



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 1, 1998

IMMEDIATE DELIVERY!!!

FAX TO: FAIR LENDING GROUP

HUD

Paul Leonard	708-0309
Peter Kaplan	708-4445
Mercedes Marquez	708-3389
John Goering	619-8000
Harry Cury	708-3389
Kenneth Zimmerman	708-3527

OCC

Chris Lewis	874-4950
Mike Bylsma	874-5322
Larry Riedman	874-5221
Steve Cross	874-5221
Peggy Hesse	874-5322
Kuss Bailey	874-5221

DOJ

Valerie O'Brian	514-1116
Sandy Ross	514-1116
Joan Magagna	514-1116

TREASURY

Michael Barr	622-5672
Cliff Kellogg	622-5672
Margaret Nilson	622-0256
Patricia Milon	622-1974
Valerie Personick	622-2563

OTS

Tim Burniston	906-5735
David Enzel	906-7606
Ellen Seidman	898-0230

WHITE HOUSE

Emil Parker	456-2223
Paul Weinstein	456-7028
Julia Fernandes	456-5581

FTC

Jodie Bernstein	326-3799
David Medine	326-2558
Peggy Twohig	326-2558

OFHEO

Ann Dewey	414-3823
-----------	----------

FROM: Michael Barr

Attached is a copy of the signed Regulation B and C Letters. (26 pages attached)

May 28, 1998

William W. Wiles
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave., N.W.
Washington, D.C. 20551

Dear Mr. Wiles:

We are submitting this comment in response to the Board's advance notice of proposed rulemaking under Regulation C, implementing the Home Mortgage Disclosure Act.

First, we urge the Board to propose amending Regulation C to require creditors to report, for loans that have been denied, the reasons for such denial. The Office of the Comptroller of the Currency and the Office of Thrift Supervision currently require such reporting by institutions that they regulate, and such information has proved to be highly useful in assessing barriers to home ownership, as well as in evaluating an institution's compliance with the fair lending laws.

Second, we recommend that the Board propose to revise Regulation C to take account of the growth in pre-approval credit evaluations. An increasing number of consumers are denied access to mortgage credit without triggering reporting requirements under Regulation C, and we are concerned about the potential for discrimination in this area.

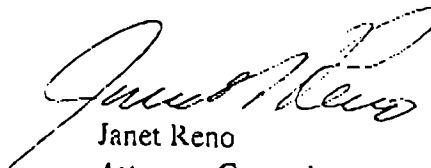
Third, we suggest that the Board consider changes to Regulation C to require the identification of mobile home transactions, given the significant differences in underwriting, denial rates, and other features from traditional home transactions.

We have enclosed more detailed comments.

Sincerely,

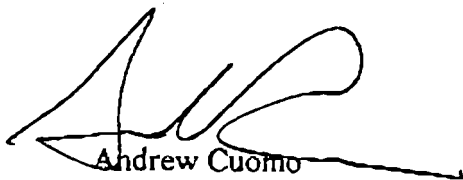


Robert E. Rubin
Secretary of the Treasury

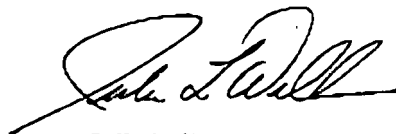


Janet Reno
Attorney General

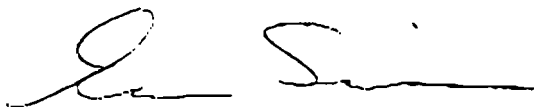
2



Andrew Cuomo
Secretary of Housing and Urban
Development



Julie Williams
Acting Comptroller of the Currency



Ellen Seidman
Director, Office of Thrift Supervision



Robert Pitofsky
Chairman, by direction of the
Federal Trade Commission

Enclosure

From: To: Julia Fernandes

Date: 6/2/98 Time: 17:58:33

Page 4 of 28

06/02/98 TUE 16:35 FAX 2026221829

US TREASURY DEPARTMENT

004

TAB 2

JOINT AGENCY COMMENTS ON REGULATION C

First, we urge the Board to propose amending Regulation C to require creditors to report, for loans that have been denied, the reasons for such denial. The Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) currently require such reporting by institutions that they regulate, and such information has proved to be highly useful in assessing an institution's compliance with the fair lending laws.¹

In our judgment, although HMDA data are only one factor to consider in assessing an institution's record, reporting data on reasons for denial assists supervisory agencies in evaluating whether patterns of loan denials may reflect discrimination, or are supported by valid business objectives. The data also permits agencies to focus their efforts on reasons for denial where racial or other disparities are the greatest and thus may merit further examination. In addition, the information helps agencies to discern whether a creditor's decision making process itself may be discriminatory. Such information would also help to advance the public discourse about home mortgage discrimination.

Collection of such data would not be burdensome. Creditors already must keep track of the reasons for their loan denials in order to ensure compliance with the adverse action notice requirements of the Equal Credit Opportunity Act (ECOA). Such data are readily transferable to HMDA registers, which contain a field for such information.

Second, we recommend that the Board propose to revise Regulation C to take account of the growth in pre-approval credit evaluations as standard industry practice. An increasing number of mortgage applicants are denied access to credit prior to coming under the purview of current Regulation C. We are concerned that the potential for discrimination exists in this arena, and support the ANPR's suggested approach, under which reporting preapproval decisions would simply track the requirements of Regulation B with respect to declined preapproval requests. A minimal burden would be required to transfer the information already required to be recorded on adverse action reports to the HMDA registers. We recognize that in some cases, HMDA reporting of preapplication denials may necessarily omit certain information, such as property location or precise loan size, but the reporting of other data would nonetheless be helpful.

As noted in the ANPR, home ownership counseling programs sometimes share similarities with aspects of preapproval programs. We urge the Board not to make any change in Regulation C that would discourage such counseling programs. These programs are critical to increasing home ownership opportunities for underserved families. Counseling programs need not report assisting customers, even if such assistance involves verifying credit information, as long as the program does not use such information to decide, for itself or as agent, whether or not to extend credit to a customer.

¹The Department of Housing and Urban Development intends to initiate a rulemaking process to require the reporting of such data by creditors where the HUD statute allows such a rule.

Third, we recommend that the Board propose to revise Regulation C to require the identification of transactions involving mobile homes, given the significant differences in underwriting standards, denial rates, and other features from transactions involving traditional homes. In our experience, the aggregation of mobile home and traditional home transactions in HMDA data reduces the usefulness of such data for financial institutions to monitor their own lending activities, and for supervisory agencies and the public to assess the potential for discrimination in the provision of home mortgages. We believe that the data would be more useful and significantly easier to analyze if transactions involving mobile homes were reported using a separate code. In addition, we believe that the Board should study the impact of subprime lending on the HMDA data, and should develop recommendations to address any distortions that may arise from present reporting.

May 28, 1998

William W. Wiles
Secretary of the Board
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave., NW
Washington, DC 20551

Dear Mr. Wiles:

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

In particular, we are writing to express our strong support and encouragement for the Board to propose an amendment to Regulation B to allow lenders voluntarily to collect information about the race and gender of applicants for non-mortgage credit. While the Board recently considered the issue, we believe that its importance warrants a fresh look.

The current regulatory prohibition needlessly 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 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,



Robert E. Rubin
Secretary of the Treasury



Janet Reno
Attorney General



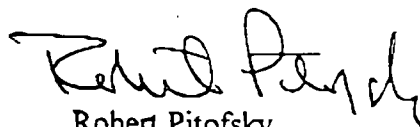
Andrew Cuomo
Secretary of Housing and Urban
Development



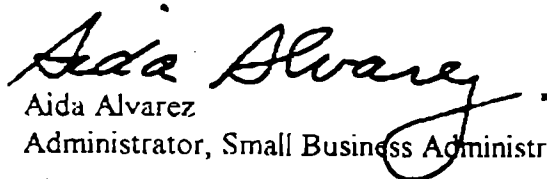
Julie Williams
Acting Comptroller of the Currency



Ellen Seidman
Director, Office of Thrift Supervision



Robert Pitofsky
Chairman, by direction of the
Federal Trade Commission



Aida Alvarez
Administrator, Small Business Administration

Enclosure

From: To: Julia Fernandes

Date: 8/2/98 Time: 17:57:54

Page 8 of 28

08/02/98 TUE 16:37 FAX 2026221829

US TREASURY DEPARTMENT

009

TAB 2

JOINT AGENCY COMMENTS ON ADVANCE NOTICE OF PROPOSED RULEMAKING UNDER REGULATION B

I. Voluntary Data Collection

A. *Data Collected on Mortgage Loans Have Not Been Used to Discriminate and Have Increased Access to Credit for Home Mortgages*

In 1977, the Board published a revision of 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, little was known (but assumptions were made) about the nature and scope of lending discrimination. Since then, much has been learned about mortgage lending discrimination. The original 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 is having a salutary effect. During the 1990s, lending to minorities has increased dramatically relative to non-minorities, and in 1996, total home purchase loans (conventional and government-backed) to both blacks and Hispanics reached record high levels. Between 1993 and 1996, mortgage originations for Hispanics and blacks grew by 56 percent and 53 percent, respectively, more than three times as rapidly as the 14 percent increase registered for white borrowers. Though minority home ownership rates remain low relative to non-minorities, the gap is diminishing. As Chairman Greenspan has stated, "[o]ur experience with mortgage applications is one that underscores the role that free market competitive pressures can play in undermining discrimination and improving the profitability of business activity."

B. *Lifting The Prohibition For Other Types Of Loans Would Eliminate an Unnecessary Regulatory Restriction and Foster Innovation*

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 credit demands of its market. The current prohibition in Regulation B on the collection of the race and gender 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 financial service providers to meet the needs of underserved communities with innovative new financial products, by making it difficult for financial institutions to understand whether new products expand access to credit for minorities. Race and gender data would help to provide a creditor with the information it needs to help 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 lenders 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 lenders to establish "special purpose credit programs" to serve economically disadvantaged persons, including members of a prohibited basis group. However, to use this exception, a lender must submit a written plan that supports the need for the program. Because lenders are currently prohibited from collecting race and gender information from applicants for non-mortgage credit, lenders often lack the supporting data that would enable them to take full advantage of the special purpose credit program exception. In our judgment, if creditors were permitted to collect race and gender information from applicants for non-mortgage credit, overall lending to minorities, women, and other economically disadvantaged persons would increase.

In addition, after the Board's decision in December of 1996 not to eliminate the prohibition, institutions that have made commitments to lend to underserved markets have expressed a desire to monitor information relating to loan applicants that would enable them to determine the number and dollar volume of loans originated to minority or women borrowers. Eliminating the prohibition in Regulation B would enable these creditors to monitor their commitments.

With voluntary data collection, lenders would have maximum flexibility to collect and use applicant data. The creditor might choose not to collect data on all non-mortgage loan products; lenders could focus data collection, for example, on large volume loan products that involve personal dealings with customers or on particular small business product lines. Lenders would also be free to disclose statistical information publicly, if they believe that would be useful, or not to disclose such information.

C. *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 (background paper on studies of business and consumer credit discrimination and evidence that data collection can improve access to credit).

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

The supervisory and enforcement agencies have consistently 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 have sought permission from supervisory agencies to collect such information in order to monitor their fair lending compliance.

To be fully effective, self-evaluation and subsequent corrective action for problems found requires documentation of loan applicant data such as the race, ethnicity, sex, and age of applicants. Without the data that creditors are prohibited from collecting under Regulation B, lenders 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.

E. *Without Monitoring Information, the Ability of the Agencies to Detect Discrimination on the Basis of Race or National Origin in Consumer or Business Loans is Limited*

The prohibition also inhibits effective monitoring and enforcement of ECOA. Without the necessary data, enforcement agencies must rely on other investigative techniques that are less efficient, accurate, or complete. In the home mortgage area, data collected under the 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 towards cases involving discrimination by regulated creditors in the home mortgage market, because the enforcement agencies do not have sufficient information to enforce the 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 would include the voluntary collection of monitoring data – and prompt corrective actions by the lender as needed will be considered as a substantial mitigating factor in considering any remedies. See *Policy Statement on Discrimination in Lending*, 59 Fed. Reg. 18,266-69 (April 15, 1994).

II. Pre-application Marketing Practices

We believe that the Board should clarify that creditors may not discriminate on a prohibited basis in their pre-application marketing practices. Pre-application marketing practices are becoming an increasingly significant factor in determining which consumers obtain credit, and at what price. This type of marketing is now frequently used to market special rates and terms for credit cards and increasingly, home equity and other types of loans. Regulation B should be amended to keep pace with the evolving marketing

practices of the industry, by prohibiting discrimination on prohibited bases in marketing.

Regulation B should also prohibit creditors from considering prohibited bases in pre-screening solicitations for credit. Under the current regulation, a creditor could intentionally decide not to send credit card solicitations to individuals residing in areas in which the population is predominantly African American or Hispanic without violating Regulation B. As a result, such individuals are effectively discouraged from applying for those credit offers because they are denied the information that would cause them to approach the creditor and apply. We suggest that the Board address this issue by explaining that the consideration of one or more prohibited bases in deciding to whom to send solicitations for credit constitutes discouraging applicants in violation of 12 C.F.R. section 202.5(a), and that the consideration of factors that are close proxies for a prohibited basis may constitute evidence of such discouragement.

The Board notes in the advance notice of proposed rulemaking that in some instances pre-screening on a prohibited basis may facilitate the identification of potential customers and provide greater access to credit for some customers (*e.g.*, using age to target older individuals or college students for credit solicitations and related financial services). We believe that the Board's exception authority would enable it to allow such pre-screening where it serves to expand credit opportunities, while simultaneously prohibiting pre-screening where it limits access to credit on a prohibited basis. The ECOA authorizes the Board to exempt a class of transactions, or a particular type of transaction within a class, if the Board determines that the application of all or part of the regulation to such transactions would not contribute substantially to effectuating the purpose of the regulation. 15 U.S.C. section 1691b(a)(1).

ATTACHMENT A

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

U.S. Department of the Treasury
May 1998

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. Currently, 11.6 percent of white workers are self-employed, whereas 3.6 percent of black workers are self-employed. A study of self-employment trends since 1910 found that this 3 to 1 self-employment rate holds for both men and women and, for men, has remained roughly constant over 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-employed. 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. 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. The study is based on a sample drawn from Census's 1982 *Characteristics of Business Owners* database. While part of the explanation for lower bank loan amounts awarded to black businesses can be explained by 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 whites. 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 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 currently 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.

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 credit-worthy 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 lowered 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.

- In the past four years, two 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.¹ The First National Bank of Gordon in Nebraska, after allegations that the bank unfairly charged higher

¹United States of America v. Security State Bank of Pecos, W.D. of Texas, Civil Action SA95CA0996 (1995).

interest rates for American Indians, 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.²

- 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 HMDA demonstrates that data collection improves the functioning of credit markets and reduces discrimination.*

A. Summary of findings on mortgage discrimination

HMDA data for the years 1991, 1992, and 1993 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 for the year 1990 with additional data relevant to the lender's decision-making process and found that race did indeed play a significant role in the decision to approve or deny a loan application in that year.

Their findings showed that minorities, on average, have less wealth, weaker credit histories and higher loan-to-value ratios than white applicants and these disadvantages do account for a large portion of the difference in denial rates. Even after controlling for these factors, however, a statistically and economically significant gap between white and minority rejection rates remained. Specifically, their results showed that black and Hispanic mortgage applicants in the Boston area face a probability of denial that is roughly 8 percentage points higher than that facing a white individual with the same economic characteristics.

²United States of America v. First National Bank of Gordon, Nebraska. D.S.D. Civil Action 96-
6025 (1997)

A number of subsequent studies have also found that discrimination plays a role in the discrepancy between denial rates for minority and white mortgage applicants. Carr and Megbolugbe (1993) and Glennon and Stengel (1994) used data from Munnell et al. and found the gap between rejection rates for white and minority applicants remained even after the data was cleaned.³ Using a model similar to Munnell et al. to evaluate the Boston and Philadelphia markets, Schill and Wachter (1993) also found evidence consistent with redlining and discrimination.

B. Evidence that mortgage markets opened to minorities after HMDA

Since the HMDA data first revealed a black/white gap in the early 1990's, the access of minority borrowers to the mortgage market appears to have improved. Lending to both black and Hispanic borrowers has risen and minority homeownership has reached record levels. It is likely that data collection has played a critical role in reducing discrimination and opening the mortgage market to minority borrowers.

Since the early 1990's, lending to minorities has increased dramatically relative to nonminorities. As shown in the table below, between 1993 and 1996, mortgage originations for Hispanics and blacks grew by 56 percent and 53 percent, respectively -- more than three times as rapidly as the 14 percent increase registered for white borrowers.

Between 1993 and 1996, total home-purchase loans to Blacks and Hispanics grew more rapidly than loans to White borrowers.

GROWTH IN ANNUAL HOME-PURCHASE LOAN ACTIVITY, 1993 - 1996
(percent)

Racial / Ethnic Group	Total Home-Purchase Loans	Conventional Home-Purchase Loans
White	14.0	19.4
Black	52.5	67.2
Hispanic	55.6	48.5
Other Minority	16.6	17.9

Source: Federal Financial Institutions Examination Council.

In 1996, more blacks and Hispanics received home mortgage loans than ever before.⁴ During that year, total home-purchase loans to blacks rose by 3.1 percent (or 7,421 loans) to reach a record high of 247,692 loans. At the same time, total home-

³Other researchers had questioned the reliability of their data because of what they perceived as data entry errors, missing data, and unreliable recording techniques.

⁴Recent lending growth by race may be understated, as race and ethnicity are not reported for an increasing number of HMDA loans. In 1996, race was not reported for 125,000 loans.

8

purchase loans to Hispanics grew by slightly more than 13 percent (or 28,977 loans) to reach an all-time high of 245,026 loans.

There has been some concern as to the quality of the new loans that have been extended under affordable mortgage programs, 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 (OCC Advisory Letter 97-7, July 23, 1997). 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.

In addition to the data on loan originations, an alternative way of assessing the extent to which the supply of mortgage credit to minorities has increased since the early 1990's is to examine homeownership rates over time. Between the first quarter of 1981 and the first quarter of 1993, the homeownership rate for all households dropped from 65.6 percent to 63.7 percent. Since early 1993, however, it has risen to 65.9 percent. This is the largest 4-1/2 year rise in homeownership on record and was propelled, in part, by a sharp increase among black and Hispanic households.

In the first quarter of this year, the homeownership rate of black and Hispanic households rose to 45.2 percent and 44.4 percent, respectively. While homeownership for both minority groups still remains well below that of white households, both blacks and Hispanics have enjoyed much more rapid growth in homeownership than the white population over the past four years. (See chart that follows.)

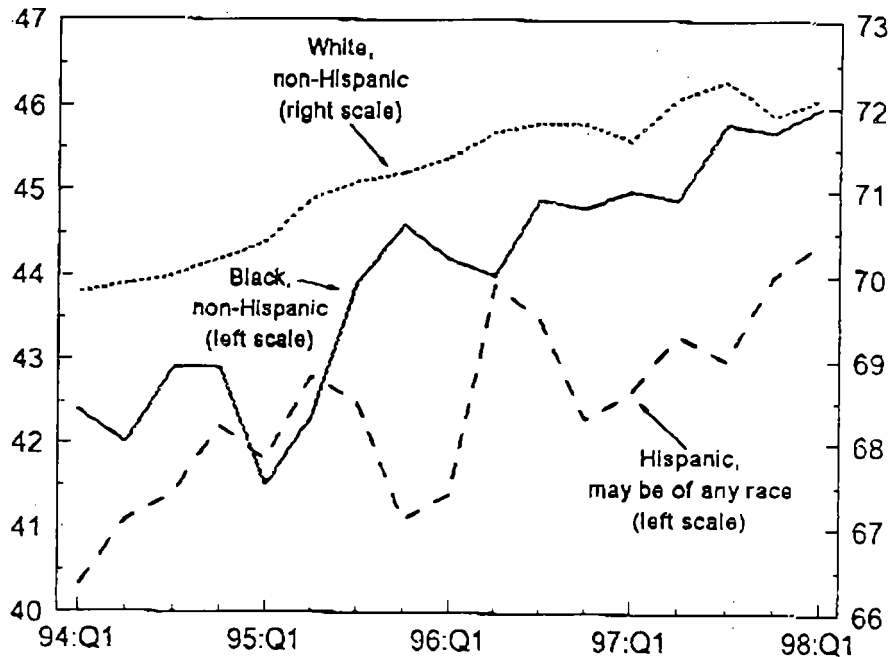
Since the beginning of 1994, the homeownership rate for blacks and Hispanics has risen faster than that of the white population and the US average.

Homeownership rates by race (percent)

	US Total	White (non-Hispanic)	Black	Hispanic (may be of any race)
1994:Q1	63.8	69.8	42.1	40.3
1998:Q1	65.9	72.1	45.2	44.4
Percent Change, 94:1 to 98:1	3.3	3.3	7.4	10.2

9

HOMEOWNERSHIP RATES BY RACE



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

Recent increases in lending and homeownership rates for minorities have been partly due to the strong economy and lower mortgage interest rates. However, data collection has 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.

In addition recent fair lending and fair housing initiatives have helped make homeownership easier and more affordable for all households. The revamped regulations under the Community Reinvestment Act (CRA) have been given credit for encouraging banks to implement loan programs aimed at lower-income communities and for effectively increasing access to credit for previously under served areas and minority groups.⁵ Other examples of initiatives aimed at eliminating discriminatory

⁵Using HMDA data from 1982 to 1995 period, the Federal Reserve Bank of Chicago analyzed the effectiveness of the CRA and fair lending regulations and found that between 1990 and 1995, loan applications and originations increased significantly to groups targeted by the CRA and fair lending legislation. The study concluded that stricter enforcement of the CRA and fair lending laws since the early 1990s contributed to the surge in credit to minority groups, although it also acknowledged the contribution of other factors.

10

lending practices and encouraging lending to low-income individuals and low-income areas include the National Homeownership Strategy, changes in the FHA home mortgage insurance program, and voluntary best practices agreements signed by HUD and real estate industry leaders.

Moreover, the rise in lending to minorities has also been characterized by some important changes in the mortgage market, including growing roles for government-backed loans and loans by lenders specializing in manufactured homes and sub-prime mortgages. Minority borrowers are less likely than white borrowers to rely on conventional mortgages and more likely to use government-backed mortgages (OCC, 1997). In recent years, the use of government-backed mortgages, especially FHA loans, by minorities has been rising.

Although the number of conventional home-purchase loans extended to blacks fell by 2,090 in 1996 from a record high in 1995, government-backed loans to blacks jumped up by 9,511 loans. The increase in the use of government-backed loans more than offset the decline in conventional loans and pushed the number of total home-purchase loans for blacks to a record high level. In the same year, government-backed loans for Hispanics loans surged almost 35 percent (or 28,276 loans) while conventional loans ticked up by only 1/2 of a percent (701 loans) -- just enough to hit a new high of 135,683 loans.

Although it is difficult to attribute the rise in lending to minorities solely to the collection of HMDA data given the confluence of additional factors outlined above, it appears likely 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.

REFERENCES

Ando, Faith (1988), "Capital Issues and the Minority-Owned Business," *The Review of Black Political Economy*, Vol. 16, No. 4, pp 77-109.

[Ayres, Ian (1991), "Fair Driving: Gender and Race Discrimination in Retail Car Negotiations", *Harvard Law Review*, Vol. 104, No. 4, pp. 817-872.]

Ayres, Ian (October 1995), "Further Evidence of Discrimination in New Car Negotiations and Estimates of its Cause", *Michigan Law Review*, Vol. 94, No. 109, pp. 109-147.

Ayres, Ian, and Peter Siegelman (June 1995), "Race and Gender Discrimination in Bargaining for a New Car", *American Economic Review*, Vol. 85, No. 3, pp. 304-321.

Bates, Timothy (1989), "The Changing Nature of Minority Business: A Comparative Analysis of Asian, Nonminority, and Black-owned Businesses," *The Review of Black Political Economy*, pp. 25-42.

Bates, Timothy (1991), "Commercial Bank Financing of White- and Black-Owned Small Business Startups," *Quarterly Review of Economics and Business*, Vol. 31, No. 1, pp. 64-80.

[Bates, Timothy (1997), "Unequal Access: Financial Institution Lending to Black- and White-Owned Small Business Startups," *Journal of Urban Affairs*, Vol. 19, No. 19, pp. 487-495.]

Berkovec, Jim, and Peter Zorn (1996), "Measuring the Market: Easier Said Than Done," *Secondary Mortgage Markets, A Freddie Mac Quarterly*, Vol. 13, No. 1, pp. 18-21.

Bunce, Harold, and Randall Seessele (1996), "The GSE's Funding of Affordable Loans," HUD Working Paper Series HF-001, December.

[Canner, Glenn B., and Wayne Passmore (1994), "Residential Lending to Low-Income and Minority Families: Evidence from the 1992 HMDA Data," *Federal Reserve Bulletin*, Vol. 80, February, pp. 79-108.]

Chen, Gavin M., and John A. Cole (1988), "The Myths, Facts, and Theories of Ethnic, Small-Scale Enterprise Financing," *The Review of Black Political Economy*, Vol. 16, No. 4, pp 111-123.

Cole, Rebel A. and John D. Wolken (1995), "Financial Services Used by Small Businesses: Evidence from the 1993 National Survey of Small Business Finances", *Federal Reserve Bulletin*, Vol. 81, No. 7, pp. 630-667.

Evanoff, Douglas D. and Lewis M. Segal (1996), "CRA and Fair Lending Regulations: Resulting Trends in Mortgage Lending," Federal Reserve Bank of Chicago, *Economic Perspectives*, Nov./Dec., pp. 19-43.

Fairlie, Robert W., and Bruce D. Meyer (1996), "Trends in Self-Employment Among White and Black Men: 1910-1990," University of California, Santa Cruz Working Paper.

Getter, Darryl E. (1998), "Do Lenders Evaluate Applicants Differently?", working paper, United States Naval Academy.

Immergluck, Daniel (1998), "Intrametroplitan Patterns of Small Business Lending; What Do the New Community Reinvestment Act Data Tell Us?", paper prepared for the Urban Affairs Association Annual Meeting.

Kim, S. and G. Squires (1995), "Lender Characteristics and Racial Disparities in Mortgage Lending," *Journal of Housing Research*, Vol. 6, pp. 99-113.

Longhofer, Stanley D. (1996), "Discrimination in Mortgage Lending: What Have We Learned," Federal Reserve Bank of Cleveland, *Economic Commentary*, August 15.

Munnell, Alicia H., Geoffrey M. B. Tootell, Lynn E. Browne, and James McEneaney (1996), "Mortgage Lending in Boston: Interpreting HMDA Data," *American Economic Review*, Vol. 86, No. 1, pp. 25-53.

* Office of the Comptroller of the Currency (1998), "Home Mortgage Lending in 1996: An Analysis of Home Loan Growth to Minorities and Denial Rate Patterns," March 31.

Ross, Stephen L. (1997), "Mortgage Lending Discrimination and Racial Differences in Loan Default: A Simulation Approach," *Journal of Housing Research*, Vol. 8, No. 2, pp. 277-297.

Tootell, Geoffrey M. B. (1993), "Defaults, Denials, and Discrimination in Mortgage Lending," Federal Reserve Bank of Boston, *New England Economic Review*, Sept./Oct., pp. 45-51.

13

U.S. Department of Housing and Urban Development (1997), "The 1996 HMDA Data: A Closer Look," *U.S. Housing Market Conditions*, November, pp. 4-9.

Wells Fargo Bank (1997), "Latino Owned Businesses: Access to Capital," October 2.



U. S. Department of Housing and Urban Development
Washington, D.C. 20410

OFFICE OF THE DEPUTY ASSISTANT SECRETARY
FOR ENFORCEMENT AND PROGRAMS

FACSIMILE COVER SHEET

DATE: 6/2/98

TO: Emil Parker
Paul Weinstein
Julia Fernandes

FAX NO:

FROM: Ken Zimmerman

PHONE NO: (202) 619-8046

FAX NO:

NUMBER OF PAGES

COMMENTS:

For your information, see attached



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-2000

OFFICE OF THE ASSISTANT SECRETARY
FOR FAIR HOUSING AND EQUAL OPPORTUNITY

JUN 1 1998

Honorable William W. Wiles
Secretary
Board of Governors of the Federal Reserve
20th Street and Constitution Avenue NW
Washington, DC 20551

Dear Mr. Wiles:

Thank you for this opportunity to comment on possible revisions to Regulation C [Docket No. R-1001]. As a tool used in the enforcement of the Fair Housing Act, it is important that Home Mortgage Disclosure Act (HMDA) data reflect, as closely as possible, true mortgage lending activities. In addition to the recommendations which HUD endorsed in the Joint Agency Comments letter of May 28, we offer the following comments.

1. Reporting pre-approvals.

As noted in the Joint Agency Comments, the Department favors revising Regulation C to take into account the growth in pre-approval credit evaluations. The approach described in the Advance Notice of Proposed Rulemaking, under which preapproval reporting decisions follow Regulation B with respect to declined preapproval requests, has merit and should be implemented. As the Board notes, however, this will cover only declined preapprovals. A more complete picture of activity early in the mortgage process may require the Board to develop a reporting system for all preapprovals, using a special code to distinguish preapprovals from formal applications. Any preapproval reporting should be similar to that required on "regular" loans e.g. approved, denied, withdrawn, and income, but would necessarily not include certain other information e.g. property location. However, home counseling programs should not be required to report assisting customers, even if such assistance involves verifying credit information, if the program does not use such information to decide, for itself or as agent, whether to extend credit to a customer.

2. Reporting refinancing and home improvement loans.

The Department favors any change in Regulation C which distinguishes between refinancing loans obtained solely to reduce the borrowers interest rate (no "cash out") on the one hand, and home-secured loans obtained by the borrower to consolidate and replace previously unsecured consumer loans, or to provide cash

for home improvement or other consumer purchases or expenses. "Debt consolidation" or "cash out" loans secured by residential real property are the most common "predatory lending" situations and should be the subject of ongoing monitoring by federal regulatory and enforcement agencies.

3. Source of loan application.

The home mortgage origination market has changed substantially since HMDA was enacted in 1975. Lenders rely increasingly on brokers, correspondents, wholesalers and servicers in the mortgage process, yet HMDA data do not reveal the role of the reporting institution in the transaction. Regulation C could be revised to require reporters to indicate whether they actually solicited the loan application, and gathered the requisite data, or if another entity (such as a broker) did so.

4. Automated Underwriting.

The expanded use of automated underwriting systems may be an appropriate future reporting concern. Because the improper use of automated underwriting systems may result in lessened availability of affordable loans to members of protected classes, and because criteria used in automated underwriting credit and mortgage scores could have a disparate impact on protected classes, the Board may wish to monitor the use of such systems closely to determine whether there is a need for separate reporting for loans underwritten by such systems.

5. Reorganization of the Regulation and Appendices.

New questions occur regularly from lenders and others and they have to be addressed. This is now done through the Federal Reserve Board's HMDA Commentary. Various HMDA-related materials should remain as separate documents, but they should also be presented in one package as was done with the latest Guide to HMDA Reporting.

6. Purchased Loans.

The Department has no comment on proposals regarding HMDA reporting of purchased loans.

7. Temporary Financing.

The Department has no comment on proposals regarding HMDA reporting of temporary financing.

Sincerely,



Eva M. Plaza
Assistant Secretary for
Fair Housing and Equal Opportunity



UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Division of Credit Practices

Peggy L. Twohig
Assistant Director

Direct Dial
(202) 326-3210

MEMORANDUM

To: Fair Lending Group
From: Peggy L. Twohig
Subject: Comments on Final Draft Regulation B Comment Letter
Date: May 14, 1998

In the course of starting the approval process within the Commission for the proposed Regulation B comment letter, we have learned that our Bureau of Economics objects to the final sentence of the second paragraph in the preapplication marketing practices section, and will recommend against Commission approval if this sentence remains. The sentence now reads:

We suggest that the Board address this issue by explaining that the consideration of one or more prohibited bases (or factors closely correlated with prohibited bases) in deciding whom should receive solicitation for credit constitutes (or is evidence of) discouraging applicants in violation of 12 C.F.R. section 202.5(a).

Our economists are concerned that the phrase "or factors closely correlated with prohibited bases" does not provide enough guidance about what is allowed and not allowed, since many factors (e.g. income) may be closely correlated with a prohibited basis, and could substantially chill the ability of creditors to target their marketing to those more likely to be creditworthy. It also suggests that practices normally analyzed under a disparate impact theory would be considered per se disparate treatment in marketing practices. We therefore suggest the following substitute language:

We suggest that the Board address this issue by explaining that the consideration of one or more prohibited bases in deciding whom should receive solicitation for credit constitutes discouraging applicants in violation of 12 C.F.R. section 202.5(a), and that factors that are close proxies for a prohibited basis may constitute evidence of such discouragement.



UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Bureau of Consumer Protection

April 14, 1998

FAX TO: FAIR LENDING GROUP

HUD

Paul Leonard	708-0309
Peter Kaplan	708-7446
Mercedes Marquez	708-3389
John Goering	619-8000
Harry Carey	708-3389

OCC

Chris Lewis	874-4950
Mike Bylsma	874-5322
Larry Riedman	874-5221
Steve Cross	874-5221
Peggy Hesse	874-5322
Russ Bailey	874-5221

DOJ

Sandy Ross	514-1116
Joan Magagna	514-1116

TREASURY

Michael Barr	622-5672
Cliff Kellogg	622-5672
Margaret Nilson	622-0256
Patricia Milon	622-1974
Valarie Personick	622-2563

OTS

Tim Burniston	906-5735
David Enzel	906-7606
Ellen Seidman	898-0230

WHITE HOUSE

Emil Parker	456-2223
Paul Weinstein	456-7028
Julia Fernandes	456-5581

FROM: Peggy Twohig
(2 pages)



UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Division of Credit Practices

Peggy L. Twohig
Assistant Director

Direct Dial
(202) 326-3210

MEMORANDUM

To: Fair Lending Group
From: Peggy L. Twohig
Subject: Comments on Final Draft Regulation B Comment Letter
Date: May 14, 1998

In the course of starting the approval process within the Commission for the proposed Regulation B comment letter, we have learned that our Bureau of Economics objects to the final sentence of the second paragraph in the preapplication marketing practices section, and will recommend against Commission approval if this sentence remains. The sentence now reads:

We suggest that the Board address this issue by explaining that the consideration of one or more prohibited bases (or factors closely correlated with prohibited bases) in deciding whom should receive solicitation for credit constitutes (or is evidence of) discouraging applicants in violation of 12 C.F.R. section 202.5(a).

Our economists are concerned that the phrase "or factors closely correlated with prohibited bases" does not provide enough guidance about what is allowed and not allowed, since many factors (e.g. income) may be closely correlated with a prohibited basis, and could substantially chill the ability of creditors to target their marketing to those more likely to be creditworthy. It also suggests that practices normally analyzed under a disparate impact theory would be considered per se disparate treatment in marketing practices. We therefore suggest the following substitute language:

We suggest that the Board address this issue by explaining that the consideration of one or more prohibited bases in deciding whom should receive solicitation for credit constitutes discouraging applicants in violation of 12 C.F.R. section 202.5(a), and that factors that are close proxies for a prohibited basis may constitute evidence of such discouragement.



UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Bureau of Consumer Protection

MAY 14, 1998

FAX TO: **FAIR LENDING GROUP**

HUD

Paul Leonard	708-0309
Peter Kaplan	708-7446
Mercedes Marquez	708-3389
John Goering	619-8000
Harry Carey	708-3389

OCC

Chris Lewis	874-4950
Mike Bylsma	874-5322
Larry Riedman	874-5221
Steve Cross	874-5221
Peggy Hesse	874-5322
Russ Bailey	874-5221

DOJ

Sandy Ross	514-1116
Joan Magagna	514-1116

TREASURY

Michael Barr	622-5672
Cliff Kellogg	622-5672
Margaret Nilson	622-0256
Patricia Milon	622-1974
Valarie Personick	622-2563

OTS

Tim Burniston	906-5735
David Enzel	906-7606
Ellen Seidman	898-0230

WHITE HOUSE

Emil Parker	456-2223
Paul Weinstein	456-7028
Julia Fernandes	456-5581

FROM: Peggy Twohig
(2 pages)



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220
May 6, 1998

FAX TO: FAIR LENDING GROUP

HUD

<i>Paul Leonard</i>	<i>708-0309</i>
<i>Peter Kaplan</i>	<i>708-7446</i>
<i>Mercedes Marquez</i>	<i>708-3389</i>
<i>John Goering</i>	<i>619-8000</i>
<i>Harry Carey</i>	<i>708-3389</i>

OCC

<i>Chris Lewis</i>	<i>874-4950</i>
<i>Mike Bylsma</i>	<i>874-5322</i>
<i>Larry Riedman</i>	<i>874-5221</i>
<i>Steve Cross</i>	<i>874-5221</i>
<i>Peggy Hesse</i>	<i>874-5322</i>
<i>Russ Bailey</i>	<i>874-5221</i>

DOJ

<i>Sandy Ross</i>	<i>514-1116</i>
<i>Joan Magagna</i>	<i>514-1116</i>

TREASURY

<i>Michael Barr</i>	<i>622-5672</i>
<i>Cliff Kellogg</i>	<i>622-5672</i>
<i>Margaret Nilson</i>	<i>622-0256</i>
<i>Patricia Milon</i>	<i>622-1974</i>
<i>Valarie Personick</i>	<i>622-2563</i>

OTS

<i>Tim Burniston</i>	<i>906-5735</i>
<i>David Enzel</i>	<i>906-7606</i>
<i>Ellen Seidman</i>	<i>898-0230</i>

WHITE HOUSE

<i>Emil Parker</i>	<i>456-2223</i>
<i>Paul Weinstein</i>	<i>456-7028</i>
<i>Julia Fernandes</i>	<i>456-5581</i>

FTC

<i>Jodie Bernstein</i>	<i>326-3799</i>
<i>David Medine</i>	<i>326-2558</i>
<i>Peggy Twohig</i>	<i>326-2558</i>

FROM: *Michael Barr*

*Attached is information on Regulation B and Regulation C Letters
9 (pages including the cover - my fax number is 622-5672)*

To: Fair Lending Group

From: Michael Barr

Enclosed please find:

(1) First draft of Regulation C comment letter, to be discussed next Monday, May 11.

(2) Final draft of Regulation B comment letter, to be circulated for clearance and signature within your agency. Please provide any final comments from your agency to me as soon as possible, but no later than Thursday, May 14. I will circulate an absolutely final letter on joint agency letterhead for signature on Monday, May 18. I would expect that we would submit the signed letter on May 21.

DRAFT

4 proposed revisions
to Reg C.

William W. Wiles
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave., N.W.
Washington, D.C. 20551

Re: Docket No. R-1001

Dear Mr. Wiles:

We are submitting this comment in response to the Board's advanced notice of proposed rulemaking with respect to Regulation C, which implements the Home Mortgage Disclosure Act (HMDA).

First, we urge the Board to propose amending Regulation C to require institutions that report under HMDA to record the reasons for denial of loans on their Loan Application Registers. The Office of the Comptroller of the Currency and the Office of Thrift Supervision currently require such reporting for institutions that they regulate, and such information has proved to be invaluable in assessing an institution's compliance with the fair lending laws. In addition, the Department of Housing and Urban Development is currently revising its rules to require the recording of such information for the institutions that report HMDA data to the Department.

In our experience, the information greatly assists supervisory agencies in evaluating patterns of lending or denials. Such information, for example, helps the agencies to determine whether patterns of denial may reflect discrimination, or are supported by valid business objectives. [more here, citing OCC or OTS experience]

Collection of such data would not be burdensome. [Most/all?] institutions already note such information on loan applications, and the data are easily transfereable to registers. [OCC/OTS experience]

Second, we recommend that the Board propose to revise Regulation C to take account of the growth in pre-approval credit evaluations as standard industry practice. We are attracted to the ANPR's suggested approach to this issue, under which reporting preapproval decisions would simply track the requirements of Regulation B with respect to declined preapproval requests. In some cases, HMDA reporting at this stage may necessarily omit certain information, such as property location or precise loan size. In our judgment, home counseling programs need not report assisting customers, even if such assistance involves verifying credit information, as long as the home counseling program does not use such information to decide, for itself or as agent, whether or not to

extend credit to a customer.

Third, we recommend that the Board propose to revise Regulation C to require the identification of reported transaction by source of loan application. The home mortgage origination market has changed dramatically over the last 20 years. Depository institutions increasingly rely on brokers, non-banks, correspondents, wholesalers, or servicers, yet HMDA statistics do not reveal the role of the reporting institution in the transaction. HMDA reporting could be revised so that reporters could accurately describe their role in the home mortgage lending process, by indicating whether the reporting institution gathered the the loan application, or another entity (such as a broker) did. Such a change would allow managers throughout the lending industry to assess more accurately their companies' performance while imposing minimal additional burden.

Fourth, we recommend that the Board propose to revise Regulation C to require the identification of transactions involving mobile homes, given the significant differences in underwriting standards, denial rates, and other features from transactions involving traditional homes. In our experience, the aggregation of mobile home and traditional home transactions in HMDA data reduce the usefulness of such data for institutions to monitor their lending activities, and for supervisory agencies to understand trends in the provision of home mortgages or to assess the potential for discrimination. We believe that the data would be more useful and significantly easier to analyze if transactions involving mobile homes were repored using a separate code.

Sincerely,

DRAFT

William W. Wiles
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave., N.W.
Washington, D.C. 20551

Re: Docket No. R-1008

Dear Mr. Wiles:

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

In particular, we are writing to express our strong support and encouragement for the Board to propose an amendment to Regulation B to allow lenders voluntarily to collect information about the race and gender of applicants for non-mortgage credit. While the Board recently considered the issue, we believe that its importance warrants a fresh look.

The current regulatory prohibition inhibits the ability of financial service providers to learn about and respond to market opportunities to better serve underserved communities by making it difficult for institutions to know whether new products intended to expand access to credit for minorities reach their intended customer base. In addition, allowing creditors to collect data for business and consumer loans will lead to 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,

JOINT AGENCY COMMENTS ON REGULATION B

I. Voluntary Data Collection

A. *Data Collected on Mortgage Loans Have Not Been Used to Discriminate and Have Increased Access to Credit for Home Mortgages*

In 1977, Regulation B was changed to prohibit data collection in order to avoid discriminatory use of such data. However, the Board made an exception to this general prohibition by requiring creditors to collect information on home mortgage loans. At that time, little was known (but assumptions were made) about the nature and scope of lending discrimination. Since then, much has been learned about mortgage lending discrimination. As Chairman Greenspan has explained, "[o]ur experience with mortgage applications is one that underscores the role that free market competitive pressures can play in undermining discrimination and improving the profitability of business activity." The original 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 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 is having a salutary effect. During the 1990s, lending to minorities has increased dramatically relative to nonminorities, and in 1996, total home purchase loans (conventional and government-backed) to both blacks and Hispanics reached record high levels. Between 1993 and 1996, mortgage originations for Hispanics and blacks grew by 56 percent and 53 percent, respectively, more than three times as rapidly as the 14 percent increase registered for white borrowers. This has meant that both blacks and Hispanics have enjoyed much more rapid growth in homeownership than the total U.S. population has over the past five years.

B. *Lifting The Prohibition For Other Types Of Loans Would Eliminate an Unnecessary Regulatory Restriction and Foster Innovation*

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 credit demands of its market. The current prohibition in Regulation B on the collection of the race and gender 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 these markets. In particular, it inhibits the ability of financial service providers

to meet the needs of underserved communities with innovative new financial products, by making it difficult for financial institutions to understand whether new products expand access to credit for minorities. Race and gender data would help to provide a creditor with the information it needs to help meet the credit needs of particular communities.

With voluntary data collection, lenders would have maximum flexibility to collect and use applicant data. The creditor might choose not to collect data on all non-mortgage loan products; lenders could focus data collection, for example, on large volume loan products that involve personal dealings with customers or on particular small business product lines. Lenders would also be free to disclose statistical information publicly, if they believe that would be useful, or not to disclose such information.

Permitting creditors to collect race and gender data from applicants for non-mortgage credit would also enhance access to credit, by enabling lenders 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 lenders to establish "special purpose credit programs" to serve economically disadvantaged persons, including members of a prohibited basis group. However, to use this exception, a lender must submit a written plan that supports the need for the program. Because lenders are currently prohibited from collecting race and gender information from applicants for non-mortgage credit, lenders often lack the supporting data that would enable them to take full advantage of the special purpose credit program exception. In our judgment, if creditors were permitted to collect race and gender information from applicants for non-mortgage credit, overall lending to minorities, women and other economically disadvantaged persons would increase.

After the Board's decision in December of 1996 not to eliminate the prohibition, institutions that have made commitments to lend to underserved markets have expressed a desire to monitor information relating to loan applicants that would enable them to determine the number and dollar volume of loans originated to minority or women borrowers. Eliminating the prohibition in Regulation B would enable these creditors to monitor their commitments.

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

In our judgment, discrimination remains a significant barrier in non-mortgage credit markets, based upon both anecdotal information and studies that indicate disparate treatment in business lending. See e.g., Tim Bates & Caren Grown, *Commercial Bank Lending Practices and the Development of Black Owned Construction Companies*, Journal of Urban Affairs, Vol. 14, No. 1, pp. 25-41 (1992); "Appendix -- The Compelling Interest for Affirmative Action in Federal Procurement: A Preliminary Survey," in Proposed Reforms to Affirmative Action in Federal Procurement, 61 Fed. Reg. 25042, 26057, May 23, 1996 (indicating that lending discrimination continues to play a major

role in suppressing the formation and development of minority owned businesses). Wells Fargo Bank, *Latino Owned Businesses: Access to Capital* (1997) (Latino business owners are far less likely than non-Latino business owners to have the business capital they need); see Attachment A (background paper on studies of business credit discrimination and evidence that data collection can improve access to credit).

D. Allowing Voluntary Collection of Data Would Permit Creditors to Monitor Their Own Performance

The supervisory and enforcement agencies have consistently 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 have sought permission from supervisory agencies to collect such information in order to monitor their fair lending compliance.

To be fully effective, self-evaluation and subsequent corrective action for problems found requires documentation of loan applicant data such as the race, ethnicity, sex, and age of applicants. Without the data that creditors are prohibited from collecting under Regulation B, lenders 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.

E. Without Monitoring Information, the Ability of the Agencies to Detect Discrimination in Consumer or Business Loans Will be Limited

The prohibition also inhibits effective monitoring and enforcement of the Equal Credit Opportunity Act. Without the necessary data, enforcement agencies must rely on other investigative techniques that are less efficient, accurate, or complete. In the home mortgage area, data collected under the HMDA is critical to the decision whether or not to delve deeper into an institution's lending practices when complaints are raised. Moreover, the prohibition has the effect of skewing enforcement efforts towards cases involving discrimination by regulated creditors in the home mortgage market, because the enforcement agencies do not have sufficient information to enforce the ECOA effectively with respect to business and consumer loans, particularly those made by non-depository institutions. At the same time, voluntary collection of data and correction of any problems discovered will assist an institution in any enforcement action contemplated by the Department of Justice. When evidence of discriminatory lending practices is found, self-evaluation – which would include the voluntary collection of monitoring data – and prompt corrective actions by the lender as needed will be considered as a substantial mitigating factor in considering any remedies. See February 25, 1995 Letter from Deval Patrick, Assistant Attorney General for Civil Rights, to Banking Trade Associations; *Policy Statement on Discrimination in Lending*, 59 Fed. Reg. 18,266-69 (April 15, 1994).

II. Pre-application Marketing Practices

We believe that the Board should clarify that creditors may not discriminate on a prohibited basis in their pre-application marketing practices. Pre-application marketing practices are becoming an increasingly significant factor in determining which consumers obtain credit, and at what price. This type of marketing is now frequently used to market special rates and terms for credit cards and increasingly, home equity and other types of loans. Regulation B should be amended to keep pace with the evolving marketing practices of the industry, by prohibiting discrimination on prohibited bases in marketing.

Regulation B should also prohibit creditors from considering prohibited bases in prescreening solicitations for credit. Under the current regulation, a creditor could intentionally decide not to send credit card solicitations to individuals residing in areas because they are predominantly African American without violating Regulation B. Yet such individuals are effectively discouraged from applying for those credit offers because they are denied the information that would cause them to approach the creditor and apply. We suggest that the Board address this issue by explaining that the consideration of one or more prohibited bases (or factors closely correlated with prohibited bases) in deciding whom should receive solicitations for credit constitutes (or is evidence of) discouraging applicants in violation of 12 C.F.R. section 202.5(a).

This is still confusing: are we setting up an either/or trying one standard to each?

The Board notes in the ANPR that in some instances prescreening on a prohibited basis may facilitate the identification of potential customers and provide greater access to credit for some customers (e.g., using age to target older individuals or college students for credit solicitations and related financial services). We believe that the Board's exception authority would enable it to allow such prescreening while simultaneously prohibiting prescreening where it limits access to credit on a prohibited basis. The ECOA authorizes the Board to exempt a class of transactions, or a particular type of transaction within a class, if the Board determines that the application of all or part of the regulation to such transactions would not contribute substantially to effectuating the purpose of the regulation. 15 U.S.C. section 1691b(a)(1).

Pres 2
go
to go



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220
May 6, 1998

FAX TO: FAIR LENDING GROUP

HUD

<i>Paul Leonard</i>	<i>708-0309</i>
<i>Peter Kaplan</i>	<i>708-7446</i>
<i>Mercedes Marquez</i>	<i>708-3389</i>
<i>John Goering</i>	<i>619-8000</i>
<i>Harry Carey</i>	<i>708-3389</i>

OCC

<i>Chris Lewis</i>	<i>874-4950</i>
<i>Mike Bylsma</i>	<i>874-5322</i>
<i>Larry Riedman</i>	<i>874-5221</i>
<i>Steve Cross</i>	<i>874-5221</i>
<i>Peggy Hesse</i>	<i>874-5322</i>
<i>Russ Bailey</i>	<i>874-5221</i>

DQI

<i>Sandy Ross</i>	<i>514-1116</i>
<i>Joan Magagna</i>	<i>514-1116</i>

TREASURY

<i>Michael Barr</i>	<i>622-5672</i>
<i>Cliff Kellogg</i>	<i>622-5672</i>
<i>Margaret Nilson</i>	<i>622-0256</i>
<i>Patricia Milon</i>	<i>622-1974</i>
<i>Valarie Personick</i>	<i>622-2563</i>

OTS

<i>Tim Burniston</i>	<i>906-5735</i>
<i>David Enzel</i>	<i>906-7606</i>
<i>Ellen Seidman</i>	<i>898-0230</i>

WHITE HOUSE

<i>Emil Parker</i>	<i>456-2223</i>
<i>Paul Weinstein</i>	<i>456-7028</i>
<i>Julia Fernandes</i>	<i>456-5581</i>

ETC

<i>Jodie Bernstein</i>	<i>326-3799</i>
<i>David Medine</i>	<i>326-2558</i>
<i>Peggy Twohig</i>	<i>326-2558</i>

FROM: *Michael Barr*

*Attached is information on Regulation B and Regulation C Letters
9 (pages including the cover - my fax number is 622-5672)*

To: Fair Lending Group

From: Michael Barr

Enclosed please find:

- (1) First draft of Regulation C comment letter, to be discussed next Monday, May 11.
- (2) Final draft of Regulation B comment letter, to be circulated for clearance and signature within your agency. Please provide any final comments from your agency to me as soon as possible, but no later than Thursday, May 14. I will circulate an absolutely final letter on joint agency letterhead for signature on Monday, May May 18. I would expect that we would submit the signed letter on May 21.

DRAFT

William W. Wiles
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave., N.W.
Washington, D.C. 20551

Re: Docket No. R-1001

Dear Mr. Wiles:

We are submitting this comment in response to the Board's advanced notice of proposed rulemaking with respect to Regulation C, which implements the Home Mortgage Disclosure Act (HMDA).

First, we urge the Board to propose amending Regulation C to require institutions that report under HMDA to record the reasons for denial of loans on their Loan Application Registers. The Office of the Comptroller of the Currency and the Office of Thrift Supervision currently require such reporting for institutions that they regulate, and such information has proved to be invaluable in assessing an institution's compliance with the fair lending laws. In addition, the Department of Housing and Urban Development is currently revising its rules to require the recording of such information for the institutions that report HMDA data to the Department.

In our experience, the information greatly assists supervisory agencies in evaluating patterns of lending or denials. Such information, for example, helps the agencies to determine whether patterns of denial may reflect discrimination, or are supported by valid business objectives. [more here, citing OCC or OTS experience]

Collection of such data would not be burdensome. [Most/all?] institutions already note such information on loan applications, and the data are easily transfereable to registers. [OCC/OTS experience]

Second, we recommend that the Board propose to revise Regulation C to take account of the growth in pre-approval credit evaluations as standard industry practice. We are attracted to the ANPR's suggested approach to this issue, under which reporting preapproval decisions would simply track the requirements of Regulation B with respect to declined preapproval requests. In some cases, HMDA reporting at this stage may necessarily omit certain information, such as property location or precise loan size. In our judgment, home counseling programs need not report assisting customers, even if such assistance involves verifying credit information, as long as the home counseling program does not use such information to decide, for itself or as agent, whether or not to

extend credit to a customer.

Third, we recommend that the Board propose to revise Regulation C to require the identification of reported transaction by source of loan application. The home mortgage origination market has changed dramatically over the last 20 years. Depository institutions increasingly rely on brokers, non-banks, correspondents, wholesalers, or servicers, yet HMDA statistics do not reveal the role of the reporting institution in the transaction. HMDA reporting could be revised so that reporters could accurately describe their role in the home mortgage lending process, by indicating whether the reporting institution gathered the the loan application, or another entity (such as a broker) did. Such a change would allow managers throughout the lending industry to assess more accurately their companies' performance while imposing minimal additional burden.

Fourth, we recommend that the Board propose to revise Regulation C to require the identification of transactions involving mobile homes, given the significant differences in underwriting standards, denial rates, and other features from transactions involving traditional homes. In our experience, the aggregation of mobile home and traditional home transactions in HMDA data reduce the usefulness of such data for institutions to monitor their lending activities, and for supervisory agencies to understand trends in the provision of home mortgages or to assess the potential for discrimination. We believe that the data would be more useful and significantly easier to analyze if transactions involving mobile homes were repored using a separate code.

Sincerely,

DRAFT

William W. Wiles
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave., N.W.
Washington, D.C. 20551

Re: Docket No. R-1008

Dear Mr. Wiles:

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

In particular, we are writing to express our strong support and encouragement for the Board to propose an amendment to Regulation B to allow lenders voluntarily to collect information about the race and gender of applicants for non-mortgage credit. While the Board recently considered the issue, we believe that its importance warrants a fresh look.

The current regulatory prohibition inhibits the ability of financial service providers to learn about and respond to market opportunities to better serve underserved communities by making it difficult for institutions to know whether new products intended to expand access to credit for minorities reach their intended customer base. In addition, allowing creditors to collect data for business and consumer loans will lead to 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,

JOINT AGENCY COMMENTS ON REGULATION B

I. Voluntary Data Collection

A. *Data Collected on Mortgage Loans Have Not Been Used to Discriminate and Have Increased Access to Credit for Home Mortgages*

In 1977, Regulation B was changed to prohibit data collection in order to avoid discriminatory use of such data. However, the Board made an exception to this general prohibition by requiring creditors to collect information on home mortgage loans. At that time, little was known (but assumptions were made) about the nature and scope of lending discrimination. Since then, much has been learned about mortgage lending discrimination. As Chairman Greenspan has explained, "[o]ur experience with mortgage applications is one that underscores the role that free market competitive pressures can play in undermining discrimination and improving the profitability of business activity." The original 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 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 is having a salutary effect. During the 1990s, lending to minorities has increased dramatically relative to nonminorities, and in 1996, total home purchase loans (conventional and government-backed) to both blacks and Hispanics reached record high levels. Between 1993 and 1996, mortgage originations for Hispanics and blacks grew by 56 percent and 53 percent, respectively, more than three times as rapidly as the 14 percent increase registered for white borrowers. This has meant that both blacks and Hispanics have enjoyed much more rapid growth in homeownership than the total U.S. population has over the past five years.

B. *Lifting The Prohibition For Other Types Of Loans Would Eliminate an Unnecessary Regulatory Restriction and Foster Innovation*

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 credit demands of its market. The current prohibition in Regulation B on the collection of the race and gender 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 these markets. In particular, it inhibits the ability of financial service providers

to meet the needs of underserved communities with innovative new financial products, by making it difficult for financial institutions to understand whether new products expand access to credit for minorities. Race and gender data would help to provide a creditor with the information it needs to help meet the credit needs of particular communities.

With voluntary data collection, lenders would have maximum flexibility to collect and use applicant data. The creditor might choose not to collect data on all non-mortgage loan products; lenders could focus data collection, for example, on large volume loan products that involve personal dealings with customers or on particular small business product lines. Lenders would also be free to disclose statistical information publicly, if they believe that would be useful, or not to disclose such information.

Permitting creditors to collect race and gender data from applicants for non-mortgage credit would also enhance access to credit, by enabling lenders 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 lenders to establish "special purpose credit programs" to serve economically disadvantaged persons, including members of a prohibited basis group. However, to use this exception, a lender must submit a written plan that supports the need for the program. Because lenders are currently prohibited from collecting race and gender information from applicants for non-mortgage credit, lenders often lack the supporting data that would enable them to take full advantage of the special purpose credit program exception. In our judgment, if creditors were permitted to collect race and gender information from applicants for non-mortgage credit, overall lending to minorities, women and other economically disadvantaged persons would increase.

After the Board's decision in December of 1996 not to eliminate the prohibition, institutions that have made commitments to lend to underserved markets have expressed a desire to monitor information relating to loan applicants that would enable them to determine the number and dollar volume of loans originated to minority or women borrowers. Eliminating the prohibition in Regulation B would enable these creditors to monitor their commitments.

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

In our judgment, discrimination remains a significant barrier in non-mortgage credit markets, based upon both anecdotal information and studies that indicate disparate treatment in business lending. See e.g., Tim Bates & Caren Grown, *Commercial Bank Lending Practices and the Development of Black Owned Construction Companies*, Journal of Urban Affairs, Vol. 14, No. 1, pp. 25-41 (1992); "Appendix -- The Compelling Interest for Affirmative Action in Federal Procurement: A Preliminary Survey," in Proposed Reforms to Affirmative Action in Federal Procurement, 61 Fed. Reg. 25042, 26057, May 23, 1996 (indicating that lending discrimination continues to play a major

role in suppressing the formation and development of minority owned businesses). Wells Fargo Bank, *Latino Owned Businesses: Access to Capital* (1997) (Latino business owners are far less likely than non-Latino business owners to have the business capital they need); see Attachment A (background paper on studies of business credit discrimination and evidence that data collection can improve access to credit).

D. Allowing Voluntary Collection of Data Would Permit Creditors to Monitor Their Own Performance

The supervisory and enforcement agencies have consistently 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 have sought permission from supervisory agencies to collect such information in order to monitor their fair lending compliance.

To be fully effective, self-evaluation and subsequent corrective action for problems found requires documentation of loan applicant data such as the race, ethnicity, sex, and age of applicants. Without the data that creditors are prohibited from collecting under Regulation B, lenders 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.

E. Without Monitoring Information, the Ability of the Agencies to Detect Discrimination in Consumer or Business Loans Will be Limited

The prohibition also inhibits effective monitoring and enforcement of the Equal Credit Opportunity Act. Without the necessary data, enforcement agencies must rely on other investigative techniques that are less efficient, accurate, or complete. In the home mortgage area, data collected under the HMDA is critical to the decision whether or not to delve deeper into an institution's lending practices when complaints are raised. Moreover, the prohibition has the effect of skewing enforcement efforts towards cases involving discrimination by regulated creditors in the home mortgage market, because the enforcement agencies do not have sufficient information to enforce the ECOA effectively with respect to business and consumer loans, particularly those made by non-depository institutions. At the same time, voluntary collection of data and correction of any problems discovered will assist an institution in any enforcement action contemplated by the Department of Justice. When evidence of discriminatory lending practices is found, self-evaluation – which would include the voluntary collection of monitoring data – and prompt corrective actions by the lender as needed will be considered as a substantial mitigating factor in considering any remedies. See February 25, 1995 Letter from Deval Patrick, Assistant Attorney General for Civil Rights, to Banking Trade Associations; *Policy Statement on Discrimination in Lending*, 59 Fed. Reg. 18,266-69 (April 15, 1994).

II. Pre-application Marketing Practices

We believe that the Board should clarify that creditors may not discriminate on a prohibited basis in their pre-application marketing practices. Pre-application marketing practices are becoming an increasingly significant factor in determining which consumers obtain credit, and at what price. This type of marketing is now frequently used to market special rates and terms for credit cards and increasingly, home equity and other types of loans. Regulation B should be amended to keep pace with the evolving marketing practices of the industry, by prohibiting discrimination on prohibited bases in marketing.

Regulation B should also prohibit creditors from considering prohibited bases in prescreening solicitations for credit. Under the current regulation, a creditor could intentionally decide not to send credit card solicitations to individuals residing in areas because they are predominantly African American without violating Regulation B. Yet such individuals are effectively discouraged from applying for those credit offers because they are denied the information that would cause them to approach the creditor and apply. We suggest that the Board address this issue by explaining that the consideration of one or more prohibited bases (or factors closely correlated with prohibited bases) in deciding whom should receive solicitations for credit constitutes (or is evidence of) discouraging applicants in violation of 12 C.F.R. section 202.5(a).

The Board notes in the ANPR that in some instances prescreening on a prohibited basis may facilitate the identification of potential customers and provide greater access to credit for some customers (*e.g.*, using age to target older individuals or college students for credit solicitations and related financial services). We believe that the Board's exception authority would enable it to allow such prescreening while simultaneously prohibiting prescreening where it limits access to credit on a prohibited basis. The ECOA authorizes the Board to exempt a class of transactions, or a particular type of transaction within a class, if the Board determines that the application of all or part of the regulation to such transactions would not contribute substantially to effectuating the purpose of the regulation. 15 U.S.C. section 1691b(a)(1).

Fair Lending

① Reg B - comments on letter?

② Reg C - DOT sent in comments on Reg C letter

③ Tracking pre-approvals under HMDA.

Fed Q: Should those who do not extend credit have to report? NO (turned away after ^{pepin} inquiry)
But if acting as an agency agent, who reports? The principal, not the agent.

When an inquiry becomes an application

Could set a rule that once you pull a credit report, counts as a serious inquiry - warrants a reporting requirement



One more round on this?

Proj can next week

④ Reasons for denial

any data or stats on this?

RER



Optional certification process

on both recruitment and the "substantive
equiv."

Lay-off

→ Wed. afternoon meeting w/ HR folks.

→ SOL on enforcement (?)

Loan program run
by an agency
Who can you file a complaint
with (?)

Fed. govt. regulates banks, Thrifts, and credit unions to ensure that they operate in a safe and sound manner.

5 agencies regulate federally-insured depository institutions: (1) The office of the Comptroller of the Currency regulates national banks; (2) Office of Thrift Supervision regulates Thrifts; (3) Federal Reserve regulates state-chartered banks that are Federal Reserve members; (4) FDIC regulates other state-chartered banks; NCUA regulates credit unions.

ECOA
Equal Credit
Opportunity
Act

FEDERAL RESERVE SYSTEM

12 CFR Part 203

[Regulation C; Docket No. R-1001]

Home Mortgage Disclosure

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: Pursuant to its Regulatory Planning and Review Program, the Board is undertaking a review of Regulation C (Home Mortgage Disclosure). The purpose of the review is to identify ways in which the Board could revise Regulation C to clarify and simplify the regulatory language; respond to technological and other developments; reduce undue regulatory burden on the industry; delete obsolete provisions; and improve the quality and usefulness of the data. To gather information necessary for this review and to ensure the participation of interested parties, the Board is soliciting comment on several specific issues, while also soliciting comment generally on potential revisions to the regulation.

DATE: Comments must be received by May 29, 1998.

ADDRESSES: Comments should refer to Docket No. R-1001, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. Comments also may be delivered to Room B-2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) at any time. Comments received will be available for inspection in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.12 of the Board's Rules Regarding Availability of Information.

FOR FURTHER INFORMATION CONTACT: Jane Jensen Gell or John C. Wood, Senior Attorneys, or Pamela Morris Blumenthal, Staff Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, at (202) 452-3667 or (202) 452-2412; for the hearing impaired only, Diane Jenkins, Telecommunications Device for the Deaf, at (202) 452-3544.

SUPPLEMENTARY INFORMATION:

I. Background on HMDA and Regulation C

The Home Mortgage Disclosure Act of 1975 (HMDA) (12 U.S.C. 2801 et seq.) requires institutions to collect and report data about home purchase and home improvement loans. Institutions must report data for loans originated or purchased, as well as for loan applications that do not result in an origination. Regulation C, which carries out the act, requires institutions to report information about the application or loan: the application date, the action taken and the date of that action, the loan amount, and the loan type and purpose. Institutions must also report data about applicants or borrowers: their race, sex, and income. Finally, institutions must report the property location and occupancy status, and identify the type of purchaser for loans that they sell.

Institutions report this information to their supervisory agencies on an application-by-application basis using a register format. Institutions must make this register available to the public, with certain fields redacted to preserve applicants' privacy. In addition, the Federal Financial Institutions Examination Council (FFIEC), on behalf of the supervisory agencies, compiles this information and prepares individual disclosure statements for each institution, aggregate reports for all covered institutions in each metropolitan statistical area (MSA), and other reports. Individual disclosure statements are available to the public from each institution, and disclosure statements and aggregate reports are available at central depositories in each MSA.

The purpose of HMDA is threefold. One purpose is to provide the public and government officials with information that will help show whether financial institutions are serving the housing needs of the neighborhoods and communities in which they are located. A second purpose is to help public officials target public investments to promote private investments in neighborhoods where investment is needed. Finally, the collection and disclosure requirements provide data that assist in identifying possible discriminatory lending patterns and enforcing antidiscrimination statutes.

HMDA specifies the data that institutions must collect and report. Because of the volume of information that must be aggregated (in 1996, the data reflected 14.8 million loans and applications) institutions must standardize the data reports and generally submit them to their supervisory agency in a machine-readable form. The Board has imposed few additional items of data collection beyond those in the statute. To facilitate data retrieval, each entry in the

institution's HMDA loan/application register (HMDA-LAR) must contain a unique identifier. Each entry must also contain the application date and the action taken date. Institutions must distinguish loans to purchase or improve multifamily dwellings from other home purchase or home improvement loans.

II. Review of Regulation C

Pursuant to the Board's Regulatory Planning and Review Program, the Board has undertaken a review of Regulation C to determine whether revisions might be made to improve the regulation. The regulation was last reviewed in 1988, when the Board made organizational and technical changes to reduce burden. As discussed below, the Board has identified several possible areas for revision. The Board invites comments on these and any other issues that might warrant review. After evaluating the comments, the Board will publish a proposed rule for public comment.

Concurrently, the Board is also undertaking a review of Regulation B (Equal Credit Opportunity); an advance notice of proposed rulemaking is published elsewhere in today's Federal Register.

Comment is specifically solicited on the following issues:

1. Reporting Preapprovals

HMDA and Regulation C require lenders to report data regarding applications for mortgage loans that do not result in originations. Under Regulation C, an application is defined as an oral or written request for a home purchase or home improvement loan that is made according to the procedures established by the lender for the type of credit requested. Currently, a creditor that makes a preliminary decision about a potential applicant's creditworthiness before receiving a formal application does not report the decision--whether the decision involves a "prequalification" following a cursory review or involves comprehensive underwriting that could result in an approval subject to the applicant's finding an acceptable property (a "preapproval"). Following a preapproval, home buyers identify the property they wish to purchase and lenders evaluate information relating to the property offered as security for the loan. Preapprovals that lead to an origination are reported on the HMDA-LAR. Currently, requests for preapprovals that result in denials are not reported.

To the extent that reliance on preapprovals becomes standard industry practice, the application data could become less useful for the intended purpose of providing a basis for comparison regarding a creditor's lending decisions. If potential borrowers are denied at the preapproval stage and preapproval decisions are not reported, the reported denials may not be fully representative of a lender's credit decisions. The Board has been asked to consider requiring creditors to collect and report preapprovals, using a special code to distinguish them from formal applications.

Comment is requested on all aspects of the issue including the following:

(1) Has the practice of preapprovals become common enough to suggest the need for coverage under Regulation C?

(2) In preapproval transactions, the creditor may lack some of the data called for by the HMDA-LAR. For example, the loan amount may be preliminary and the consumer often has not identified a property address. What level of information would make the reporting of data on preapprovals useful? More generally, at what stage in the loan application process would data regarding these decisions better reflect the pattern of a creditor's lending practices?

(3) Does reporting preapproval requests represent a potentially greater burden than reporting other transactions? Are there reporting distinctions, in either the level of information or the type of preapprovals, that would minimize the burden?

(4) Home-ownership counseling programs sometimes share similarities with preapproval programs. Some home-ownership counseling programs may target low- and moderate-income consumers; others are available to any first-time home buyer and have elements of both counseling and credit evaluation. The more formal the process of providing information and assistance becomes--for example, by verifying credit information--the more the counseling process resembles a preapproval. The Board believes it is important to ensure that creditors are not discouraged from providing assistance to consumers seeking credit information through counseling programs. Consequently, the Board solicits comment on ways to distinguish counseling programs from preapproval programs so as not to discourage creditors from providing information, assistance, and counseling to consumers shopping for credit.

(5) One approach for reporting preapproval decisions would be to track the requirements of Regulation B (Equal Credit Opportunity) and require reporting of all requests that require an adverse action notice under Regulation B. If a creditor evaluates information about a consumer, decides to decline the request, and communicates the decision to the consumer, Regulation B requires the creditor to treat the request as an application and send a notice of adverse action. Currently under Regulation C, creditors are instructed not to report preapproval decisions, even if

under Regulation B they are required to give adverse action notices on preapproval requests that are denied. One disadvantage to this approach is that only denials would be reported.

(6) Would tracking the requirements of Regulation B work better if that regulation were revised along with Regulation C to establish a “bright-line” test that distinguished between an inquiry and an application? Suppose that, under both regulations, an inquiry (or request for a preapproval) would be treated as an application only if a creditor evaluated or verified credit information through third party information (such as by obtaining a credit report or credit score).

2. Reporting Refinancings and Home Improvement Loans

Regulation C provides considerable flexibility in the reporting of refinancing transactions in order to minimize compliance burden. A creditor, at its option, may report a refinancing transaction under one of several tests: if the existing obligation was a reportable transaction under Regulation C; if the existing obligation was secured by a lien on a dwelling; or if the new transaction will be secured by a lien on a dwelling. This approach, adopted in 1995, is intended to facilitate compliance by allowing lenders to report all dwelling-secured refinances.

Some reporting institutions as well as users of the HMDA data believe this rule makes the resulting data difficult to analyze and of limited value. They note that the data merge refinancings to reduce the borrower’s interest rate on a home mortgage with newly home-secured loans used by the borrower to consolidate and replace previously unsecured consumer loans such as credit card debt.

The Home Mortgage Disclosure Act requires the reporting of information about mortgage loans in part to determine whether lenders are meeting the housing needs of their communities. The act defines a “mortgage loan” as (1) a loan secured by residential real property or (2) a home improvement loan. Regulation C implements the act by establishing a “purpose test” and requiring lenders to report loans for the purpose of home purchase or home improvement, and the refinancings of those loans. By expanding the definition of “refinancing,” the Board broadened that category to include--at the institutions’s option--all dwelling-secured loans, regardless of the purpose of the original loan. The Board solicits comment on whether the reporting categories should be further modified.

Comment is requested on all aspects of the issue including the following:

(1) Would a change in the reporting categories improve the usefulness of the data?

(2) Would a change in the reporting categories make compliance easier and reduce burden?

(3) Would the cost of a change in the reporting categories outweigh any possible benefits?

3. Purchased Loans

Under HMDA and Regulation C, institutions must report all loans that they purchase, even those purchased in bulk or in the context of the purchase of a branch. In some circumstances, this requirement may impose a burden. For example, some institutions believe that obtaining the correct geographic reporting data is more costly if the loans were originated many years ago and the entity that originated and sold the loans was not a HMDA reporter.

The staff commentary to Regulation C provides that a HMDA reporter need not report loans acquired through a merger. The Board has received requests to extend this merger exception to loans acquired through the acquisition of a branch. The Board has also received requests to exclude “seasoned” purchased loans, or those that were not purchased at or shortly after the origination of the loan. Comment is requested on all aspects of the issue including the following:

(1) How useful is public disclosure of data on loans purchased as part of a branch acquisition? To what extent, if any, is it more burdensome to report loans purchased as part of a branch acquisition than other purchased loans? If the Board were to exclude loans purchased as part of a branch acquisition, should the exclusion be limited to a purchase involving “bricks and mortar?” What if an institution purchased the assets of a branch but not the liabilities?

(2) Is there some other way to modify the purchased loan category that would improve the data quality and reduce burden?

4. Temporary Financing

Regulation C excludes certain data from HMDA reporting, including temporary financing such as construction or bridge loans. Some institutions that make a considerable number of construction loans would like to include them with their HMDA data. More generally, a number of HMDA reporters have requested that the Board define “temporary financing.” Comment is requested on all aspects of the issue including the following:

(1) How useful would it be for creditors to disclose data on construction lending? Would these data be more burdensome to collect and report than data on permanent financing? If the Board permitted lenders to report construction loans, should such loans be reported with home purchase loans or with a separate code?

(2) Regarding temporary financing generally, should the Board define home purchase loans with a term of less than a specified time as temporary? If so, should the threshold be one year? Two years?

5. Mobile Home Transactions

Currently, purchases or refinancings of mobile homes are reported together with purchases or refinancings of traditional homes. However, underwriting standards for transactions involving mobile homes may differ significantly from transactions involving traditional homes. Some HMDA reporters and users of the HMDA data have suggested that the data would be more useful and easier to analyze if transactions involving mobile homes were reported using a separate code. Comment is requested on all aspects of the issue, including whether it would reduce burden and improve the usefulness of the HMDA data to identify transactions involving mobile homes using a special code.

6. Additional Reporting

Some users believe that the HMDA data would be more useful if certain additional pieces of information were collected. For example, requiring institutions to report the reasons for denial could facilitate fair lending reviews. Currently, only those institutions supervised by the Office of the Comptroller of the Currency and the Office of Thrift Supervision are required to report denial reasons (which is voluntary under the statute). The data reported voluntarily show that the level of reporting varies by supervisory agency. For example, for data collected in 1996, 84 percent of the denied loans reported to the Federal Deposit Insurance Corporation and 64 percent of the denied loans reported to the Federal Reserve included denial reasons. In contrast, only 27 percent of the denied loans reported to the Department of Housing and Urban Development contained denial reasons.

Other HMDA users suggest that the regulation should require institutions to report the appraised value of the property purchased. This reporting would allow users of the data to calculate a loan-to-value ratio.

Comment is requested on all aspects of these issues including the following:

- (1) Would the public disclosure of data concerning denial reasons or property value further the purposes of HMDA, and in what way?
- (2) Are there practical difficulties in obtaining and reporting these data?

(3) What costs would be involved in reporting denial reasons or property value?

7. Reorganization of the Regulation and Appendices

Currently, institutions have a variety of sources to assist them with HMDA compliance. Appendix A to Regulation C provides instructions for completing the loan/application register, and Appendix B provides instructions for completing the data collection form. In addition, the Board issued a staff commentary (as Supplement I to the regulation), and the FFIEC publishes the Guide to HMDA Reporting: Getting it Right! The Board will consider reorganizing the regulation, appendices, and supplement to clarify and simplify the presentation of the material, and thereby reduce burden.

Comment is requested on all aspects of the issue including the following:

(1) Would it lessen burden if the interpretive material from the instructions were incorporated into the commentary and the instructions were converted into simple code descriptions?

(2) Could the regulation be organized to present information more clearly (for example, by consolidating the coverage requirements currently found in both the definitional section and the exemptions sections in a single "coverage" section)? Would the burden of learning a reorganized regulation outweigh the benefits of simplification and clarification?

8. Other Issues

The Board solicits comments on any other broad policy issues that should be addressed in the regulation.

By order of the Board of Governors of the Federal Reserve System, March 6, 1998.

William W. Wiles
Secretary of the Board
BILLING CODE 6210-01-P



DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

May 1, 1998

IMMEDIATE DELIVERY!!!**FAX TO: FAIR LENDING GROUP****HUD**

Paul Leonard	708-0309
Peter Kaplan	708-7446
Mercedes Marquez	708-3389
John Goering	619-8000
Harry Carey	708-3389

OCC

Chris Lewis	874-4950
Mike Bylsma	874-5322
Larry Riedman	874-5221
Steve Cross	874-5221
Peggy Hesse	874-5322
Russ Bailey	874-5221

DOJ

Sandy Ross	514-1116
Joan Magagna	514-1116

TREASURY

Michael Barr	622-5672
Cliff Kellogg	622-5672
Margaret Nilson	622-0256
Patricia Milon	622-1974
Valarie Personick	622-2563

OTS

Tim Burniston	906-5735
David Enzel	906-7606
Ellen Seidman	898-0230

WHITE HOUSE

Emil Parker	456-2223
Paul Weinstein	456-7028
Julia Fernandes	456-5581

FTC

Jodie Bernstein	326-3799
David Medine	326-2558
Peggy Twohig	326-2558

FROM: Michael Barr

Attached is for our Fair Lending Meeting on Monday, May 4, at 3:00 p.m., in Room 2127. (Total pages are 6 including the cover sheet)

DRAFT

William W. Wiles
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave., N.W.
Washington, D.C. 20551

Re: Docket No. R-1008

Dear Mr. Wiles:

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

In particular, we are writing to express our strong support and encouragement for the Board to propose an amendment to Regulation B to allow lenders voluntarily to collect information about the race and gender of applicants for non-mortgage credit. While the Board recently considered the issue, we believe that its importance warrants a fresh look.

The current regulatory prohibition inhibits the ability of financial service providers to learn about and respond to market opportunities to better serve underserved communities by making it difficult for institutions to know whether new products intended to expand access to credit for minorities reach their intended customer base. In addition, allowing creditors to collect data for business and consumer loans will lead to 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 support.

Sincerely,

JOINT AGENCY COMMENTS ON REGULATION B

I. Voluntary Data Collection

A. *Data Collected on Mortgage Loans Have Not Been Used to Discriminate and Have Increased Access to Credit for Home Mortgages*

In 1977, Regulation B was changed to prohibit data collection in order to avoid discriminatory use of such data. However, the Board made an exception to this general prohibition by requiring creditors to collect information on home mortgage loans. At that time, little was known (but assumptions were made) about the nature and scope of lending discrimination. Since then, much has been learned about mortgage lending discrimination. As Chairman Greenspan has explained, "[o]ur experience with mortgage applications is one that underscores the role that free market competitive pressures can play in undermining discrimination and improving the profitability of business activity." The original 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 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.

[Insert HMDA data.]

B. *Lifting The Prohibition For Other Types Of Loans Would Eliminate an Unnecessary Regulatory Restriction and Foster Innovation*

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 credit demands of its market. The current prohibition in Regulation B on the collection of the race and gender 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 these markets. In particular, it inhibits the ability of financial service providers to meet the needs of underserved communities with innovative new financial products, by making it difficult for financial institutions to understand whether new products expand access to credit for minorities. Race and gender data would help to provide a creditor with the information it needs to help meet the credit needs of particular communities.

With voluntary data collection, lenders would have maximum flexibility to collect and use applicant data. The creditor might choose not to collect data on all non-mortgage

loan products; lenders could focus data collection, for example, on large volume loan products that involve personal dealings with customers or on particular small business product lines. Lenders would also be free to disclose statistical information publicly, if they believe that would be useful, or not to disclose such information.

Permitting creditors to collect race and gender data from applicants for non-mortgage credit would also enhance access to credit, by enabling lenders 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 lenders to establish "special purpose credit programs" to serve economically disadvantaged persons, including members of a prohibited basis group. However, to use this exception, a lender must submit a written plan that supports the need for the program. Because lenders are currently prohibited from collecting race and gender information from applicants for non-mortgage credit, lenders often lack the supporting data that would enable them to take full advantage of the special purpose credit program exception. In our judgment, if creditors were permitted to collect race and gender information from applicants for non-mortgage credit, overall lending to minorities, women and other economically disadvantaged persons would increase.

After the Board's decision in December of 1996 not to eliminate the prohibition, institutions that have made commitments to lend to underserved markets have expressed a desire to monitor information relating to loan applicants that would enable them to determine the number and dollar volume of loans originated to minority or women borrowers. Eliminating the prohibition in Regulation B would enable these creditors to monitor their commitments.

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

In our judgment, discrimination remains a significant barrier in non-mortgage credit markets, based upon anecdotal information and studies that indicate disparate treatment in business lending. See e.g., Tim Bates & Caren Grown, *Commercial Bank Lending Practices and the Development of Black Owned Construction Companies*, Journal of Urban Affairs, Vol. 14, No. 1, pp. 25-41 (1992); "Appendix -- The Compelling Interest for Affirmative Action in Federal Procurement: A Preliminary Survey," in Proposed Reforms to Affirmative Action in Federal Procurement, 61 Fed. Reg. 25042, 26057, May 23, 1996 (indicating that lending discrimination continues to play a major role in suppressing the formation and development of minority owned businesses). Wells Fargo Bank, *Latino Owned Businesses: Access to Capital* (1997) (Latino business owners are far less likely than non-Latino business owners to have the business capital they need). [More to be added.]

D. Allowing Voluntary Collection of Data Would Allow Creditors to Monitor Their Own Performance

The supervisory and enforcement agencies have consistently 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 have sought to collect such information in order to monitor their fair lending compliance.

To be fully effective, self-evaluation and subsequent corrective action for problems found requires documentation of loan applicant data such as the race, ethnicity, sex, and age of applicants. Without the data that creditors are prohibited from collecting under Regulation B, lenders 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.

E. Without Monitoring Information, the Ability of the Agencies to Detect Discrimination in Consumer or Business Loans Will be Limited

The prohibition also inhibits effective monitoring and enforcement of the Equal Credit Opportunity Act. Without the necessary data, enforcement agencies must rely on other investigative techniques that are less efficient, accurate, or complete. In the home mortgage area, data collected under the HMDA is critical to the decision whether or not to delve deeper into an institution's lending practices when complaints are raised. Moreover, the prohibition has the effect of skewing enforcement efforts towards cases involving discrimination by regulated creditors in the home mortgage market, because the enforcement agencies do not have sufficient information to enforce the ECOA effectively with respect to business and consumer loans, particularly those made by non-depository institutions. At the same time, voluntary collection of data and correction of any problems discovered will assist an institution in any enforcement action contemplated by the Department of Justice. When evidence of discriminatory lending practices is found, self-evaluation – which would include the voluntary collection of monitoring data – and prompt corrective actions by the lender as needed will be considered as a substantial mitigating factor in considering remedies. See February 25, 1995 Letter from Deval Patrick, Former Assistant Attorney General for Civil Rights to Banking Trade Associations; *Policy Statement on Discrimination in Lending*, 59 Fed. Reg. 18,266-69 (April 15, 1994).

II. Pre-application Marketing Practices

We believe that the Board should clarify that creditors may not discriminate on a prohibited basis in their pre-application marketing practices. Pre-application marketing practices are becoming an increasingly significant factor in determining which consumers obtain credit, and at what price. This type of marketing is now frequently used to market special rates and terms for credit cards and increasingly, home equity and other types of loans. Regulation B should be amended to keep pace with the evolving marketing

practices of the industry.

Under the current regulation, a creditor could intentionally decide not to send credit card solicitations to individuals residing in areas because they are predominantly African American without violating Regulation B. Yet such individuals are effectively discouraged from applying for those credit offers because they are denied the information that would cause them to approach the creditor and apply. We suggest that the Board address this issue by explaining that the consideration of one or more prohibited bases in deciding whom should receive solicitations for credit is evidence of discouraging applicants in violation of 12 C.F.R. section 202.5(a).

Prescreening applicants if solicitations for
 Regulation B should also prohibit creditors from considering prohibited bases in prescreening "pre-approved" credit card solicitations. In such circumstances, the creditor is treating the individuals it is screening as if they were "applicants" for credit. Thus, a formal application should not be required to trigger the non-discrimination requirements of Regulation B.

*do not want to be discouraged
 (or factor closely correlated w/ prohibited bases)*

The Board notes in the ANPR that in some instances prescreening on a prohibited basis may facilitate the identification of potential customers and provide greater access to credit for some customers (e.g., using age to target older individuals or college students for credit solicitations and related financial services). We believe that the Board's exception authority would enable it to allow such prescreening while simultaneously prohibiting prescreening where it limits access to credit on a prohibited basis. The ECOA authorizes the Board to exempt a class of transactions, or a particular type of transaction within a class, if the Board determines that the application of all or part of the regulation to such transactions would not contribute substantially to effectuating the purpose of the regulation. 15 U.S.C. section 1691b(a)(1).

Comments
to MB

BACKGROUND PAPER -- STUDIES OF BUSINESS CREDIT DISCRIMINATION AND EVIDENCE THAT DATA COLLECTION CAN IMPROVE ACCESS TO CREDIT

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

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 play only a small role in 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. Currently, 11.6 percent of white workers are self-employed, whereas 3.6 percent of black workers are self-employed. A study of self-employment trends since 1910 found that this 3 to 1 self-employment rate holds for both men and women and, for men, has remained roughly constant over 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. 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. The study is based on a sample drawn from Census's 1982 *Characteristics of Business Owners* database. While part of the explanation for lower bank loan amounts awarded to black businesses can be explained by 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 the reason blacks receive smaller loans is rooted in both lower equity capital investments (due to low household wealth), and to an ability 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. 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 controlled for statistically, black-owned businesses were more likely to be denied bank loans than whites. Her 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.

-- 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.

Data on credit rejections from the Federal Reserve Board's 1995 *Survey of Consumer Finances* also suggest that households with different demographic characteristics are held to different credit standards, even if they have similar economic characteristics (Getter, 1998). The data in this study show that the probability of being rejected for a loan is 27 percent for white low-wealth households and almost 47 percent for low-wealth minority households. Among high-wealth households, 11 percent of whites are rejected compared with 29 percent of black or Hispanic households. This by itself is not evidence of discrimination because of the importance of other factors in credit risk. However, when the households were fitted to the lending criteria of their counterparts by race, the discrepancies in the probabilities remained quite large. Controlling for demographic characteristics indicated that black and Hispanic households were evaluated under stricter lending standards that led to the rejection of

relatively more credit-worthy households. Evidence in this study suggests that the existence of borrowing constraints is tied not only to wealth but to racial bias as well.

Immergluck (1998) uses data from the Community Reinvestment Act 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.

B. *Experience with HMDA demonstrates that data collection improves the functioning of credit markets and reduces discrimination.*

1. Munnell et al. - summary of findings

HMDA data for the years 1991, 1992, and 1993 showed higher denial rates for black and Hispanic mortgage applicants than for whites. This discovery set off a heated debate about whether differential treatment by race was occurring in the mortgage market. 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. (1992) augmented HMDA data for the year 1990 with additional data relevant to the lender's decision-making process and found that race did indeed play a significant role in the decision to approve or deny a loan application in that year.

Their findings showed that while minorities, on average, do have less wealth, weaker credit histories and higher loan-to-value ratios than white applicants and these disadvantages do account for a large portion of the difference in denial rates, a statistically and economically significant gap between white and minority rejection rates remained even after controlling for these factors. Specifically, their results showed that black and Hispanic mortgage applicants in the Boston area face a probability of denial that is roughly 8 percentage points higher than that facing a white individual with the same economic characteristics.

A number of subsequent studies have also found that discrimination plays a role in the discrepancy between denial rates for minority and white mortgage applicants.

Carr and Megbolugbe (1993) and Glennon and Stengel (1994) used data from Munnell et al. and found the gap between rejection rates for white and minority applicants remained even after the data was cleaned.¹ Using a model similar to Munnell et al. to evaluate the Boston and Philadelphia markets, Schill and Wachter (1993) also found evidence consistent with redlining and discrimination. (These subsequent studies cited in Evanoff et al., 1996.)

2. Evidence that mortgage markets opened to minorities after HMDA

Since the HMDA data first revealed a black/white gap in the early 1990's, the access of minority borrowers to the mortgage market appears to have improved. Lending to both black and Hispanic borrowers has risen and minority homeownership has reached record levels. It is likely that data collection has played a critical role in reducing discrimination and opening the mortgage market to minority borrowers.

During the 1990's, lending to minorities has increased dramatically relative to nonminorities, and in 1996, total home purchase loans (conventional and government-backed loans) to both blacks and Hispanics reached record high levels. As shown in the table below, between 1993 and 1996 mortgage originations for Hispanics and blacks grew by 56 percent and 53 percent, respectively -- more than three times as rapidly as the 14 percent increase registered for white borrowers.

Between 1993 and 1996, total home-purchase loans to Blacks and Hispanics grew more rapidly than loans to White borrowers.

**GROWTH IN ANNUAL HOME-PURCHASE LOAN ACTIVITY, 1993 - 1996
(percent)**

Racial / Ethnic Group	Total Home-Purchase Loans	Conventional Home-Purchase Loans
White	14.0	19.4
Black	52.5	67.2
Hispanic	55.6	48.5
Other Minority	16.6	17.9

Source: Federal Financial Institutions Examination Council.

In 1996, more blacks and Hispanics received home mortgage loans than ever before. During that year, total home-purchase loans to blacks rose by 3.1 percent (or

¹A frequent criticism of Munnell et al. concerns the quality of much of the data. Other researchers attempting to verify the results presented in Munnell et al. have questioned the reliability of their data because of what they perceive as data entry errors, missing data, and unreliable recording techniques.

7,421 loans) to reach an all-time high of 247,692 loans. At the same time, total home-purchase loans to Hispanics grew by slightly more than 13 percent (or 28,977 loans) to reach an all-time high of 245,026 loans.

Recent lending growth by race may be understated, however, as race and ethnicity are not reported for an increasing number of HMDA loans. In 1996, race was not reported for 135,320 home-purchase loans, an increase of 33 percent over the number of loans for which data on race were not collected in 1995. A rise in the number of loans for which race is not reported could distort year-to-year comparisons of loan growth by race. (Unfortunately, there is no information in the HMDA data that would enable one to determine whether that omitted information would affect some racial categories disproportionately.)

An alternative way to assess the extent to which the supply of mortgage credit to minorities has increased since the early 1990's is to examine homeownership rates over time. Between the first quarter of 1981 and the first quarter of 1993, the homeownership rate for all households dropped from 65.6 percent to 63.7 percent. Since early 1993, however, it has risen to 65.9 percent. This is the largest 4-1/2 year rise in homeownership on record and was propelled, in part, by a sharp increase in homeownership among black and Hispanic households.

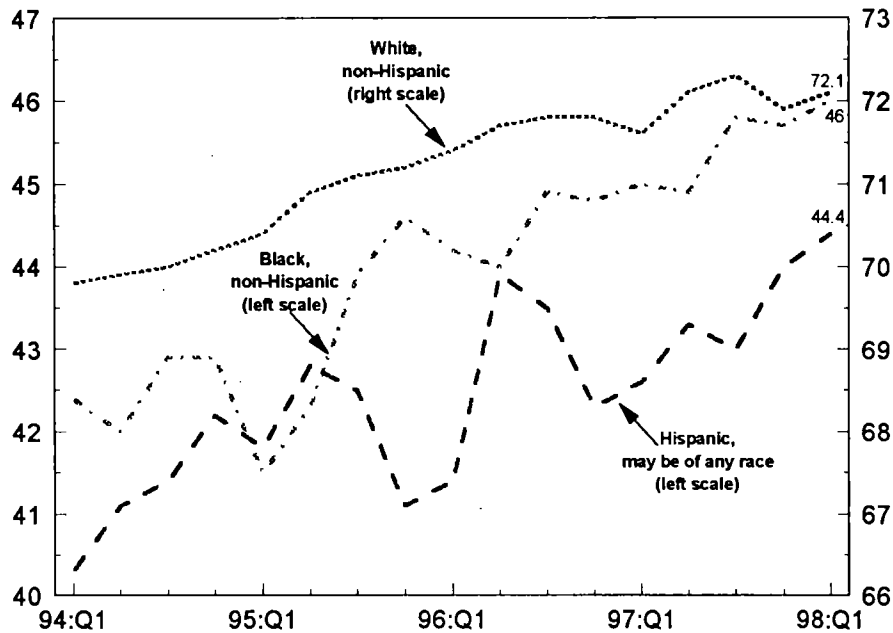
In the first quarter of this year, the shares of homes owned by black and Hispanic households rose to 45.2 percent and 44.4 percent, respectively. (See table below.) While homeownership for both minority groups still remains well below that of white households, both blacks and Hispanics have enjoyed much more rapid growth in homeownership than the white population over the past five years. (See chart that follows.)

Since the beginning of 1994, the homeownership rate for blacks and Hispanics has risen faster than that of the white population and the US average.

Homeownership rates by race (percent)

	US Total	White (non-hispanic)	Black	Hispanic (may be of any race)
1994:Q1	63.8	69.8	42.1	40.3
1998:Q1	65.9	72.1	45.2	44.4
Pct Change, 94:I to 98:I	3.3	3.3	7.4	10.2

HOMEOWNERSHIP RATES BY RACE



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

Recent increases in lending and homeownership rates for minorities undoubtedly have been partly due to the strong economy and lower mortgage interest rates. However, data collection has led to better lending practices, better enforcement of fair lending laws, and the creation of new lending initiatives targeted at minority borrowers.

Aggressive fair lending and fair housing initiatives enacted in the last few years have helped make homeownership easier and more affordable for all households. The recently revamped Community Reinvestment Act (CRA) has been given credit for encouraging banks to implement special loan programs aimed at lower-income communities and for effectively channeling funds toward previously under served areas and minority groups.² Other examples of initiatives aimed at eliminating discriminatory

²Using HMDA data from 1982 to 1995 period, the Federal Reserve Bank of Chicago analyzed the effectiveness of the CRA and fair lending regulations and found that between 1990 and 1995 (and especially 1993-94), loan applications and originations increased significantly to groups targeted by the CRA and fair lending legislation. While the study concluded that stricter enforcement of the CRA and fair lending laws since the early 1990s certainly contributed to the surge in credit to minority groups, it acknowledged the contribution of other factors.

lending practices and encouraging lending to low-income individuals in low-income areas include the following:

- The National Homeownership Strategy, launched in 1995, has helped to lower regulatory barriers and expand homeownership opportunities for all Americans.
- FHA home mortgage insurance premiums have been cut four times since 1993, lowering closing costs for qualified first-time home buyers. In addition, unnecessary and overly strict requirements were eliminated, making it easier to qualify for FHA loans. The FHA has also given lenders more flexibility to make homeownership possible for a growing number of nontraditional borrowers and has clarified certain underwriting requirements so they are not applied in a discriminatory manner.
- HUD signed 141 "Fair Housing Best Practices" agreements with real estate industry leaders, including mortgage bankers, in which the industry pledged to exceed their responsibilities under the Fair Housing Act.

The rise in lending to minorities has also been characterized by some important changes in the mortgage market, including growing roles for government-backed loans and loans by lenders specializing in manufactured homes and sub-prime mortgages.

Some notable differences exist in the use of conventional and government-backed loans by home buyers of different races and national origin. According to a recent study by the OCC (1997), minority borrowers are less likely than white borrowers to rely on conventional mortgages and more likely to opt for government-backed mortgages. In recent years, the use of government-backed mortgages by minorities has been rising. FHA loans in particular have become a more attractive source of financing for minorities due to changes implemented by the FHA specifically designed to make them so as well as to changes that have occurred in the conventional market.

Although the number of conventional home-purchase loans extended to blacks fell by 2,090 in 1996 from a record high in 1995, government-backed loans to blacks jumped up by 9,511 loans. The increase in the use of government-backed loans more than offset the decline in conventional loans and pushed the number of total home-purchase loans for blacks to a record high level. In the same year, government-backed loans for Hispanics loans surged almost 35 percent (or 28,276 loans) while conventional loans ticked up by only ½ of a percent (701 loans) -- just enough to hit a new high of 135,683 loans.

In addition, lenders specializing in manufactured housing and subprime loans account for a growing proportion of home purchases in HMDA data and applications for

these types of loans represent a bigger share of black and Hispanic applications than white applications. Although denial rates are higher among manufactured housing and subprime lenders than among other mortgage lenders, denial rate disparities by race are smaller among manufactured and subprime lenders than among other HMDA reporters.

Although it is difficult to attribute the rise in lending to minorities directly to HMDA data given the confluence of additional factors outlined above, it appears likely 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. In the early 1990s, studies like that of Munnell et al. drew considerable attention to the issue of discrimination in the market for home mortgages. Without a doubt this study and similar studies -- which rely largely on HMDA data -- bear some responsibility for prompting recent reforms in fair lending laws which have improved minority access to the mortgage market and contributed to the rise in lending and homeownership rates among minority households over the past few years.

Office of Economic Policy
May 4, 1998

REFERENCES

- Ando, Faith (1988), "Capital Issues and the Minority-Owned Business," *The Review of Black Political Economy*, Vol. 16, No. 4, pp 77-109.
- Avery, Robert et al. (1994), "Underserved Mortgage Markets: Evidence from HMDA Data," Federal Reserve Bank of Cleveland, Working Paper No. 9421, December.*
- Bates, Timothy (1989), "The Changing Nature of Minority Business: A Comparative Analysis of Asian, Nonminority, and Black-owned Businesses," *The Review of Black Political Economy*, pp. 25-42.*
- Bates, Timothy (1991), "Commercial Bank Financing of White and Black-Owned Small Business Startups," *Quarterly Review of Economics and Business*, Vol. 31, No. 1, pp. 64-80.
- Bates, Timothy (1997), "Unequal Access: Financial Institution Lending to Black- and White-Owned Small Business Startups," *Journal of Urban Affairs*, Vol. 19, No. 19, pp. 487-495.
- Berkovec, Jim, and Peter Zorn (1996), "Measuring the Market: Easier Said Than Done," *Secondary Mortgage Markets, A Freddie Mac Quarterly*, Vol. 13, No. 1, pp. 18-21.
- Bunce, Harold, and Randall Seessele (1996), "The GSE's Funding of Affordable Loans," HUD Working Paper Series HF-001, December.*
- Canner, Glenn B., and Wayne Passmore (1994), "Residential Lending to Low-Income and Minority Families: Evidence from the 1992 HMDA Data," *Federal Reserve Bulletin*, Vol. 80, February, pp. 79-108.
- Chen, Gavin M., and John A. Cole (1988), "The Myths, Facts, and Theories of Ethnic, Small-Scale Enterprise Financing," *The Review of Black Political Economy*, Vol. 16, No. 4, pp 111-123.
- Evanoff, Douglas D. and Lewis M. Segal (1996), "CRA and Fair Lending Regulations: Resulting Trends in Mortgage Lending," Federal Reserve Bank of Chicago, *Economic Perspectives*, Nov./Dec., pp. 19-43.
- Fairlie, Robert W., and Bruce D. Meyer (1996), "Trends in Self-Employment Among White and Black Men: 1910-1990," University of California, Santa Cruz Working Paper.

- Getter, Darryl E. (1998), "Do Lenders Evaluate Applicants Differently?", working paper, United States Naval Academy.
- Immergluck, Daniel (1998), "Intrametroplitan Patterns of Small Business Lending; What Do the New Community Reinvestment Act Data Tell Us?", paper prepared for the Urban Affairs Association Annual Meeting.
- Kim, S, and G. Squires (1995), "Lender Characteristics and Racial Disparities in Mortgage Lending," *Journal of Housing Research*, Vol. 6, pp. 99-113.*
- Longhofer, Stanley D. (1996), "Discrimination in Mortgage Lending: What Have We Learned," Federal Reserve Bank of Cleveland, *Economic Commentary*, August 15.
- Munnell, Alicia H., Geoffrey M. B. Tootell, Lynn E. Browne, and James McEneaney (1996), "Mortgage Lending in Boston: Interpreting HMDA Data," *American Economic Review*, Vol. 86, No. 1, pp. 25-53.
- Office of the Comptroller of the Currency (1997), "1996 Home Mortgage Lending: An Overview of Loan Growth and Denial Rates," DRAFT, December 5, 1997.
- Ross, Stephen L. (1997), "Mortgage Lending Discrimination and Racial Differences in Loan Default: A Simulation Approach," *Journal of Housing Research*, Vol. 8, No. 2, pp. 277-297.*
- Tootell, Geoffrey M. B. (1993), "Defaults, Denials, and Discrimination in Mortgage Lending," Federal Reserve Bank of Boston, *New England Economic Review*, Sept./Oct., pp. 45-51.
- U.S. Department of Housing and Urban Development (1997), "The 1996 HMDA Data: A Closer Look," *U.S. Housing Market Conditions*, November, pp. 4-9.
- Wienk, R. (1992), "Discrimination in Urban Credit Markets: What We Know and Why We Don't Know It," *Housing Policy Debate*, Vol. 3, pp 217-240.*
- Yinger, John (1995), *Closed Doors, Opportunities Lost: The Continuing Costs of Housing Discrimination*, Russell Sage, New York, N.Y.*

* To be reviewed.



Comptroller of the Currency

Administrator of National Banks

Legislative, Regulatory, and International Activities

Washington, DC 20219

FACSIMILE TRANSMITTAL SHEET

Number of Pages: Cover + 1

To:

Emil Parker
Paul Weinstein
Julia Fernandes

From:

Michael Bylsma

Phone: (202) 874-5750
Fax: (202) 874-5322

Date:

April 29, 1998

Additional Information:

These are the edits I propose to the Regulatory B letter.

04/21/98 TUE 17:10 FAX 202 622 5672

Barr Comm Dev Policy

004

Re: Docket No. R-1008

underlined agencies are submitting this comment in response to the Board's
 The Board has ~~raised a series of questions~~ in its advanced notice of proposed rulemaking with respect to its review of Regulation B, which implement the provisions of the Equal Credit Opportunity Act (ECOA).

In particular,

strong
 1. We are writing to you to express our support and encouragement for the Board to revisit the question whether Regulation B should be ~~revised~~ to permit lenders voluntarily to collect information about the race and gender of applicants for non-mortgage credit. While we know that this is an issue that the Board has addressed within the past year, we believe that ~~the~~ *the* importance warrants a new look. *Considered in the recent past*

2. This is a
 The prohibition inhibits the ability of financial services providers to better serve underserved communities, by making it difficult for financial institutions to understand whether new products intended to expand access to credit for minorities reach their intended customer base.

for example,
 Eliminating the prohibition will also tend to improve CRA compliance and performance. *in this regard, it is noted that, since the time of the Board's last consideration of Regulation B, there has been an increase in the number of private agreements between firms and community-based groups to increase*
~~regulation B has caused confusion among financial institutions about CRA compliance.~~
~~Reinvestment Act plans are being used for successful resolution of the Regulation B issue.~~

In addition, there is a strong view among supervisory and enforcement agencies that the prohibition on collection of this data inhibits monitoring by regulators, self-testing by the financial services industry, and enforcement by the Department of Justice and the Federal Trade Commission, with respect to discrimination in the non-mortgage lending markets.

paid
 We would also support additional changes to Regulation B, with respect to preapplication marketing practices, the definition of an application [and of a creditor, documentation for business credit, and other matters]. *by nondepository institutions*

We have enclosed a more detailed comment and supporting evidence.

Sincerely,

All Agencies

DRAFT

10
 William W. Wiles
 Secretary
 Board of Governors of the
 Federal Reserve System
 20th Street and Constitution Ave., N.W.
 Washington, D.C. 20551

The effectiveness of business agreements cannot be monitored by the parties without a...
Community-based groups to increase
lending to particular segments of the population.

Comment Letter

I. Voluntary Data Collection

A. Lifting the Prohibition would Reduce Regulatory Burden and Foster Innovation

The current prohibition in Regulation B on the collection of data on the race and gender of 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 these markets. It inhibits the ability of financial services providers to better serve underserved communities with innovative new financial products, by making it difficult for financial institutions to understand whether new products ~~in~~ ^{for example,} expand access to credit for minorities reach their intended customer base. It is critical for any business to ~~have~~ ^{understand} its customer base, and race and gender data may provide a creditor with the ~~information it needs to respond to the credit needs of~~ ^{information it needs to respond to the credit needs of} a particular community.

In today's competitive financial services market, a creditor simply cannot afford to be subject to a regulatory prohibition that limits its ability to have the information it needs to be responsive to the credit needs of its market. With voluntary data collection, lenders would have maximum flexibility to collect and use applicant data. The creditor might choose not to collect data on all non-mortgage loan products; lenders could focus data collection, for example, on large volume loan products that involve personal dealings with customers, or on particular small business product lines, or under other circumstances. Lenders would also be free to choose to disclose ~~that~~ ^{such} information publicly, if ~~at all~~ ^{in whatever form they believe would be most useful.} ^[Would such data be viewable by regulators and enforcement agencies?] ^{They believe that would be}

In addition to making good business sense, permitting creditors to collect race and gender data from applicants for non-mortgage credit may also enhance access to credit. Regulation B sets out a limited exception to the general rule prohibiting discrimination on a prohibited basis, to permit lenders to establish "special purpose credit programs" to serve economically disadvantaged persons, including members of a protected class. However, in order to use this exception, a lender must submit a written plan that supports the need for the program. Because lenders are currently prohibited from collecting race and gender information from applicants for non-mortgage credit, lenders lack the supporting data that would enable them to take full advantage of the special purpose credit program exception. In our judgment, if creditors were permitted to collection race and gender information from applicants for non-mortgage credit, overall lending to minorities, women and other economically disadvantaged persons would increase.

Our judgment is supported by the recent and dramatic increase in mortgage lending reported pursuant to the Home Mortgage Disclosure Act (HMDA). In the home mortgage credit markets, the collection of data under HMDA has facilitated identification of weaknesses in lending practices by financial institutions, and has honed the ability of financial institutions to respond

04/21/98 TUE 17:11 FAX 202 622 5672

Barr Comm Dev Policy

4006

creatively to address the credit needs of underserved communities.

[Examples]

~~B. Removing the Prohibition Would Improve CRA Performance~~

~~Eliminating the prohibition will also further the broad purpose of the Community Reinvestment Act. After the Board's decision not to eliminate the prohibition, institutions have made commitments to provide various types of lending to underserved markets. In carrying out these commitments, some institutions have expressed a desire to monitor certain information relating to loan applicants that would enable them to determine the number and dollar volume of loans originated to minority or women borrowers. The goal of the proposed monitoring is simply to track progress, not to favor women or minorities. Eliminating the prohibition in Regulation B would help further these valid, pro-community objectives and would further the goal of nondiscrimination in lending.~~

~~The banking regulatory agencies have consistently encouraged institutions to conduct self-evaluations of their lending practices. Creditors cannot conduct fair lending self-evaluations for non-mortgage lending without appropriate monitoring information. Numerous institutions have in their compliance examinations asked for authorization to collect such information in order to improve their CRA and fair lending compliance. [etc. excerpted]~~

~~B. Enhance Monitoring, Self-Testing, and Enforcement~~

~~There is a strong view among supervisory and enforcement agencies that the prohibition on collection of this data inhibits monitoring by regulators, self-testing by the financial services industry, and enforcement by the Department of Justice and the Federal Trade Commission, with respect to discrimination in the non-mortgage lending markets.~~

1. Monitoring [Regulator background on why important for monitoring]
2. Self-testing [Examples of how would be useful; how difficult now.]

~~Leading financial institutions, as well as the bank regulatory agencies, HUD, the FTC, and the Justice Department seek to promote voluntary compliance with the fair lending laws throughout all credit markets. In our judgment, effective self-evaluation and subsequent corrective action for problems found are not possible without documentation of loan applicant data such as the race, ethnicity, sex, and age of applicants. In our experience in detailed reviews of hundreds of applicant files, in our examinations, [and...]. Without the data that is prohibited from being collected under Regulation B, lenders must rely on less efficient, less reliable methods of self-evaluation. Limited self-testing, or spot checking employees by direct observation, is costly and ineffective, and many forms of discrimination cannot be separated out from harmless differences without an institution's careful review and comparison of a large number of loan files containing the pertinent information. Lenders 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.~~

that could be used to discriminate

It appears that to be fully effective, requires removing the Regulatory prohibition would allow lenders the means for a

refer to Policy, Statement of Agencies on self-compliance

can be

and

04/21/88 10E 11:11 FAX 206 066 3012

ה'תש"ח י"ב י"ג י"ד י"ה י"ו י"ז י"ח י"ט

3. Enforcement

a. Enforcement would be improved by collection of data.

The prohibition inhibits effective enforcement of the Equal Credit Opportunity Act. Without the necessary data, enforcement agencies must rely on other investigative techniques, such as testing and applicant interviews, that are less efficient, accurate, or complete. Moreover, the prohibition has the effect of skewing enforcement efforts towards cases involving discrimination by regulated creditors in the home mortgage market, because the enforcement agencies do not have sufficient information to enforce the ECOA effectively with respect to business and consumer loans, particularly those made by non-depository institutions.

[Enforcement statistics; complaints, other data on enforcement.]

In the home mortgage area, as to most of the discriminatory practices that the Department of Justice has uncovered, data collected under HMDA was critical to the decision to delve deeper into the institution's lending practices. Moreover, public disclosure of HMDA data has helped consumer and community groups become more effective in responsibly drawing attention to disproportionate minority denial rates and to residential neighborhoods with low loan rates.

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

Evidence indicates that lending discrimination continues to play a major role in suppressing the formation and development of minority owned businesses. See "Appendix--The Compelling Interest for Affirmative Action in Federal Procurement: A Preliminary Survey," in Proposed Reforms to Affirmative Action in Federal Procurement, 61 Fed. Reg. 25042, 26057, May 23, 1996. [Add other data, academic studies.]

D. Experience with HMDA Demonstrates that Data Collection and Disclosure Improves the Functioning of Credit Markets and Reduces Discrimination.

When the Board first adopted the prohibition 20 years ago, the Board was concerned that collection of data on race and other matters might tend to encourage, rather than discourage, discrimination. In our experience, it has become clear in the intervening two decades that the collection and reporting of data on race tends to diminish discrimination, not foster it. As has been demonstrated in the case of data collected under the Home Mortgage Disclosure Act, transparency in credit markets helps to make the markets work with greater efficiency, enhanced fair lending enforcement, and reduce discrimination. As Chairman Greenspan has said, "[o]ur experience with mortgage applications is one that underscores the role that free market competitive pressures can play in undermining discrimination and improving the profitability of business activity."

There is no evidence that data collection and reporting under HMDA has led to discrimination, and no reason to believe a contrary result would obtain were the prohibition under ECOA to be lifted. Discrimination most often occurs when there is face-to-face contact between an applicant

Cable City

Wally Kunkin

Mary Ann Smith

John Smith

John Smith

portunity Act. Without the

increased
information
about
the mortgage

valuable
collected
can help to
where is
the
if
worked

repeated / more often / appears to

and an employee of a creditor. In the home mortgage context, we have encountered numerous instances in which mid-level management has been able to prevent or avoid potentially discriminatory treatment by front-line employees through actions taken pursuant to second review procedures. Permitting collection of data on the non-mortgage context could have a similar salutary effect.

[HMDA evidence.]

The experience under HMDA demonstrates that disclosure reduces discrimination. When creditor specific data on approval and denial rates, broken down by race and ethnicity, for home mortgages were first made public in the fall of 1991, public and industry reaction was confrontational. However, these reactions changed over time, with consumer and community groups gaining a better understanding of the data, and industry leaders moving quickly to rectify problems in their own institutions. The collection of data permitted the Department of Justice and the banking regulators to move quickly to enforce the laws, and the industry itself to change practices that had permitted discrimination to occur.

[Academic studies.]

II. Other ECOA matters.

A. Preapplication Marketing Practices.

We believe that the Board should clarify that creditors may not discriminate on a prohibited basis in their preapplication marketing practices. Preapplication marketing practices are becoming an increasingly significant factor in determining which consumers obtain credit, and at what price. This type of marketing is now frequently used to market special rates and terms for credit cards and increasingly, home equity and other types of loans. Regulation B should be amended to keep pace with the evolving marketing practices of the industry.

Under the current Regulation, a creditor could intentionally decide not to send credit card solicitations to individuals residing in ~~predominantly African American~~ areas without violating Regulation B. Yet such individuals are effectively discouraged from applying for those credit offers because they are denied the information that would cause them to approach the creditor and apply. We suggest that the Board address this issue by explaining that the consideration of one or more prohibited bases, ~~or factors closely correlated with prohibited bases,~~ in deciding whom should receive solicitations for credit is evidence of discouraging applicants in violation of 12 C.F.R. section 202.5(a). Regulation B should also prohibit creditors from considering prohibited bases in prescreening "pre-approved" credit card solicitations. In such circumstances, the creditor is treating the individuals it is screening as if they were "applicants" for credit. Thus, a formal application should not be required to trigger the non-discrimination requirements of Regulation B. Prohibiting prescreening in such instances would also be consistent with the FFIEC Policy Statement entitled "Prescreening by Financial Institutions and the Fair Credit Reporting Act." The FFIEC Policy Statement explains that institutions may use demographic data to target creditworthy consumers but cautions that the "application of demographic analysis

*because they are
predominately
African
American*

~~must not have the effect of excluding person on a prohibited basis."~~

The Board notes in the ANPR that in some instances prescreening on a prohibited basis may facilitate the identification of potential customers and provide greater access to credit for some customers (e.g., using age to target older individuals or college students for credit solicitations and related financial services). We believe that the Board's exception authority would enable it to allow such prescreening while simultaneously prohibiting prescreening where it limits access to credit on a prohibited basis. The ECOA authorizes the Board to exempt a class of transactions, or a particular type of transaction within a class, if the Board determines that the application of all or part of the regulation to such transactions would not contribute substantially to effectuating the purpose of the regulation. 15 U.S.C. section 1691b(a)(1).



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 1, 1998

IMMEDIATE DELIVERY!!!

FAX TO: FAIR LENDING GROUP

HUD

Paul Leonard	708-0309
Peter Kaplan	708-7446
Mercedes Marquez	708-3389
John Goering	619-8000
Harry Carey	708-3389

OCC

Chris Lewis	874-4950
Mike Bylsma	874-5322
Larry Riedman	874-5221
Steve Cross	874-5221
Peggy Hesse	874-5322
Russ Bailey	874-5221

DOJ

Sandy Ross	514-1116
Joan Magagna	514-1116

TREASURY

Michael Barr	622-5672
Cliff Kellogg	622-5672
Margaret Nilson	622-0256
Patricia Milon	622-1974
Valarie Personick	622-2563

OTS

Tim Burniston	906-5735
David Enzel	906-7606
Ellen Seidman	898-0230

WHITE HOUSE

Emil Parker	456-2223
Paul Weinstein	456-7028
Julia Fernandes	456-5581

ETC

Jodie Bernstein	326-3799
David Medine	326-2558
Peggy Twohig	326-2558

FROM: Michael Barr

See The Attached Re Change of Time for the Fair Lending Meeting
2 (pages including the cover)

Fair Lending Meeting will now be on Monday, May 4, at 3:00 p.m., in Room 2127, here at the Treasury Department. We will be discussing Regulation B Letter and Regulation C Letter. Please confirm your attendance with Irma Tucker, at 622-0016.

If you are unavailable to attend, please send a representative.



DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

IMMEDIATE DELIVERY!!!**FAX TO: FAIR LENDING GROUP****HUD**

<i>Paul Leonard</i>	<i>708-0309</i>
<i>Peter Kaplan</i>	<i>708-7446</i>
<i>Mercedes Marquez</i>	<i>708-3389</i>
<i>John Goering</i>	<i>619-8000</i>
<i>Harry Carey</i>	<i>708-3389</i>

OCC

<i>Chris Lewis</i>	<i>874-4950</i>
<i>Mike Bylsma</i>	<i>874-5322</i>
<i>Larry Riedman</i>	<i>874-5221</i>
<i>Steve Cross</i>	<i>874-5221</i>
<i>Peggy Hesse</i>	<i>874-5322</i>
<i>Russ Bailey</i>	<i>874-5221</i>

DOJ

<i>Sandy Ross</i>	<i>514-1116</i>
<i>Joan Magagna</i>	<i>514-1116</i>

TREASURY

<i>Michael Barr</i>	<i>622-5672</i>
<i>Cliff Kellogg</i>	<i>622-5672</i>
<i>Margaret Nilson</i>	<i>622-0256</i>
<i>Patricia Milon</i>	<i>622-1974</i>
<i>Valarie Personick</i>	<i>622-2563</i>

OTS

<i>Tim Burniston</i>	<i>906-5735</i>
<i>David Enzel</i>	<i>906-7606</i>
<i>Ellen Seidman</i>	<i>898-0230</i>

WHITE HOUSE

<i>Emil Parker</i>	<i>456-2223</i>
<i>Paul Weinstein</i>	<i>456-7028</i>
<i>Julia Fernandes</i>	<i>456-5581</i>

ETC

<i>Jodie Bernstein</i>	<i>326-3799</i>
<i>David Medine</i>	<i>326-2558</i>
<i>Peggy Twohig</i>	<i>326-2558</i>

FROM: *Michael Barr*

See Attached Re Tomorrow's Fair Lending Meeting
(total pages 10 including the cover)

I apologize for the delay in getting this to you. Attached is a proposed agenda, and the next iteration of the comment letter; as you can see, it still needs a lot of work. I look forward to seeing you tomorrow. We have changed the time of the meeting slightly. It will now take place at 4:30pm (Wednesday, April 22), in Rm. 2127. Please confirm your attendance with Irma Tucker, at 622-0016.

If you are unavailable to attend, please send a representative.

Fair Lending Group

Agenda

April 22, 1998

1. Regulation B comment letter.
 - additional arguments/evidence
 - definition of application, creditor
2. proposed Regulation C comment letter.
 - reporting on reasons for denial
 - home equity, refinancings, etc.
 - identification of loan by type/source
3. Small business CRA - renewal of data reporting.

Re: Docket No. R-1008

The Board has raised a series of questions in its advanced notice of proposed rulemaking with respect to its review of Regulation B, which implement the provisions of the Equal Credit Opportunity Act (ECOA).

We are writing to you to express our support and encouragement for the Board to revisit the question whether Regulation B should be amended to permit lenders voluntarily to collect information about the race and gender of applicants for non-mortgage credit. While we know that this is an issue that the Board has addressed within the past year, we believe that its importance warrants a new look.

The prohibition inhibits the ability of financial services providers to better serve underserved communities, by making it difficult for financial institutions to understand whether new products intended to expand access to credit for minorities reach their intended customer base.

Eliminating the prohibition will also tend to improve CRA compliance and performance. In this regard, I understand that, since the time of the Board's last consideration of Regulation B, regulators have received applications from financial institutions whose Community Reinvestment Act plans are contingent on successful resolution of the Regulation B issue.

In addition, there is a strong view among supervisory and enforcement agencies that the prohibition on collection of this data inhibits monitoring by regulators, self-testing by the financial services industry, and enforcement by the Department of Justice and the Federal Trade Commission, with respect to discrimination in the non-mortgage lending markets.

We would also support additional changes to Regulation B, with respect to preapplication marketing practices, the definition of an application [and of a creditor, documentation for business credit, and other matters].

We have enclosed a more detailed comment and supporting evidence.

Sincerely,

DRAFT

cc: William W. Wiles
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave., N.W.
Washington, D.C. 20551

Comment Letter

I. Voluntary Data Collection

A. Lifting the Prohibition would Reduce Regulatory Burden and Foster Innovation

The current prohibition in Regulation B on the collection of data on the race and gender of 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 these markets. It inhibits the ability of financial services providers to better serve underserved communities with innovative new financial products, by making it difficult for financial institutions to understand whether new products intended to expand access to credit for minorities reach their intended customer base. It is critical for any business to know its customer base, and race and gender data may provide a creditor with the key to lending successfully in a particular community.

In today's competitive financial services market, a creditor simply cannot afford to be subject to a regulatory prohibition that limits its ability to have the information it needs to be responsive to the credit needs of its market. With voluntary data collection, lenders would have maximum flexibility to collect and use applicant data. The creditor might choose not to collect data on all non-mortgage loan products; lenders could focus data collection, for example, on large volume loan products that involve personal dealings with customers, or on particular small business product lines, or under other circumstances. Lenders would also be free to choose to disclose information publicly, if at all, in whatever form they believe would be most useful. [Would such data be reviewable by regulators and enforcement agencies?]

In addition to making good business sense, permitting creditors to collect race and gender data from applicants for non-mortgage credit may also enhance access to credit. Regulation B sets out a limited exception to the general rule prohibiting discrimination on a prohibited basis, to permit lenders to establish "special purpose credit programs" to serve economically disadvantaged persons, including members of a protected class. However, in order to use this exception, a lender must submit a written plan that supports the need for the program. Because lenders are currently prohibited from collecting race and gender information from applicants for non-mortgage credit, lenders lack the supporting data that would enable them to take full advantage of the special purpose credit program exception. In our judgment, if creditors were permitted to collection race and gender information from applicants for non-mortgage credit, overall lending to minorities, women and other economically disadvantaged persons would increase.

Our judgment is supported by the recent and dramatic increase in mortgage lending reported pursuant to the Home Mortgage Disclosure Act (HMDA). In the home mortgage credit markets, the collection of data under HMDA has facilitated identification of weaknesses in lending practices by financial institutions, and has honed the ability of financial institutions to respond

creatively to address the credit needs of underserved communities.

[Examples]

B. Removing the Prohibition Would Improve CRA Performance

Eliminating the prohibition will also further the broad purposes of the Community Reinvestment Act. After the Board's decision not to eliminate the prohibition, institutions have made commitments to provide various types of lending to underserved markets. In carrying out these commitments, some institutions have expressed a desire to monitor certain information relating to loan applicants that would enable them to determine the number and dollar volume of loans originated to minority or women borrowers. The goal of the proposed monitoring is simply to track progress, not to favor women or minorities. Eliminating the prohibition in Regulation B would help further these valid, pro-community objectives and would further the goal of nondiscrimination in lending.

The banking regulatory agencies have consistently encouraged institutions to conduct self-evaluations of their lending practices. Creditors cannot conduct fair lending self-evaluations for non-mortgage lending without appropriate monitoring information. Numerous institutions have, in their compliance examinations, asked for authorization to collect such information in order to improve their CRA and fair lending compliance. [cite excerpts]

C. Enhance Monitoring, Self-Testing, and Enforcement

There is a strong view among supervisory and enforcement agencies that the prohibition on collection of this data inhibits monitoring by regulators, self-testing by the financial services industry, and enforcement by the Department of Justice and the Federal Trade Commission, with respect to discrimination in the non-mortgage lending markets.

1. Monitoring [Regulator background on why important for monitoring]
2. Self-testing [Examples of how would be useful; how difficult now.]

Leading financial institutions, as well as the bank regulatory agencies, HUD, the FTC, and the Justice Department seek to promote voluntary compliance with the fair lending laws throughout all credit markets. In our judgment, effective self-evaluation and subsequent corrective action for problems found are not possible without documentation of loan applicant data such as the race, ethnicity, sex, and age of applicants. In our experience in detailed reviews of hundreds of applicant files, in our examinations, [and....], without the data that is prohibited from being collected under Regulation B, lenders must rely on less efficient, less reliable methods of self-evaluation. Limited self-testing, or spot checking employees by direct observation, are costly and ineffective, and many forms of discrimination cannot be separated out from harmless differences without an institution's careful review and comparison of a large number of loan files containing the pertinent information. Lenders 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. Enforcement

a. Enforcement would be improved by collection of data.

The prohibition inhibits effective enforcement of the Equal Credit Opportunity Act. Without the necessary data, enforcement agencies must rely on other investigative techniques, such as testing and applicant interviews, that are less efficient, accurate, or complete. Moreover, the prohibition has the effect of skewing enforcement efforts towards cases involving discrimination by regulated creditors in the home mortgage market, because the enforcement agencies do not have sufficient information to enforce the ECOA effectively with respect to business and consumer loans, particularly those made by non-depository institutions.

[Enforcement statistics; complaints, other data on enforcement.]

In the home mortgage area, as to most of the discriminatory practices that the Department of Justice has uncovered, data collected under HMDA was critical to the decision to delve deeper into the institution's lending practices. Moreover, public disclosure of HMDA data has helped consumer and community groups become more effective in responsibly drawing attention to disproportionate minority denial rates and to residential neighborhoods with low loan rates.

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

Evidence indicates that lending discrimination continues to play a major role in suppressing the formation and development of minority owned businesses. See "Appendix--The Compelling Interest for Affirmative Action in Federal Procurement: A Preliminary Survey," in Proposed Reforms to Affirmative Action in Federal Procurement, 61 Fed. Reg. 25042, 26057, May 23, 1996. [Add other data, academic studies.]

D. Experience with HMDA Demonstrates that Data Collection and Disclosure Improves the Functioning of Credit Markets and Reduces Discrimination.

When the Board first adopted the prohibition 20 years ago, the Board was concerned that collection of data on race and other matters might tend to encourage, rather than discourage, discrimination. In our experience, it has become clear in the intervening two decades that the collection and reporting of data on race tends to diminish discrimination, not foster it. As has been demonstrated in the case of data collected under the Home Mortgage Disclosure Act, transparency in credit markets helps to make those markets work with greater efficiency, enhances fair lending enforcement, and reduces discrimination. As Chairman Greenspan has said, "[o]ur experience with mortgage applications is one that underscores the role that free market competitive pressures can play in undermining discrimination and improving the profitability of business activity."

There is no evidence that data collection and reporting under HMDA has led to discrimination, and no reason to believe a contrary result would obtain were the prohibition under ECOA to be lifted. Discrimination most often occurs when there is face-to-face contact between an applicant

and an employee of a creditor. In the home mortgage context, we have encountered numerous instances in which mid-level management has been able to prevent or avoid potentially discriminatory treatment by front-line employees through actions taken pursuant to second review procedures. Permitting collection of data on the non-mortgage context could have a similar salutary effect.

[HMDA evidence.]

The experience under HMDA demonstrates that disclosure reduces discrimination. When creditor specific data on approval and denial rates, broken down by race and ethnicity, for home mortgages were first made public in the fall of 1991, public and industry reaction was confrontational. However, these reactions changed over time, with consumer and community groups gaining a better understanding of the data, and industry leaders moving quickly to rectify problems in their own institutions. The collection of data permitted the Department of Justice and the banking regulators to move quickly to enforce the laws, and the industry itself to change practices that had permitted discrimination to occur.

[Academic studies.]

II. Other ECOA matters.

A. Preapplication Marketing Practices.

We believe that the Board should clarify that creditors may not discriminate on a prohibited basis in their preapplication marketing practices. Preapplication marketing practices are becoming an increasingly significant factor in determining which consumers obtain credit, and at what price. This type of marketing is now frequently used to market special rates and terms for credit cards and increasingly, home equity and other types of loans. Regulation B should be amended to keep pace with the evolving marketing practices of the industry.

Under the current Regulation, a creditor could intentionally decide not to send credit card solicitations to individuals residing in predominately African American areas without violating Regulation B. Yet such individuals are effectively discouraged from applying for those credit offers because they are denied the information that would cause them to approach the creditor and apply. We suggest that the Board address this issue by explaining that the consideration of one or more prohibited bases[, or factors closely correlated with prohibited bases,] in deciding whom should receive solicitations for credit is evidence of discouraging applicants in violation of 12 C.F.R. section 202.5(a). Regulation B should also prohibit creditors from considering prohibited bases in prescreening "pre-approved" credit card solicitations. In such circumstances, the creditor is treating the individuals it is screening as if they were "applicants" for credit. Thus, a formal application should not be required to trigger the non-discrimination requirements of Regulation B. Prohibiting prescreening in such instances would also be consistent with the FFIEC Policy Statement entitled "Prescreening by Financial Institutions and the Fair Credit Reporting Act." The FFIEC Policy Statement explains that institutions may use demographic data to target creditworthy consumers but cautions that the "application of demographic analysis

must not have the effect of excluding person on a prohibited basis.”

The Board notes in the ANPR that in some instances prescreening on a prohibited basis may facilitate the identification of potential customers and provide greater access to credit for some customers (e.g., using age to target older individuals or college students for credit solicitations and related financial services). We believe that the Board's exception authority would enable it to allow such prescreening while simultaneously prohibiting prescreening where it limits access to credit on a prohibited basis. The ECOA authorizes the Board to exempt a class of transactions, or a particular type of transaction within a class, if the Board determines that the application of all or part of the regulation to such transactions would not contribute substantially to effectuating the purpose of the regulation. 15 U.S.C. section 1691b(a)(1).



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

IMMEDIATE DELIVERY!!!

FAX TO: FAIR LENDING GROUP

HUD

<i>Paul Leonard</i>	<i>708-0309</i>
<i>Peter Kaplan</i>	<i>708-7446</i>
<i>Mercedes Marquez</i>	<i>708-3389</i>
<i>John Goering</i>	<i>619-8000</i>
<i>Harry Carey</i>	<i>708-3389</i>

OCC

<i>Chris Lewis</i>	<i>874-4950</i>
<i>Mike Bylsma</i>	<i>874-5322</i>
<i>Larry Riedman</i>	<i>874-5221</i>
<i>Steve Cross</i>	<i>874-5221</i>
<i>Peggy Hesse</i>	<i>874-5322</i>

DOJ

<i>Reggie Robinson</i>	<i>307-3904</i>
<i>Sandy Ross</i>	<i>514-1116</i>
<i>Joan Magagna</i>	<i>514-1116</i>

TREASURY

<i>Michael Barr</i>	<i>622-5672</i>
<i>Cliff Kellogg</i>	<i>622-5672</i>
<i>Margaret Nilson</i>	<i>622-0256</i>
<i>Patricia Milon</i>	<i>622-1974</i>
<i>Valarie Personick</i>	<i>622-2563</i>

OTS

<i>Tim Burniston</i>	<i>906-5735</i>
<i>David Enzel</i>	<i>906-7606</i>
<i>Ellen Seidman</i>	<i>906-6590</i>

WHITE HOUSE

<i>Emil Parker</i>	<i>456-2223</i>
<i>Paul Weinstein</i>	<i>456-7028</i>
<i>Julia Fernandes</i>	<i>456-5581</i>

ETC

<i>Jodie Bernstein</i>	<i>326-3799</i>
<i>David Medine</i>	<i>326-2558</i>
<i>Peggy Twohig</i>	<i>326-2558</i>

FROM: *Michael Barr*

See attached re a Fair Lending Meeting.

I would like to convene a Fair Lending Meeting on **Wednesday, April 22, at 4:15pm, in Room 2127** here at the Treasury Department. Please **RSVP to Irma Tucker, at 622-0016, or by fax to 622-5672.**

If you are unavailable to attend, please send a representative.

FEDERAL RESERVE SYSTEM

12 CFR Part 202

[Regulation B; Docket No. R-1008]

Equal Credit Opportunity

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: Pursuant to its Regulatory Planning and Review Program, the Federal Reserve Board (the "Board") is undertaking a review of Regulation B, which carries out the provisions of the Equal Credit Opportunity Act (the "ECOA"). The ECOA makes it unlawful for creditors to discriminate against an applicant in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age, and other specified bases. The review will determine whether Regulation B should be revised to address technological and other developments; identify areas in the regulation that could be revised to better balance consumer protections and industry burden; and delete obsolete provisions. To gather information necessary for this review and to ensure the participation of interested parties, the Board is soliciting comment on several specific issues, while also soliciting comment generally on potential revisions to the regulation.

DATE: Comments must be received by May 29, 1998.

ADDRESSES: Comments should refer to Docket No. R-1008, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551. Comments also may be delivered to Room B-2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) any time. Comments may be inspected in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR section 261.12 of the Board's Rules Regarding Availability of Information.

FOR FURTHER INFORMATION CONTACT: Natalie E. Taylor or Sheilah Goodman, Staff Attorneys, or Jane Jensen Gell, Senior Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551, at (202) 452-2412 or 452-3667; for the hearing impaired only, contact Diane Jenkins, Telecommunications Device for the Deaf (TDD), at (202) 452-3544.

SUPPLEMENTARY INFORMATION:

I. Background on ECOA and Regulation B

The Equal Credit Opportunity Act, 15 U.S.C. 1691, enacted in 1974, makes it unlawful for a creditor to discriminate against an applicant in any aspect of a credit transaction on the basis of sex or marital status. In 1975, pursuant to section 703 of the ECOA, the Board issued Regulation B to implement the ECOA. The Congress amended the ECOA in 1976 to prohibit discrimination on the additional bases of race, color, religion, national origin, age (provided the applicant has the capacity to contract), receipt of public assistance benefits, and good faith exercise of a right under the Consumer Credit Protection Act. The Board issued an amended Regulation B in 1976 to reflect the amendments.

Under the Board's Regulatory Planning and Review Program, which requires periodic review of the Board's regulations, the Board reviewed Regulation B and revised it in 1985 (50 FR 48018, November 20, 1985). In 1989, the Board modified Regulation B to implement amendments to the ECOA contained in the Women's Business Ownership Act of 1988. Those amendments required that creditors give written notice to business applicants of the right to a written statement of reasons for a credit denial, and imposed a record retention requirement for records relating to business credit applications (54 FR 50482, December 7, 1989). The Board further modified the regulation in 1993 to implement amendments to the ECOA contained in the Federal Deposit Insurance Corporation Improvement Act of 1991. The amendments provided applicants with a right to obtain a copy of the appraisal report used in an application secured by residential real property, and expanded the enforcement responsibilities of the federal financial supervisory agencies when information about possible violations of the ECOA becomes known (58 FR 65657, December 16, 1993). The Board also modified the regulation in 1997 to implement amendments to the ECOA contained in the Economic Growth and Regulatory Paperwork Reduction Act of 1996. The amendments created a privilege for information developed by creditors as a result of "self-tests" they conduct (62 FR 66412, December 18, 1997).

II. Review of Regulation B

The Board will review Regulation B with three goals in mind: (1) to determine whether regulatory amendments are needed to address technological and other developments; (2) to identify areas in the regulation that could be revised to better balance consumer protections and industry burden; and (3) to delete obsolete provisions.

This Advance Notice of Proposed Rulemaking is intended to gather information about broad policy issues that could be addressed by revisions to the regulation. The Board is soliciting comment on several specific issues, but also requests suggestions generally on other issues that commenters believe should be addressed or clarified. The Board will publish a proposed rule after evaluating the comments and further analysis.

Concurrently, the Board is undertaking a review of Regulation C (Home Mortgage Disclosure); an advance notice of proposed rulemaking is published elsewhere in today's Federal Register. Comment is specifically solicited on the following issues:

1. Preapplication Marketing Practices

The ECOA and Regulation B prohibit discrimination by a creditor against an applicant -- a person who has requested or received credit -- on a prohibited basis regarding any aspect of a credit transaction. Credit transaction is defined in the regulation as every aspect of an applicant's dealings with a creditor beginning with information requirements. Thus, the coverage of the ECOA is generally limited to a person who has, at a minimum, sought credit information. However, the Board recognizes that a person could be discouraged from seeking credit or credit information. Accordingly, the regulation expressly prohibits a creditor from engaging in any practice that would discourage a reasonable person (on a prohibited basis) from applying for credit. The official staff commentary provides that a creditor is prohibited from using words, symbols, or other forms of communication in advertising that express, imply, or suggest a discriminatory preference or a policy of exclusion, although a creditor is permitted to engage in affirmative advertising to solicit or encourage traditionally disadvantaged groups to apply for credit.

Aside from the prohibition against discouragement, the ECOA has not been interpreted to apply to a creditor's preapplication marketing practices -- such as the selection of persons

solicited for a credit card.¹ Creditors use a number of techniques to decide to whom solicitations will be sent. For instance, creditors will often specify criteria to credit bureaus, which then utilize credit reports to compile mailing lists that identify potential applicants who meet those criteria. This marketing technique -- involving prescreened solicitations -- is usually carried out through mailed solicitations as well as by telemarketing. Because individuals selected through the prescreening process have not requested credit, they are not deemed to be applicants for purposes of Regulation B when the prescreening occurs. It is only after the individuals respond to a creditor's invitation that the regulation applies.

During the 1985 review of Regulation B, the Board considered whether prescreened solicitations should be covered by the regulation. It was generally recognized that prescreened solicitations could result in a greater availability of credit for consumers. Also, there was no evidence at that time that creditors were improperly making use of prohibited characteristics. Therefore, the Board deemed it unnecessary to modify the regulation.

The Board recognizes that prescreening on a prohibited basis may facilitate the identification of potential customers and provide greater access to credit for some consumers. For example, some creditors have used age to target "older" individuals for credit solicitations and related financial services. However, the Board and the other banking agencies have also found instances in which creditors, primarily in the credit card industry, have used age to exclude youth and elderly persons from receiving solicitations for preapproved credit. Given the potential for using prohibited bases in prescreening to improperly exclude certain categories of individuals, the Board seeks to gain a better understanding of current practices, and solicits comment on how and to what extent creditors are using any prohibited bases in preapplication marketing.

2. Inquiry v. Application

Regulation B allows creditors to establish their own application procedures, including what and how much information to provide to consumers who request information before applying for credit. Creditors and others have expressed concern that the current distinction under Regulation B between an inquiry and an application is difficult to apply. The rule distinguishes between an inquiry and an application based on what the creditor communicates to the consumer. When a consumer requests credit information, this inquiry may entail a discussion

¹ The Fair Housing Act (FHA), which bars discrimination in housing-related transactions, differs in its treatment of prescreened solicitations. The FHA has been interpreted to prohibit persons from prescreening on a prohibited basis, whereas the ECOA permits any prescreening since only "applicants" receive the protections of the act.

of the consumer's credit characteristics. Creditors have suggested that under the regulation it is unclear when a creditor is simply providing information rather than communicating a credit decision -- for example, when the creditor explains its underwriting standards in the context of the applicant's credit characteristics. A creditor is required to notify a consumer of action taken (including, as appropriate, a notice of adverse action) if in response to a consumer's request for credit information the creditor communicates a decision not to extend credit.

Creditors say that it is burdensome to provide an adverse action notice to every consumer who is provided with negative information in the information-gathering process. Also, they suggest that some consumers might be concerned about receiving adverse action notices when they are merely in the process of gathering information to shop for a loan.

Most questions that the Board receives regarding the distinction between an inquiry and an application arise in mortgage processes. With the increased use of prequalifications, preapprovals, and interactive loan-calculation tools provided over the Internet, creditors have had difficulty determining whether a notice is required. Sometimes, what begins with a creditor providing information turns into an evaluation of creditworthiness.

With prequalifications or preapprovals, consumers begin their loan-shopping by approaching a lender to determine the price of a home they could afford. In this process, creditors often obtain and review the consumer's credit report for a more accurate picture of the consumer's debt obligations and credit history. In most cases, the consumer has not identified a specific property, nor is the consumer necessarily ready to seek a loan from a particular creditor.

Some creditors provide loan-calculation tools on their home page on the Internet; and consumers are able to calculate the price of a home they could afford by entering information about income and other data. Some programs will calculate the maximum amount for which the consumer could qualify. Other programs encourage the consumer to call the financial institution when information has been entered and it appears from the calculation that the consumer would not qualify for a mortgage due to, for example, low income and high debt. Some creditors' home pages enable the consumer to take the next step of applying to the financial institution for a home loan.

In determining whether it is possible to provide additional guidance to clarify the distinction between an inquiry and application, the Board believes it is important to encourage creditors to provide information, counseling, and assistance to consumers seeking credit

information. The sharing of information through counseling programs, such as home-ownership counseling, is a prime example. In home-ownership counseling, a third-party organization and financial institution may partner to counsel potential home buyers -- typically first-time home buyers and, often but not necessarily, low-income home buyers -- on how to obtain a mortgage. A credit report is often obtained to determine the consumer's financial position and to assist in an ongoing counseling process that could span a year or longer. In some programs, the third-party organization may not only provide counseling services, but also may prescreen applicants for the lender. The Board solicits comment on whether the more formal the process becomes in providing information, counseling, and assisting potential applicants -- for example, verifying credit information, or prescreening applicants -- the more the process should be treated as an application. The Board also solicits comment on the following:

- 1) Should the Board devise a different test for determining when an informal discussion becomes an application? If yes, what should be the test?
- 2) Should the Board seek to establish a "bright-line" test? For example, should an inquiry become an application when a creditor evaluates or verifies credit information through third-party information (such as by obtaining a credit report or credit score)?
- 3) When, if at all, would the use of an interactive loan-calculation tool constitute an application?
- 4) Is it possible or desirable to apply the current notification rules to home-ownership counseling programs? If not, how should the rules be designed to distinguish education-oriented counseling from advice offered by a lender, for example, to a consumer requesting a prequalification decision?
- 5) Are there some home-ownership counseling programs that have elements of both counseling and applications such that they should be distinguished from education-oriented counseling?
- 6) Does the issue of distinguishing an inquiry from an application also arise in nonmortgage processes? If so, what are some of the distinguishing characteristics of such processes? Would a test developed for mortgage processes be effective for nonmortgage processes?

3. Voluntary Data Collection

Regulation B generally prohibits creditors from inquiring about an applicant's sex, marital status, race, color, religion, and national origin. This provision was included in the regulation in the belief that if creditors did not have this information, they could not use it to discriminate

against applicants. At the same time, exceptions to this prohibition were also included in Regulation B. The regulation requires creditors to collect "monitoring information" (age, sex, marital status, and race or national origin) for mortgage loan applicants. This requirement was added because of the specific concern that the data was needed to help detect mortgage lending discrimination.

The regulation also allows creditors to collect data if required by another regulation, order, or agreement of a court or enforcement agency to monitor or enforce compliance with the ECOA, Regulation B, or any other federal or state statute or regulation. This exception was included in the regulation so that lenders would not have to choose between competing regulations or statutes. For example, creditors can collect data pursuant to the Home Mortgage Disclosure Act without concerns about violating Regulation B.

In April 1995, the Board published for comment a proposed amendment to Regulation B that would have allowed, but not required, creditors to collect information about an applicant's sex, marital status, race, color, and national origin for nonmortgage credit products. The regulation would have continued to bar creditors from considering this information in a credit decision. In December 1996, the Board withdrew the proposed amendment, noting that this issue might be more appropriate for the Congress to consider.

Since issuance of the final action, the Board has received requests from the other federal financial regulatory agencies, creditors, and community groups asking for further consideration of this matter. The Board believes that in light of the overall review of Regulation B it is appropriate to evaluate whether the prohibition on data collection should be changed. The Board solicits comment on whether to consider amending Regulation B to remove the prohibition barring creditors from collecting certain information about applicants for nonmortgage credit products.

4. Definition of Creditor.

The ECOA and Regulation B prohibit a creditor from discriminating against an applicant on a prohibited basis regarding any aspect of a credit transaction. The ECOA's definition of creditor includes anyone who "regularly extends" or "regularly arranges for" the extension of credit. Regulation B combines the concepts and defines a creditor as a person who, in the ordinary course of business, regularly participates in the decision of whether or not to extend credit, including persons such as a potential purchaser of an obligation who influences the decision of whether or not to extend credit. For purposes of

§§ 202.4 and 202.5(a) (the prohibitions against discrimination and discouragement), brokers or others who regularly refer applicants to creditors (or who select or offer to select creditors to whom applications can be made) are also deemed creditors.

As creditors expand their distribution systems for lending services and products, they have increasingly asked for guidance about how the definition of "creditor" applies when a lender acts in conjunction with other parties and discrimination occurs. The question could arise in the context of transactions in which a mortgage broker discriminates in originating loans that are funded by or closed in the name of the lender, for example, and also could arise in other types of lending, such as automobile financing.

Regulation B provides that a person (who may otherwise be a creditor) is not a creditor regarding a violation of the ECOA or the regulation committed by another creditor unless the person knew or had reasonable notice of the act, practice, or policy that constituted the violation before becoming involved in the credit transaction. The Board solicits comment on whether it is desirable or feasible to provide further guidance in this area, such as the circumstances under which a creditor is deemed to have knowledge of the acts of other parties when the creditor has participated in the decision to extend credit or set the credit terms.

Comment is solicited on the following:

- 1) Is it feasible for the regulation to provide more specific guidance given that most issues will depend on the facts of a particular case?
- 2) Should the current test -- which relies on whether a person knew or had reasonable notice of an act of discrimination -- be modified? If so, in what way?
- 3) Should the regulation address whether, and under what circumstances, a creditor must monitor the pricing or other credit terms when another creditor (for example, a broker) participates in the transactions?

5. Documentation for Business Credit

Currently, Regulation B requires written applications if the credit is primarily for the purchase or refinancing of an applicant's principal dwelling. This rule does not apply to business credit. Many requests for business credit are made orally or without a formal written application. In such cases, a creditor usually requests that the applicant submit a financial statement for evaluation. As a general rule, Regulation B prohibits creditors from requiring the signature of a person other than the applicant on any credit instrument where the applicant is individually creditworthy. Where the financial statement offered to support the business credit lists jointly

held property and is signed by both owners, some creditors are treating the financial statement as a joint application. Accordingly, both owners often are required to sign the note -- even where the request for credit is being made by only one of the property owners. The Board does not believe that a joint property owner's signature on a financial statement to attest to the accuracy or veracity of information is definitive evidence of a joint application.

Without documentation in the files other than the financial statement, institutions may be required to spend considerable time and expense establishing that an application was for joint, rather than individual, credit. In addition, agencies that examine for compliance with Regulation B may impose costs and other burdens on institutions when it is difficult to determine whether a joint property owner actually intended to be a joint applicant. Accordingly, the Board has been asked to revise the regulation to provide guidance on what mechanisms may be used by creditors to establish a joint property owner's intent to apply for joint business credit.

The Board solicits comment on the following:

- 1) What are some mechanisms through which evidence of an application for joint credit can be established?
- 2) Should the Board provide guidance to clarify the mechanisms through which an application for joint credit can be evidenced? If not, how can creditors ensure that their practices do not violate the regulation?

6. Business Credit Exemptions

The ECOA authorizes the Board to exempt a class of transactions, or a particular type of transaction within a class, if the Board determines that the application of all or part of the regulation to such transactions would not contribute substantially to effectuating the purposes of the regulation. Pursuant to Section 703 of the ECOA, the Board has exercised its authority to exempt business credit from certain notification and record retention requirements for consumer credit if the business had gross revenues in excess of \$1 million in its preceding fiscal year, or if the business requested an extension of trade credit, credit incident to a factoring agreement, or other similar types of business credit.

Amendments to the ECOA contained in the Women's Business Ownership Act of 1988 require the Board to review exemptions after five years to determine whether an additional extension is appropriate. While the exemptions for certain business credit do not affect the basic prohibition against discrimination in credit transactions, the exemptions do reduce burden for

creditors by modifying the notice requirements of the regulation under section 202.9(a)(3) and the record retention rules under section 202.12(b)(5). The Board solicits comment on whether these exemptions are still appropriate.

7. Other Issues

The Board solicits comments on any other broad policy issues that should be addressed in the regulation.

By order of the Board of Governors of the Federal Reserve System, March 6, 1998.

William W. Wiles
Secretary of the Board
BILLING CODE 6210-01-P



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

IMMEDIATE DELIVERY!!!

FAX TO: FAIR LENDING GROUP

HUD

Paul Leonard	708-0309
Peter Kaplan	708-7446
Mercedes Marquez	708-3389
John Goering	619-8000
Harry Carey	708-3389

OCC

Chris Lewis	874-4950
Mike Bylsma	874-5322
Larry Riedman	874-5221
Steve Cross	874-5221
Peggy Hesse	874-5322

DOJ

Reggie Robinson	307-3904
Paul Hancock	514-0293
Sandy Ross	514-1116
Joan Magagna	514-1116

TREASURY

Michael Barr	622-5672
Cliff Kellogg	622-5672
Margaret Nilson	622-0256
Patricia Milon	622-1974

OTS

Tim Burniston	906-5735
David Enzel	906-7606
Ellen Seidman	906-6590

WHITE HOUSE

Emil Parker	456-2223
Paul Weinstein	456-7028
Julia Fernandes	456-5581

FROM: Michael Barr

See attached re a Fair Lending Meeting.

2

I would like to convene a Fair Lending Meeting on Tuesday, April 7, at 4:00pm, in Room 2127 here at the Treasury Department. Please RSVP to Irma Tucker, at 622-0016, or by fax to 622-5672.

If you are unavailable to attend, please send a representative.

Reg B — permission to collect

Reg C — requires certain ones to report.

April 7, 1998
~~April 7, 1998~~ Lending

Regulation B

→ Mtg. last week w/ Assoc. AG (Sandy)

Fed has agreed to ask Q whether to amend Reg B

to lift restriction on collecting non-mortgage data
to include data on race/gender. (for non-mortgage lending)

Sign on from agencies. (including OCC, FTC)

maybe FDIC — haven't been approached.

all mortgage lenders have to collect (purchase & refinance)
NOT home improvements or others.

Reg B

→ Reg C — Fed sought comment on mandating collection who is required to report under this?
Lots not included.

Would need to be mandatory under Reg B.

~~ECOA~~

~~Collection of race/gender data on mortgage loans~~

put this in the letter

AG has taken the position that she would go easier on those who self-monitor.

Deval Patrick letter of Feb 1995.

All signed on to that principle.

✗ (reg. & eng. agencies)

DOT would like to go after non-regulated financial institutions.

→ May want to put in letter what DOT will do to go after ~~non-compliance~~ those who do not voluntarily collect.

Do we want to create a window for voluntary collection
of the data w/ no enforcement.
w/ prospective relief ☒ OR ☒ no civil penalties
for x months.
OR no punitive damages
④ only prospective relief

Why would we be willing to do a non-enforcement
came out here but not in context of mortgage lending.

Plan (?)

- ① Remove prohibitions
- ② Amend Reg. C reporting requirement
(expand who must report)
- ③ Industry pressure to collect

Want to explain complexity of ~~non~~ non-mortgage
lending enforcement w/out data

Differences btm business
consumer
non-bank mortgage
auto-finance

Price
Can matter
more than
pass/fail
(yes or no)

☒ Reg C does not identify brokers
and brokers do a lot of pre-screening

4/16

~~Check~~ Revised draft letter by next Thursday
Meet the following Tuesday (2/1st)

4/21

Reg C

Separate joint letter to change Fed rule to
require reporting of reasons for denial.

Expand categories for reports?

Home equity

~~Other~~ other areas where home is security

mobile homes (?)

and otherwise identify non-conventional
loan sub-categories

- Whether loan came from a broker

We are writing to you to express our support and encouragement for the Board to revisit the question whether Regulation B should be amended to permit lenders voluntarily to collect information about the race and gender of applicants for non-mortgage credit. While we know that this is an issue that the Board has addressed within the past year, we believe that its importance warrants a new look.

There is a strong view among supervisory and enforcement agencies that the prohibition on collection of this data inhibits monitoring by regulators, self-testing by the financial services industry, and enforcement by the Department of Justice and the Federal Trade Commission, with respect to discrimination in the non-mortgage lending markets.

Moreover, the prohibition inhibits the ability of financial services providers to better serve underserved communities, by making it difficult for financial institutions to understand whether new products intended to expand access to credit for minorities reach their intended customer base.

Eliminating the prohibition will also tend to improve CRA compliance and performance. In this regard, I understand that, since the time of the Board's last consideration of Regulation B, regulators have received applications from financial institutions whose Community Reinvestment Act plans are contingent on successful resolution of the Regulation B issue.

We would also support additional changes to Regulation B, with respect to preapplication marketing practices, the definition of an application [and of a creditor], documentation for business credit, and other matters.

We have enclosed a more detailed comment and supporting evidence.

Sincerely,

DRAFT

3 other issues

- need
positiv
Paragraphs
(not in
letter)
- ① privacy question
 - ② reliability of voluntarily-collected data
 - ③ rebut charge that this will lead to quotas in non-mortgage lending

Comment Letter

I. Voluntary Data Collection

(of non-mortgage lending data)

Any thought to making collection mandatory?
Fed proposal is voluntary
Part lots of HMDA does not reach lots of lending institutions
Reg. C issue

A. Enhance Monitoring, Self-Testing, and Enforcement
Evaluate

There is a strong view among supervisory and enforcement agencies that the prohibition on collection of this data inhibits monitoring by regulators, self-testing by the financial services industry, and enforcement by the Department of Justice and the Federal Trade Commission, with respect to discrimination in the non-mortgage lending markets.

Banks go ballistic. Don't want it.
Industry concerned that if they collect it, they will be targeted for enforcement.

1. Monitoring [Regulator background on why important for monitoring]

2. Self-testing [Examples of how would be useful; how difficult now.]

3. Enforcement

If they collect it and use it for self-regulation, OCC wouldn't need to see the data.

a. Enforcement would be improved by collection of data.

The prohibition inhibits effective enforcement of the Equal Credit Opportunity Act. Moreover, the prohibition has the effect of skewing enforcement efforts towards cases involving discrimination by regulated creditors in the home mortgage market, because the enforcement agencies do not have sufficient information to enforce the ECOA effectively with respect to business and consumer loans, particularly those made by non-depository institutions.

[Enforcement statistics; complaints, other data on enforcement.]

Want to explain complexity of non-mortgage enforcement w/out data

In the home mortgage area, as to most of the discriminatory practices that the Department of Justice has uncovered, data collected under HMDA was critical to the decision to delve deeper into the institution's lending practices. Moreover, public disclosure of HMDA data has helped consumer and community groups become more effective in responsibly drawing attention to disproportionate minority denial rates and to residential neighborhoods with low loan rates.

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

Evidence indicates that lending discrimination continues to play a major role in suppressing the formation and development of minority owned businesses. See "Appendix--The Compelling Interest for Affirmative Action in Federal Procurement: A Preliminary Survey," in Proposed Reforms to Affirmative Action in Federal Procurement, 61 Fed. Reg. 25042, 26057, May 23, 1996. [Add other data, academic studies.]

Any academic info? Through analysis of CRA data?

(geographic based)

B. Foster Industry Development of Innovative Financial Products

any evidence of lending discrim. in small business (Auto financing)

Moreover, the prohibition inhibits the ability of financial services providers to better serve underserved communities, by making it difficult for financial institutions to understand whether new products intended to expand access to credit for minorities reach their intended customer base. In the home mortgage credit markets, the collection of data under HMDA has facilitated

identification of problems by financial institutions, and has honed the ability of financial institutions to respond creatively to address those problems.

[Examples]

C. Improve CRA Compliance and Performance

Eliminating the prohibition will also tend to improve CRA compliance and performance. In this regard, I understand that, since the time of the Board's last consideration of Regulation B, regulators have received applications from financial institutions whose Community Reinvestment Act plans are contingent on successful resolution of the Regulation B issue.

[Examples; OTS?]

D. Experience with HMDA Demonstrates that Data Collection and Disclosure Improves the Functioning of Credit Markets and Reduces Discrimination.

Rem: Some evidence is not made

When the Board first adopted the prohibition 20 years ago, the Board was concerned that collection of data on race and other matters might tend to encourage, rather than discourage, discrimination. In our experience, it has become clear in the intervening two decades that the collection and reporting of data on race tends to diminish discrimination. As has been demonstrated in the case of data collected under the Home Mortgage Disclosure Act, transparency in credit markets helps to make those markets work with greater efficiency, enhances fair lending enforcement, and reduces discrimination. As Chairman Greenspan has said, "[o]ur experience with mortgage applications is one that underscores the role that free market competitive pressures can play in undermining discrimination and improving the profitability of business activity." There is no evidence that data collection and reporting under HMDA has led to discrimination, and no reason to believe a contrary result would obtain were the prohibition under ECOA to be lifted.

[HMDA evidence.]

The experience under HMDA demonstrates that disclosure reduces discrimination. When creditor specific data on approval and denial rates, broken down by race and ethnicity, for home mortgages were first made public in the fall of 1991, public and industry reaction was confrontational. However, these reactions changed over time, with consumer and community groups gaining a better understanding of the data, and industry leaders moving quickly to rectify problems in their own institutions. The collection of data permitted the Department of Justice and the banking regulators to move quickly to enforce the laws, and the industry itself to change practices that had permitted discrimination to occur.

[Academic studies.]

II. Other ECOA matters.

A. Preapplication Marketing Practices.

We believe that the Board should clarify that creditors may not discriminate on a prohibited basis in their preapplication marketing practices. [Expand.]

Difference bth
pre-application and
pre-qualified.

B. Definition of Application

(range of issues)

(C.)

Definition of Creditor

(issue of brokers)

D. Business Credit Documentation

E. Definition of adverse act.

If you are
pre-approved
for a credit
card, you
are an
applicant

use of a prohibited
basis category

Do we want
Reg B to say
that evidence of
this kind is evidence
of intent to discriminate.

(B)

This could be deemed a
"discouragement"

to prohibit
disparate treatment
in marketing

using neutral criteria
with an expected outcome =
disparate treatment

~~But, not a way to~~
craft a way to
define targeting lists
is discouragement

so using certain
zip codes would
be evidence of intent

→ May 24th is the deadline for comment

Fed. Notice

Fair Credit Reporting Act

Policy Statement
on marketing practices.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

MEMORANDUM

TO: Fair Lending Group
From: Michael Barr *It for MB*
Date: November 12, 1997
Re: Final Outline of Action Items

Thank you for all your hard work. Without attempting to capture all points of view, I have listed next steps in each of the areas we discussed. I have also suggested assignments. I would suggest that each agency representative obtain any internal sign off necessary from his or her agency by November 20, so that we may proceed to implement these suggestions shortly thereafter. Please let my office know whether we may proceed as planned, or if there are any further changes

HMDA Denial Data

- HUD will examine whether FHA lenders should report denial data and investigate whether HUD has the legal authority to require non-FHA lenders to report denial data.
- The President should call on the FRB and FDIC to require that denial data be reported. Treasury, DOJ, OCC, OTS and HUD (assuming accomplishment of the above bullet point) will write a letter to the FRB explaining why requiring this data collection is important to each regulator, and requesting that FRB consider a uniform rule. OTS will take the lead in drafting the letter. Each agency will work with outside organizations to highlight why this data collection is important to the public.
- HUD will explore whether it should require a "negative report," that is, if lenders are not required to report data in the reporting period, they would certify that this is the case. This may require Paperwork Reduction Act and regulatory burden analysis, as well as examination of Regulation C questions.

ECOA/Reg. B - non-mortgage data collection

- The President should publicly urge the FRB to require collection of this data. The Attorney General and the Comptroller of the Currency will call Board Governors to urge them to reconsider their decision not to require this collection. To make progress on this issue, all agencies would need to move forward as a group; if agencies proceeded individually, consumers might be confused or regulators or financial institutions placed at a competitive disadvantage. FRB is likely to remain opposed, but DOJ, Treasury, OTS,

and OCC agree that such collection would be justified.

- Treasury will explore with FTC whether FTC involvement would advance this issue.
- OTS and OCC staff will continue to explore with FRB staff whether Reg. B could be altered to permit other regulators to make such collection voluntary.

Credit Scoring

- The President should ask us to report back to him in one year on how the private and public sector can maximize the potential for credit scoring to increase access to credit for low-income and minority borrowers, and avoid the risks for credit scoring to diminish that access.
- OTS should draft a scope paper for informal information exchange (building on the interagency credit scoring group), jointly funded and pursued research projects, ongoing monitoring, and draft guidance on key issues to clarify important issues for the regulators and the industry. Treasury, OCC, OTS, and HUD would jointly fund this effort.
- HUD will work with OFHEO to ensure that credit scoring information of the GSEs is included in this research and monitoring effort.

Small Business Lending

- DOJ and the banking regulators will form a working group to explore how to test for business lending discrimination, leading to examiner guidance by the banking regulators and to self-testing plans for the industry.
- The Attorney General (or other senior Administration officials?) will give a speech focusing on best practices in lending to small and minority-owned businesses.
- The President should call on the banking regulators to replicate and expand programs such as OCC's new minority business dialogue and OTS's small business lending conferences.

Underwriting Discrimination

- The banking regulators should work to develop quality assurance programs along the lines of the new work by OCC, in which a checklist of structural problems exposing the institution to the risk of discriminatory behavior may lead to more intensive examination.
- (FFIEC joint examination procedures are being field tested now.)

Pre-Application Testing

- There is no established methodology for pre-application testing, and no solid evidence that

3

such testing works; yet pre-application testing may be the only means to uncover discrimination prior to the submission of applications.

 Treasury, HUD, DOJ, OTS, and OCC will jointly fund research, development, and field-testing of an agreed-upon methodology for pre-application testing.

Risk-based pricing/Predatory Lending

- We will include risk-based pricing in the credit scoring research and monitoring program.
- We should explore writing an interagency advisory on risk-based pricing.