclosure requirements play an important role in expanding access to credit. During the 1990s, lending to minorities has increased dramatically relative to non-minorities, and in 1998, total home purchase loans (conventional and government-backed) to both blacks and Hispanics reached record high levels. Between 1993 and 1998, mortgage originations for Hispanics and blacks grew by 87 percent and 72 percent, respectively, more than twice as rapidly as the 31 percent increase registered for the market as a whole. Though minority home ownership rates remain low relative to non-minorities, the gap is diminishing.

Id. (emphasis added). The Joint Comment apparently reasons that if the HMDA's requirements can have this beneficial effect on minority lending, then Regulation B should be amended to allow lenders to collect prohibited basis information so that the revised Regulation B can improve minority lending too.

Based on my experience with lenders and, in particular, as a government lender to low-income borrowers, I believe that the booming United States economy and private credit markets, not HMDA data collection and reporting requirements, have caused the increases in minority lending. The United States economy has experienced unprecedented growth and low unemployment rates since the early 1980s. This robust economy has been instrumental in improving the lot of the poorest of Americans, which include a disproportionate number of minorities. As the creditworthiness of minorities has improved because of their increased income and wealth, they naturally have become better candidates for the extension of credit, which far more likely accounts for recent increases in lending to them. In seeking to make money by lending money, lenders simply have selected new borrowers who are likely

to repay loans because they are creditworthy. While the persistence of discrimination requires continued and vigorous enforcement of our credit discrimination laws, the lion's share of the credit for the recent increase in minority lending must go to the performance of the United States economy, not to HMDA data collection and reporting requirements. I am troubled by the logic of the proposed revisions to Regulation B that seem predicated on the reasoning that HMDA data collection and reporting requirements have caused significant increases in minority lending.

The Joint Comment also states that giving lenders the option of collecting prohibited basis information would aid Commission law enforcement. I have doubts about this. If lenders have the option to collect (or not collect) information, lenders who discriminate are unlikely to compile information that would reveal that they have violated the law. Some lenders who do not discriminate may decide to incur the costs of collecting this information for their own business reasons. I do not think that the information collected under this optional scheme likely would tell us much about which lenders have or have not engaged in credit discrimination. The "assisting enforcement" rationale thus does not justify a data collection option under Regulation B either.

My suspicion is that giving lenders the option of collecting prohibited basis information might be but an interim measure until Regulation B can be amended again to *require* that lenders collect this information. If one accepts the Joint Comment's rationale for the proposed revisions to Regulation B, it seems only natural to conclude that making collection requirements mandatory is the way to boost minority lending similar to that attributed to the HMDA. If HMDA-imposed mandatory collection requirements worked, then why not more of the same? Similarly, if optional collection requirements prove ineffective in assisting the Commission to compiling sufficient information to assist the Commission in enforcing the credit discrimination laws, the natural next step would be to impose mandatory collection requirements.

Two of the rationales on which the Joint Comment relies for permitting the collection of prohibited basis information -- increases in minority lending and assistance to law enforcement -- lay the groundwork for the future imposition of mandatory collection requirements that may be burdensome and intrusive. To avoid future pressure to adopt mandatory collection requirements, the Joint Comment instead should make clear at the outset that the exclusive justification for the proposed amendment to Regulation B is to provide increased flexibility for lenders in their business practices.