FAIR LENDING

Race and Gender Data Are Limited for Nonmortgage Lending

June 2008
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What GAO Found

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

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

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

DOJ  Department of Justice  
ECOA  Equal Credit Opportunity Act of 1974  
FDIC  Federal Deposit Insurance Corporation  
FHAct  Fair Housing Act  
FRB  Federal Reserve Bank  
FTC  Federal Trade Commission  
HMDA  Home Mortgage Disclosure Act  
NCUA  National Credit Union Administration  
OCC  Office of the Comptroller of the Currency  
OTS  Office of Thrift Supervision  
SBA  Small Business Administration  
SCF  Survey of Consumer Finances  
SSBF  Survey of Small Business Finances  

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June 27, 2008

The Honorable Barney Frank  
Chairman  
Committee on Financial Services  
United States House of Representatives  

The Honorable Carolyn B. Maloney  
Chair  
Subcommittee on Financial Institutions and Consumer Credit  
Committee on Financial Services  
United States House of Representatives  

The Honorable Melvin L. Watt  
Chairman  
Subcommittee on Oversight and Investigations  
Committee on Financial Services  
United States House of Representatives  

The Equal Credit Opportunity Act (ECOA) of 1974, one of the federal fair lending laws, prohibits discrimination in lending based on an applicant’s personal characteristics, such as race, gender, color, religion, national origin, marital status, or age.\(^1\) A provision of the Federal Reserve Board’s (FRB) Regulation B, which implements ECOA, generally prohibits lenders from asking for, inquiring about, or documenting such information for individuals who apply for nonmortgage loans, such as small business, 

automobile, or credit card loans. FRB established the general prohibition as a means of discouraging discrimination in lending, based on its belief that if lenders could not inquire about or note such information on applicants' personal characteristics, they would be less likely to unlawfully consider it when making lending decisions. However, some members of Congress and consumer advocates argue that the prohibition on data collection has limited the ability of researchers, regulators, Congress, and the public to monitor nonmortgage lending practices and to identify possible discrimination.

In response to such criticism and in conjunction with an overall review of Regulation B, the FRB in 1999 proposed and considered an amendment to the regulation that would have permitted lenders to voluntarily inquire about and collect, without any restrictions or standards, data on the personal characteristics of nonmortgage loan applicants. However, in 2003, after reviewing more than 600 public comments on the proposed amendment and taking other steps, FRB ultimately decided to leave the basic elements of the prohibition intact. In so doing, FRB largely reaffirmed the basis underlying its initial decision to impose the prohibition—that allowing lenders to voluntarily collect and use such information without restrictions or standards could create some risk that it would be used for discriminatory purposes. In 2003, FRB also concluded that data collected voluntarily and without standards would not be

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2Regulation B allows lenders to collect data on personal characteristics if required or permitted 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, the Small Business Administration (SBA) requires lenders participating in its 7(a), or SBA guaranteed loan program to collect race and gender information from applicants. Under the regulatory exception, lenders can comply with the SBA requirements without violating Regulation B. SBA uses these data for purposes of assessing the performance of the 7(a) program. Based on our literature review, the data do not appear to be widely used as a tool for conducting research on potential discrimination in small business lending. In addition, as described in this report, many lenders are required to collect data on personal characteristics for residential mortgage loan applicants.

3FRB’s analysis of the proposed amendment was done in conjunction with its policy of periodically reviewing existing regulations, such as Regulation B, to determine whether they continue to meet their stated purposes.
reliable. However, FRB did revise Regulation B to permit lenders to collect data on race, gender, and other personal characteristics of all credit applicants (including applicants for nonmortgage credit) for the specific purpose of conducting a “self-test” to allow lenders to assess their compliance with ECOA. But such data may be privileged—that is, if the requirements of a self-test are satisfied, the lender is generally not required to disclose the results of these tests to regulators in connection with a fair lending investigation or enforcement action involving the lender.

Some members of Congress, consumer advocates, and others have questioned FRB’s 2003 rationale for leaving Regulation B’s general prohibition on the collection of data on personal characteristics on nonmortgage credit applicants largely intact. In particular, these critics have questioned the conclusion that such data could be used for unlawful discrimination. For example, they argue that the Home Mortgage Disclosure Act of 1975 (HMDA), as amended, which requires many lenders to collect and publicly report data on racial, gender, and other personal characteristics for mortgage loan applicants, has facilitated the ability of minorities and other targeted groups to obtain mortgages.

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5 A self-test is a program, practice, or study that is used to determine a lender’s compliance with ECOA and Regulation B and that creates unique data or factual information—i.e., data that are not available from loan or application files or other records.

6 The federal banking regulators—FRB, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration—as well as the Department of Housing and Urban Development and the Department of Justice, have responsibility for monitoring lender compliance with the fair lending laws and taking civil or criminal enforcement actions as may be deemed appropriate. Regulators may carry out their responsibilities through, for example, periodic examinations of lenders to assess their loan underwriting guidelines and credit decisions to detect possible discrimination in both mortgage and nonmortgage lending.

This report responds to your request that we conduct a review of the issues surrounding Regulation B. Specifically, we agreed to (1) discuss available research on possible discrimination in nonmortgage lending and review the strengths and limitations of the data that researchers and regulators use to detect possible discrimination, (2) analyze FRB’s basis for largely retaining Regulation B’s prohibition against the voluntary collection of data on personal characteristic for nonmortgage loan applicants in 2003, and (3) assess the potential benefits and costs of requiring lenders to collect and publicly report data on the personal characteristics of nonmortgage loan applicants and options to mitigate such costs.

To meet our objectives, we conducted a literature review to identify studies that used nationwide databases and statistical techniques to identify possible discrimination in nonmortgage lending, identified the reports’ key findings, and assessed the strengths and weaknesses of key data used to support the studies’ findings, particularly in comparison to HMDA data. In addition, we reviewed relevant FRB documents pertaining to Regulation B, did a content analysis of a random sample of 90 from the more than 600 comment letters that FRB received in response to its 1999 Regulation B proposed rule, and analyzed existing standards on data quality, as appropriate. We also conducted interviews with a range of researchers, officials, and others who were knowledgeable about issues surrounding Regulation B. We interviewed senior officials from FRB regarding Regulation B and the agency’s documentary and analytical basis for the 2003 regulatory ruling. Additionally, we interviewed researchers and other experts on discrimination in nonmortgage and mortgage lending, as well as staff from federal bank regulatory agencies responsible for enforcing fair lending laws. We asked these officials to comment on Regulation B, FRB’s analytical basis for largely retaining the data collection prohibition, related HMDA issues, and the benefits and costs of a data collection and reporting requirement. We also interviewed representatives from banking and business trade groups, banks, consumer and community groups, and groups that represent minority- and women-owned businesses.

We conducted this performance audit from September 2007 to June 2008 in Washington, D.C., in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable
basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Appendix I describes the objectives, scope, and methodology of our review in more detail.

Results in Brief

Most studies suggest that discrimination may play a role in certain types of nonmortgage lending, but data limitations have complicated efforts by researchers and regulators to understand the extent to which possible discrimination occurs. For example, available research on minority business lending generally indicates that African-American business owners are denied loans more often or pay significantly higher interest rates than white-owned businesses with similar risk characteristics. While the primary data source for these studies, FRB's Survey of Small Business Finances (SSBF), provides important insights into possible discrimination in small business lending, the data have limitations. For example, SSBF data are collected from small business loan borrowers rather than their lenders and, therefore, cannot be used to conduct in-depth analyses of the practices of individual lenders or the lending industry generally. The studies we identified that addressed the possibility of discrimination in automobile and credit card lending also relied on a data source that has limitations similar to those of the SSBF. In contrast, studies on possible discrimination in mortgage lending often use HMDA data, which are collected directly from a large population of lenders and thus provide for more in-depth analyses among other research benefits. Further, federal bank regulators said that HMDA data were used to facilitate the fair lending examination process for mortgage lending by helping examiners more quickly identify lenders that might be engaged in discriminatory lending practices and thus merit further investigation. In the absence of such lender-specific data for nonmortgage lending, written examination guidance directs examiners to consider other approaches that are time-consuming and may be less reliable, such as assuming that a loan

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8 Conducted about once every 5 years (i.e., 1987, 1993, 1998, and 2003), the SSBF asks a sample of small business owners to provide detailed information on their financing and credit history in addition to the race and gender of the owner(s).

9 However, as described in this report, studies that use HMDA data to assess possible discrimination in mortgage lending have been controversial because the data do not include key underwriting variables such as a loan applicant's credit score. Some studies have used HMDA data in conjunction with underwriting data available from other sources to better detect potential discriminatory mortgage lending practices.
applicant is Hispanic or female based on last or first names, to help
determine whether a lender may be engaging in discriminatory practices.
According to regulatory documents, examination data, and agency staff,
the lack of data on applicants’ personal characteristics for nonmortgage
loans may limit the relative efficiency of regulatory oversight of fair
lending practices in this sector.

While testimony from researchers and other information we collected did
not reflect full agreement with all aspects of FRB’s 2003 rationale for
retaining Regulation B’s general prohibition on collecting data on personal
characteristics, most experts agreed with the agency’s overall conclusion
that voluntarily collected data would offer limited benefits as a means of
better understanding possible discrimination in nonmortgage lending. As
discussed previously, FRB viewed such a voluntary program, without any
restrictions or standards, as (1) creating the potential for lenders to collect
and use data on personal characteristics for discriminatory purposes and
(2) likely resulting in data that would not be useful or reliable, because the
lenders would adopt inconsistent data collection approaches. Some
researchers, staff from a bank regulator, and representatives from banking
organizations agreed with FRB’s general view that restricting lender
access to data on applicants’ personal characteristics minimized the risk of
discrimination in nonmortgage lending. However, many other researchers,
staff from bank regulators, and representatives from consumer groups
disagreed with FRB’s analysis. For example, several researchers said that
in certain cases—such as small business lending, which is often done on a
face-to-face basis—lenders could already observe an applicant’s race and
gender. In these cases, they said data collection by itself would not
necessarily create a risk for discrimination. Even so, a range of
researchers, regulatory staff, and representatives from both consumer and
banking groups we contacted generally agreed with FRB that lenders
would likely adopt different approaches to collecting and using data on
personal characteristics, potentially limiting the reliability and usefulness
of the information. They also said that relatively few, if any, lenders would
likely choose to collect and use such data out of concern that their
nonmortgage lending practices would become subject to increased
regulatory oversight and potential litigation. While a staff member from a
regulatory agency, a researcher, and representatives from some consumer
groups said that any data that was collected and potentially reported
would provide important insights into possible discrimination in
nonmortgage lending than is currently available, other researchers and
officials said that such data would be prone to significant selection bias
that would compromise its usefulness. That is, they said that only lenders
with good fair lending law compliance programs would choose to collect
such data, while lenders with weak compliance programs would lack the incentive to do so.

Requiring lenders to collect and publicly report data on personal characteristics for nonmortgage loan applicants could help address some of the current data limitations that complicate efforts to better understand the potential for discrimination but would also involve additional costs and complexities that would need to be considered. In concept, such a requirement would provide researchers with more consistent, timely, and reliable data to help detect possible discrimination. It could also allow regulators to more easily detect lenders that might be engaging in discrimination and thus warranted further review during fair lending examinations or investigations. However, a data collection and reporting requirement would also impose additional costs on lenders that could be partially passed onto borrowers. These potential costs include expenses associated with information system integration and software development, data storage and verification, and employee training. One option to mitigate such costs might be to limit a lender data collection and reporting requirement to certain types of lending such as small business or automobile lending. Like mortgage lending, applications for these types of loans are often made in person, allowing lenders to observe and document applicants’ racial and gender information. While limiting a requirement to certain types of loans could be less costly to lenders than some alternatives, it could still involve complexities and costs. In particular, researchers, regulatory staff, and others said that because small business lending was more complicated than other types of lending, lenders might need to collect and report significant additional information on a range of underwriting standards and data for small business lending, in addition to applicants’ data on personal characteristics so that informed judgments could be made about their lending practices. Alternatively, lenders could be required to collect and report data on personal characteristics for use only by regulators, possibly facilitating fair lending examinations and decreasing costs. However, such a proposal would not enhance the information available to researchers, Congress, and others to assess the possibility of discrimination in nonmortgage lending. We make no

10 An FRB legal official said that the agency likely has the authority under ECOA to require lenders to collect data on personal characteristics for nonmortgage loan applicants. In 1976, FRB required lenders to collect such data for mortgage loan applicants. However, FRB officials said that it was not clear that the agency had the authority to require lenders to report such data publicly. HMDA, as amended in 1989, required many lenders to report data on mortgage applicants’ personal characteristics.
recommendations in this report, but note that, from a public policy perspective, considering the trade-offs of various options to enhance available data to assess potential discrimination in nonmortgage lending may be warranted.

We provided a copy of a draft of this report to the Chairman of FRB, and the Director of the Division of Consumer and Community Affairs provided written comments that are reprinted in appendix II. In its written comments, FRB did not take a position on the draft report’s analyses but restated a rationale for its 2003 decision for retaining Regulation B’s general prohibition on collecting data on personal characteristics for nonmortgage loan applicants. That is, FRB concluded that, permitting voluntary data collection would not produce reliable or useful market-wide data. Moreover, FRB summarized other key aspects of the draft report’s analyses. For example, FRB noted that the draft report found that a data collection and reporting requirement could help address current data limitations that complicate efforts to better understand the potential for discrimination in nonmortgage lending, but such a requirement would also impose additional costs on lenders that could be partially passed on to borrowers. Finally, FRB provided technical comments on a draft of the report, which we incorporated into this report as appropriate. We also provided a draft of this report to FDIC, OCC, and OTS, which provided technical comments that we have incorporated in this report as appropriate. In addition, we requested comments on selected excerpts of a draft of this report from 12 researchers whose studies we cited. We received technical comments from 5 of the 12 researchers and incorporated their comments into this report as appropriate. The remaining 7 did not respond to our request.

**Background**

ECOA prohibits discrimination in any type of credit decision based on an applicant’s race, color, gender, national origin, religion, marital status, or age. Through Regulation B, FRB has established various requirements to ensure and monitor lender compliance with ECOA, including the general prohibition against collecting or noting data on the personal characteristics of applicants for most nonmortgage loans. Additionally, Regulation B establishes procedures for lenders’ evaluations of credit
applications to ensure that such evaluations are not done in an unlawfully discriminatory manner.\textsuperscript{11}

While Regulation B imposes a general prohibition on collecting data on personal characteristics for nonmortgage loan applicants, FRB, in 2003, expanded its exceptions to this prohibition by permitting the collection of data on race, color, gender, national origin, religion, marital status, and age in connection with a self-test.\textsuperscript{12} A self-test is any program, practice, or study that is designed and used by creditors to determine the effectiveness of the creditor’s compliance with ECOA and Regulation B and that creates data or factual information that is not available and cannot be derived from loan or application files or other records related to credit transactions.\textsuperscript{13} The results of a self-test are privileged—that is, they cannot be obtained by any government agency in an examination or investigation in any lawsuit alleging a violation of ECOA. However, the methodology used or the scope of the test and the time period covered by the test are not privileged.

Although Regulation B prohibits creditors, except in limited circumstances such as conducting a self-test, from collecting data on personal characteristics with respect to nonmortgage loan applicants, creditors are required to collect such data for mortgage loan applicants. In 1976, FRB amended Regulation B to implement a compliance monitoring program that required lenders to request that applicants for residential mortgages provide information on their national origin or race, marital status, sex, and age.\textsuperscript{14} The amendment was adopted because, at the time, there were specific concerns about unlawful discrimination with respect to mortgage lending. In 1989, HMDA was amended to require certain financial institutions to collect and publicly report information on the racial

\textsuperscript{11}Regulation B also establishes procedures that lenders are to follow in providing notice to loan applicants that their applications for credit have been denied. See 12 C.F.R. § 202.9 (2008).

\textsuperscript{12}Other exceptions to the general prohibition on personal characteristic inquiries include inquiries about the marital status and gender of an applicant for securities credit or incidental credit. See 12 C.F.R. § 202.5 (2008).


\textsuperscript{14}Creditors were not required to note such information if the applicant declined to provide it. The amendment followed 1976 statutory amendments to expand ECOA to prohibit discrimination based on race, color, religion, national origin, age, gender, marital status, the receipt of public assistance, and the exercise of rights under the Consumer Credit Protection Credit Act. See Pub. L. No. 94-239, 90 Stat. 251 (Mar. 23, 1976).
characteristics, gender, and income level of mortgage loan applicants. In 2002, FRB, pursuant to its regulatory authority under HMDA, required financial institutions to report certain mortgage loan pricing data in response to concerns that minority and other targeted groups were being charged excessively high interest rates for mortgage loans. Specifically, lenders were required to collect and disclose information about mortgages with annual percentage rates above certain designated thresholds.

Federal Oversight of ECOA

Authority for enforcing compliance with ECOA with respect to depository institutions, such as Federal Reserve System member banks, national banks, state-chartered banks, saving associations, and credit unions, lies with the five federal banking regulators—FRB, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA). Other agencies with enforcement authority under ECOA with respect to certain nondepository institutions include, among others, the Securities and Exchange Commission (for broker dealers), the Small Business Administration (for small business investment companies), and the Farm Credit Administration (for federal land banks, federal land bank associations, federal intermediate credit banks, and production credit associations). To the extent that ECOA does not assign to another federal agency responsibility for enforcing compliance with respect to a particular creditor, the Federal Trade Commission (FTC) has enforcement authority for such creditors. For example, FTC generally is responsible for ensuring compliance with ECOA by retailers, finance companies, and mortgage companies. ECOA requires federal regulators to refer matters to the Department of Justice (DOJ) when there is reason to believe that a lender is engaging in a pattern or practice of discouraging or denying applications for credit in violation of the act.

The five banking regulators may carry out their ECOA and other fair lending enforcement responsibilities with respect to depository institutions through periodic examinations to assess their loan underwriting guidelines and credit decisions to detect possible discrimination in both mortgage and nonmortgage lending. Following the

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15The data collection and reporting requirements apply to depository lending institutions and nondepository mortgage lending institutions that satisfy specific asset thresholds and meet other criteria set forth in 12 C.F.R. § 203.2(e) (2008).
Interagency Fair Lending Examination Procedures, examiners from the five federal banking regulators are to (1) evaluate the institution’s overall fair lending compliance program, including management commitment and resources devoted to preventing violations, and (2) determine if the institution has, in fact, violated the fair lending laws by, among other tasks, reviewing lending policies and practices and testing the institution’s actual lending record for specific types of discrimination, such as underwriting discrimination in consumer and business loans or pricing discrimination in mortgage or automobile lending.

FRB’s Survey of Small Business Finances

FRB’s SSBF is one of the principal sources of information available on the factors that affect the availability of credit for small businesses. FRB has conducted the SSBF about every 5 years from 1987 through 2003 from a nationwide sample of small businesses of varying sizes, locations, and ownership characteristics. The most recent survey (2003) gathered data from 4,240 firms that were selected to be representative of small businesses in the United States. (i.e., firms with fewer than 500 employees). Through interviews, the firms answered questions about how they applied for and obtained credit, and characteristics of their businesses in addition to the race and gender of their owners. In 2007, FRB decided to discontinue the SSBF due to its cost and other considerations. However, FRB plans to include elements of the SSBF in another survey, the Survey of Consumer Finances (SCF), starting in 2010.

The limited number of studies on nonmortgage lending that met our criteria for selection focused primarily on the small business sector, largely because there is data available on this type of lending from FRB’s SSBF. While these studies suggest that discrimination may play a role in small business lending, SSBF data also have certain limitations as a research tool. For example, SSBF data are collected from small business borrowers rather than lenders, which means that SSBF data cannot be used to assess the small business lending practices of individual lenders or the lending industry. The few studies we identified that addressed possible discrimination in automobile and credit card lending relied on a data source that had certain limitations similar to those of the SSBF data. In contrast, studies on possible discrimination in mortgage lending often use HMDA data, which among their research advantages, are collected directly from a large population of lenders that make mortgage loans. Staff from federal bank regulatory agencies also said that HMDA data allowed them to identify regulated lenders that might be at high risk of engaging in possible mortgage lending discrimination and thereby to better prioritize...
fair lending law examination and investigative processes. In the absence of similar data on personal characteristics for nonmortgage loans, regulators may rely on more time-consuming and possibly unreliable techniques to conduct oversight, potentially impeding the relative efficiency of the fair lending examination process for nonmortgage loans.

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

In a previous report, we summarized available studies and research that address the challenges that minority- and women-owned businesses might face in raising debt and equity capital. This research suggests that a variety of business characteristics may make lenders reluctant to provide credit to such businesses due to the perceived risks involved in doing so. In summary, this research concluded that minority- and women-owned businesses could face challenges in raising debt and other financing because they were (1) primarily concentrated in the service and retail sectors rather than capital intensive sectors (i.e., manufacturing) and, thus, might have difficulties pledging collateral; (2) frequently new businesses with limited credit histories; and (3) on average, relatively small and often lack managerial and technical expertise.

Nevertheless, a majority of available research we reviewed on minority business lending also suggested that discrimination might play a role in lending patterns when comparing certain minority-owned businesses with white-owned businesses. Primarily using data obtained from FRB's SSBF, all eight studies we identified on minority business lending generally found that lenders denied loans to minority-owned businesses (seven of the eight specifically refer to African-American-owned businesses) or required them to pay higher interest rates for loans significantly more often than white-owned small businesses. These findings remained generally consistent after considering a variety of risk factors, such as borrower creditworthiness, industry sector, and firm size. In addition, studies have also found that Hispanic-owned businesses were denied credit or charged higher interest rates more often when compared with white-owned businesses with similar risk characteristics. On the other hand, some studies we reviewed did not identify evidence that women-owned


17See GAO-06-617.
businesses face credit denials or higher rates significantly more often than male, white-owned businesses.

Two of the studies that we reviewed illustrate researchers’ analysis with respect to possible discrimination in small business lending.¹⁸ Using 1998 SSBF data, the two studies found that African-American-owned businesses were about twice as likely to be denied credit as white-owned businesses. The studies analyzed a variety of factors that might help explain such differences, such as the applicants’ credit scores, personal wealth (such wealth can serve as collateral for business loans), history of bankruptcy, and the timeliness of business obligations payments over several years. In addition, the studies controlled for firm characteristics such as business location, industry, assets, and profits. Even after controlling for these factors, the studies could not rule out discrimination as a possible explanation for differences in loan denial rates.

While studies using SSBF data have provided important insights into possible discrimination in small business lending, researchers and FRB officials also said the data had the following certain limitations as a research tool:

- **SSBF data are collected from individual small business borrowers rather than lenders, which limit their analytical value.**¹⁹ For example, SSBF data do not allow researchers to assess the overall small business lending underwriting standards and practices of the particular lenders with whom individual survey respondents may be doing business. Further, the SSBF data do not allow researchers to assess lenders’ performance by type of institution, by size, or by geographic or metropolitan region.

- **SSBF survey data are self-reported and are not verified by FRB.** For example, FRB relies upon survey respondents to accurately report their race, gender, and other characteristics, as well as requested information on their business and their financing. The timing of the SSBF survey may


¹⁹It should be noted that data collected from borrowers can have distinct advantages. For example, survey respondents would know better than lenders whether they had been discouraged from applying for credit and could more accurately describe their race or gender.
also call into question the reliability of reported data. For example, the survey may be conducted long after the survey respondent applied for credit, increasing the risk that respondents may not accurately recall and report information from the time when the credit decision was made.

- FRB conducts the SSBF about every 5 years rather than annually and, therefore, the survey results may not be timely. To illustrate, most of the studies that we reviewed were based on surveys conducted in 1993 and 1998. As a result, the majority of available research on possible discrimination in nonmortgage lending is based on data that are about 10 years old. Researchers and FRB officials that we spoke with said it may also take FRB a significant period of time to review and process the SSBF data prior to releasing it to the public. For example, FRB did not release the 2003 survey data until November 2006, and we identified and reviewed only one study that was based on a preliminary analysis of the 2003 data.

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

Despite these advantages, we note that analyses of HMDA data as a basis for conducting research on possible discrimination in mortgage lending have been subject to criticism. In particular, HMDA data have been criticized for not including key loan underwriting variables, such as the borrowers’ credit scores or mortgages’ loan-to-value ratios. Some critics of HMDA studies argue that many apparent discrepancies between minority and white mortgage borrowers can be accounted for by including other underwriting variables in the analysis. While FRB required lenders to

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include in reported HMDA data information for certain high-interest rate mortgages starting in 2004, the data have still been criticized for not providing a comprehensive basis for understanding mortgage lending practices.\footnote{21} To compensate for the lack of underwriting variables in the HMDA data, several researchers have collected such data from proprietary sources and match it with HMDA data.\footnote{22}

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

We identified only one study meeting our criteria for selection that specifically addressed possible discrimination in automobile lending.\footnote{23} According to this study, approximately 40 percent of minority households with high credit ratings paid relatively high interest rates for new car loans as compared with nonminority households with similar credit scores and financial wealth. The study concluded that racial discrimination could play a role in these differences between minority and white automobile loan borrowers.

This study relied on data from FRB’s SCF, which has some limitations that are similar to those of the SSBF. The SCF asks a nationwide sample of about 4,500 U.S. consumers to provide detailed information on finances of their families, and on their relationships with financial institutions. While

\footnote{21}{In February 2002, FRB adopted amendments to HMDA Regulation C to require lenders to include in HMDA reports data regarding loan pricing (the rate spread annual percentage rate on a loan and the yield comparable Department of the Treasury securities) for loan originations in which the annual percentage rate exceeded the Treasury yield by a threshold amount set by FRB. See Home Mortgage Disclosure, 67 Fed. Reg. 7222 (Feb. 15, 2002) (final rule). The proposed thresholds set by FRB in February 2002—a spread of 3 percentage points for first-lien loans and 5 percentage points for subordinate-lien loans—were adopted in June of that year. See 67 Fed. Reg. 43218 (June 27, 2002). At that same time, FRB also amended Regulation C to require lenders to report the lien status of applications and originated loans.}


the SCF is conducted every 3 years and allows researchers to consider a range of variables on personal characteristics and loan underwriting factors in conducting their analysis, it is also collected from borrowers rather than lenders. Therefore, SCF data, like SSBF data, cannot be used as a basis for assessing individual lenders’ lending practices or lending practices industrywide (i.e., by type of institution, size of institution, or geographic or metropolitan area). FRB also relies on SCF respondents to provide accurate information about their personal characteristics and finances.

We note that a number of lawsuits involving allegations of discrimination in automobile lending have been settled in recent years. According to a 2006 study there had been a series of class action lawsuits filed against several large automobile dealers and lenders alleging that minority consumers—African Americans and Hispanics in particular—had systematically been charged a higher markup, or interest rate, on auto loans than white borrowers. According to the study, all of the cases were eventually settled by the litigants, with one automobile lender agreeing to pay individual cash amounts to the plaintiffs and make changes in its business practices. Further, in 2007, DOJ announced the filing of complaints and consent orders against two automobile dealerships and one bank, in each case alleging that the lenders engaged in a practice of discriminating on the basis of race (in the case of the automobile dealers) or marital status (in the case of the bank) in violation of ECOA, by charging them higher interest rates than other similarly situated applicants. In all three consent orders, the defendants agreed to pay monetary damages to remedy the allegations of discrimination.

The two studies we identified that also relied on SCF data had mixed results with respect to possible discrimination in credit card lending. One study found that minorities were likely to pay higher interest rates on

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25A consent order is the resolution of a civil action in the form of a contractual agreement between the parties to the litigation that is sanctioned by the court and in which the opposing party (in this case the defendant named in DOJ’s civil enforcement action) agrees to undertake certain remedial actions without admitting any liability with respect to the allegations in the complaint filed against it.
credit card debt than white credit card holders even after considering the payment history and financial wealth of each group. Another study did not find that minority credit card holders paid higher interest rates as compared with white credit card holders after controlling for creditworthiness factors. These studies showed the strength of the SCF as a data source (e.g., the ability to consider data on personal characteristics and loan underwriting factors), as well as its limitations (e.g., the data are collected from borrowers rather than lenders).

Representatives from the four federal bank regulatory agencies we contacted (FRB, OCC, FDIC, and OTS) said that the availability of HMDA data had facilitated the fair lending law examination process. In particular, agency staff said that the analysis of HMDA data provided insights into lenders that might be at high risk of engaging in potentially discriminatory practices in mortgage lending. For example, the consistency of HMDA data allows examiners to investigate whether a particular lender denies a relatively high number of mortgage loan applications from minority borrowers or may be charging relatively higher interest rates compared with similarly sized lenders in the same geographic or metropolitan area. While agency staff said that HMDA data were only a first start in the investigative process (because they must evaluate a range of underwriting criteria and practices that may help explain disparities in a lender’s mortgage lending patterns), HMDA data allowed them to prioritize their examination resources.

In the absence of similar race, gender, and other data on personal characteristics for nonmortgage loan applicants, regulators may rely on time-consuming and possibly unreliable techniques to assess lenders’ compliance with fair lending laws. Under the *Interagency Fair Lending Examination Procedures*, examiners can use established “surrogates” to make educated guesses as to the personal characteristics, such as race or gender of nonmortgage loan applicants to help determine whether the lenders they regulate are complying with established laws and regulations in extending credit to minority and other individuals targeted for loan applicants. For example, examination guidance allows examiners, after

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

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26 Getter, “Consumer Credit Risk and Pricing.”

consulting with their agency’s supervisory staff, to assume that an applicant is Hispanic based on the last name, female based on the first name, or likely to be an African American based on the census tract of the address. While these techniques may help identify the racial or gender characteristics of loan applicants, they have potential for error (e.g., certain first names are gender neutral, and not all residents of particular census tract may actually be African-American).

As a result of the limitations of the data on personal characteristics for nonmortgage loan applicants, as well as regulatory guidance directing examiners to consider using surrogates, federal oversight of lenders’ fair lending law compliance in this area may be less efficient than it is for mortgage lending. According to a comment letter submitted by a Federal Reserve Bank to FRB as it considered amending Regulation B from 1999 to 2003, its examiners were unable to conduct thorough fair lending examinations or review consumer complaints alleging discrimination for nonmortgage products due to the lack of available data. Moreover, our reviews of agency fair lending examination guidance and discussions with some agency staff suggest that, due in part to HMDA data availability, agencies focus most of their resources on possible discrimination in mortgage lending rather than nonmortgage lending. We plan to further explore the issue of fair lending enforcement in future work, including the impact of potential data limitations on regulatory agencies’ oversight and enforcement of the fair lending laws for mortgage and nonmortgage lending.

FRB concluded in 2003 that lifting Regulation B’s general prohibition and permitting voluntary collection of data on personal characteristic data for nonmortgage loan applicants, without any limitations or standards, could create some risk of discrimination and that such data would not be reliable. While some researchers, regulatory agency staff, and banking officials agreed with FRB that the voluntarily collected data could create the potential that it would be used for discriminatory purposes, many other researchers, regulatory staff, and representatives from consumer groups expressed skepticism about this argument. For example, some researchers said that data collection by itself would not necessarily mean the information would be used to discriminate because in many cases—such as small business lending—lenders may already be aware of an applicant’s personal characteristics because such lending is often done on a face-to-face basis. Even so, a range of researchers, regulatory staff, and representatives from both consumer and banking groups we contacted generally concurred with FRB that voluntarily collected data might not be
useful or reliable and that very few banks would choose to collect it. Consequently, the benefits of permitting lenders to voluntarily collect data on personal characteristics as a means for researchers, regulators, and others to better understand possible discrimination in nonmortgage lending would likely be limited.

FRB Concluded That Permitting Data Collection without Standards Could Create Some Risk That the Data Would Be Used for Discriminatory Purposes and Result in Data of Questionable Reliability

The FRB concluded in its 2003 final rule that the general prohibition under Regulation B’s long-standing prohibition should largely be retained after considering a proposal that would have permitted lenders to voluntarily collect data on personal characteristics, such as race and gender, for nonmortgage loan applicants without restrictions or uniform standards. FRB’s conclusion largely relied on staff analysis, including a review of more than 600 public comment letters. Moreover, FRB held periodic meetings (in 1999 and 2002) with its Consumer Advisory Council—a group of representatives from consumer groups and banking institutions—to discuss the benefits and costs of amending Regulation B. An FRB official also said that the staff consulted FRB board members and fair lending examiners to gather their views on permitting lenders to voluntarily collect data on personal characteristics for nonmortgage loan applicants.

Upon completing this analysis, FRB concluded that amending Regulation B to permit voluntary data collection, without restrictions or standards, could create some risk that the information would be used for discriminatory purposes. For example, under such permissive circumstances, FRB concluded that a lender might selectively note nonmortgage loan applicants’ personal characteristics, including their race or gender, and use such data as a basis for unlawful lending discrimination. By retaining Regulation B’s data collection prohibition, FRB essentially reaffirmed its original view of the prohibition when it was adopted in 1976. That is, possible discrimination is mitigated if lenders are not permitted to collect data on personal characteristics.

28The Consumer Advisory Council, established in 1976, advises the FRB on the exercise of its responsibilities under the Consumer Credit Protection Act and on other matters in the area of consumer financial services. 15 U.S.C. § 1691b(b). The council membership represents interests of consumers, communities, and the finance services industry. Members are appointed by the Board of Governors and serve staggered 3-year terms. The council meets three times a year in Washington, D.C., and the meetings are open to the public.
FRB also concluded that voluntarily collected data on personal characteristics for nonmortgage loan applicants would be of questionable reliability. According to an FRB official, in the absence of data collection standards, lenders could use different approaches to collecting data. For example, they could collect the data within different time frames, for different loan products and, in the case of business lending, using their own definitions of what constitutes a minority business versus nonminority business. Lenders would also have the opportunity to stop collecting data whenever they decided that it was not advantageous to do so. Consequently, regulators would not be in a position to use such voluntarily collected data, as is currently possible with HMDA data for mortgage lending, to compare a lender’s nonmortgage lending practices with those of its peers or to conduct further analysis as appropriate to follow up on evidence of possible discriminatory practices.

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

Some researchers, staff from a bank regulatory agency, and representatives from banking and business trade groups we contacted generally agreed with FRB that permitting voluntary data collection on personal characteristics, such as race and gender, could create a risk that the information would be used for discriminatory purposes relative to prohibiting data collection. Because ECOA prohibits the use of personal characteristics, such as race and gender, as criteria to make lending decisions, these officials told us that the best way to protect borrowers against discrimination is to minimize the availability of information about their personal characteristics. In addition, according to FRB’s analysis, as well as our own analyses of the comment letters that FRB received in 1999 for the proposed rule, some commenters, mostly from the banking industry, shared this view.

However, many other researchers, staff from some regulatory agencies, and officials from consumer groups expressed skepticism that voluntarily collected data on personal characteristics would create a risk of discrimination. First, a staff member from a regulatory agency, several researchers, and representatives from consumer groups said that in certain cases lenders were already aware of the race and gender or other information on personal characteristics of nonmortgage loan applicants. For example, three researchers said that, in the case of small business lending, lending officials already were aware of the race and gender of loan applicants because such lending was typically done on a face-to-face basis. Therefore, simply collecting data on personal characteristics on applicants in such cases would not necessarily create a risk of discrimination. Other researchers and officials from banking institutions
disagreed. They noted that in some cases lending decisions may be made by officials who do not interact directly with loan applicants. Further, for other types of lending, such as credit card lending, the data collection prohibition may mitigate the risk of possible discrimination. An FRB official said that lenders largely offer credit cards through the mail and thus do not have specific access to the race and gender of their customers and potential customers.

Second, lenders’ voluntary collection and use of data on personal characteristics for nonmortgage loan applicants outside of the ECOA self-test privilege, would also be subject to varying degrees of regulatory scrutiny and potentially litigation, which could serve to deter lenders from using such data for discriminatory purposes. For example, according to an FRB representative, federal bank regulators would be in a position to evaluate federally regulated lenders’ collection and use of data on personal characteristics through the fair lending law examination and oversight process. Further, all lenders that chose to collect and use such data for discriminatory purposes, would face the risk of public disclosure of such practices through litigation. While FRB’s 2003 final rule is silent on the potential deterrent effect of regulatory and public scrutiny in deterring lenders from using data on personal characteristics for discriminatory purposes, available evidence regarding HMDA suggests that it may be significant. According to a variety of regulatory staff, researchers, and other officials we contacted, as well as FRB documents we reviewed, there is no evidence that lenders have used HMDA data for discriminatory purposes. These officials generally attributed the transparency of the HMDA program, through regulatory reviews and public reporting requirements, as serving to help deter lenders from using the data to discriminate in mortgage lending.

Finally, FRB could potentially have mitigated some of its concerns that voluntarily collected data could be used for discriminatory purposes by including as part of its 1999 proposal minimum procedures for the collection and use of such data. FRB established such minimum procedures for federally regulated lenders that choose to conduct a self-test and avail themselves of the nondisclosure privilege. These procedures

29We recognize that there are differences between the level of transparency between HMDA’s data collection and reporting requirements and the voluntary data collection proposal that FRB considered in 1999 for nonmortgage loan applicants. In particular, FRB did not propose that lenders who chose to collect such data report it to the public whereas lenders are required to report HMDA data.
include developing written policies describing the methodology for data collection and keeping data on personal characteristics separate from loan underwriting data (e.g., credit scores) that are used to make credit decisions. Imposing such minimum procedures and requirements for a voluntary program could serve to enhance regulators’ oversight of lenders’ data collection, processes, practices, and uses of the data, and further deter possibly discriminatory practices.

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

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

Just as FRB could potentially have mitigated some if its concerns about the possibility that lenders would use voluntarily collected data for discriminatory purposes by adopting minimum procedures, as mentioned previously, we note that it could also potentially have considered adopting data collection standards. Such standards could have served to better ensure the consistency of the data and enabled regulators and others to use the data to assess individual lender performance and compare lending practices across different financial institutions. However, according to a senior FRB official, a researcher, and a bank industry trade association official, the imposition of such standards would have undermined the voluntary nature of the data collection proposal. For example, FRB would be required to conduct examinations to help ensure that federally regulated lenders were collecting the data in a manner consistent with any such standards.

Moreover, the establishment of such data collection standards might also have further diminished lender interest in a voluntary program, which researchers, FRB officials, and others said was likely limited due to the
potential for increased regulatory and public scrutiny of their lending practices. An apparent lack of interest by lenders in conducting ECOA compliance tests under the self-test privilege of Regulation B provides support for the contention that few lenders would choose to collect data on personal characteristics on a voluntary basis even if permitted to do so. Federal bank regulators generally said that very few, if any, lenders used the self-test to assess their compliance with ECOA; nor were any of the banking trade associations aware of any such institutions. Bank representatives we contacted, as well as some of the comment letters submitted by banking institutions, indicated that they still believed there was a potential for regulators and the public to gain access to self-test results, even with the self-test privilege. Lenders’ apparent reluctance to collect data under the self-test privilege—which affords lenders protection from being compelled to disclose such data to regulators—suggests that they would be even less likely to collect such data under a general voluntary data collection program, such as the one that FRB considered in 1999, given that such data would be subject to regulatory scrutiny and potential litigation.

While a staff member from a regulatory agency, a researcher, and representatives from some consumer groups we spoke with, as well as our analysis of the comment letters, indicated that any data that were collected and potentially reported would provide insights into nonmortgage lending practices that were not currently available, researchers and other comment letters we reviewed indicated that such data would be prone to substantial selection bias. That is, the data would likely be skewed by the possibility that only lenders with good fair lending compliance records would choose to collect such data. Conversely, it is unlikely that lenders with weak fair lending compliance programs would voluntarily collect data that might confirm fair lending violations. Consequently, although voluntarily collected data on personal characteristics could provide some additional insights into lending practices than currently available data provide, it would not likely materially assist the capacity of researchers, regulators, and others to better understand possible discrimination in nonmortgage lending.

Our review of research standards confirms that selection bias can be a limitation for voluntarily collected data and may affect the reliability and usefulness of such data. Specifically, estimates made from data collection based on a self-selected sample may be at risk of significant bias because those who choose to participate may differ from those who do not.
In concept, a requirement that lenders collect and publicly report data on the personal characteristics of nonmortgage loan applicants, similar to HMDA requirements, could help address some of the existing data limitations that complicate efforts by researchers, federal bank regulators, and others to identify possible discrimination. However, mandatory data collection and reporting would impose some additional costs on the lending industry, although opinions differed on how burdensome these costs might be. While options exist to potentially mitigate some of these costs, such as limiting data collection and reporting to specific business types, these options also involve additional complexities and costs that must be considered.

Required data collection and reporting for nonmortgage loan applicants, similar to HMDA's requirements, could help address some of the existing limitations of available data. For example, researchers would be able to analyze the practices of specific lenders and compare practices across lenders, assessing lending practices by type, size, and location of the institutions, similar to analyses done currently with HMDA data. Such data would also be more timely than SSBF data, and the implementation of data collection standards could help ensure its reliability. As a result, the availability of such data could also better inform Congress, regulators, and the public about possible discrimination in nonmortgage lending.

Such a requirement on personal characteristics collection and reporting could also facilitate the efficiency of the fair lending examination process for nonmortgage lending. As is currently the case with fair lending examinations for mortgage lending due to the availability of HMDA data, bank examiners could potentially use data on personal characteristics that were collected from lenders to focus the examination process on those lenders they regulate that appeared to show the highest risk of engaging in potentially discriminatory practices. Further, examiners could use such data to compare practices across lenders to identify possibly discriminatory practices. While such analyses would represent only the first step in determining whether or not particular lenders were engaging in discriminatory practices, they could potentially help regulators...
prioritize their examinations and better utilize existing staff and other resources.

While it is not possible to quantify the potential costs associated with a reporting requirement, in part because the requirements could vary, banking organizations and banks that we contacted identified a variety of additional costs that lenders might face. These officials also said that they were concerned about such costs and that the additional expenses associated with data collection and reporting would, in part, be passed on to borrowers. According to the officials, most of the costs associated with a reporting requirement would involve developing the information technology necessary to capture and report the data, including system integration, software development, and employee training. Moreover, the officials said that, as with HMDA data, verifying any reported data would also entail costs, including expenses associated with conducting internal audits. The regulatory agency responsible for assembling, verifying, and reporting the data to the public would also accrue costs for these activities.\footnote{According to FRB officials, it will cost the agency approximately $3.5 million to process the 2008 HMDA data.}

Some researchers and representatives from consumer groups we contacted said that they did not think that the costs associated with required collection and reporting of data on personal characteristics of nonmortgage loan applicants would be significant. They pointed out that because many lenders already collect and report data on personal characteristics under HMDA, it should not be prohibitively expensive for them to collect similar data for nonmortgage applicants. But other representatives from banks and banking organizations along with one researcher said that in many cases mortgage and nonmortgage lending information systems and personnel were not integrated. For example, mortgage and nonmortgage lending might be conducted within different subsidiaries of a single financial conglomerate. For this reason, they reiterated that a new data collection and reporting requirement for nonmortgage lending would involve additional system integration and employee training costs, among other things.
Limiting a Data Collection and Reporting Requirement to Specific Types of Nonmortgage Loans Would Also Have Benefits and Costs

One potential option to mitigate the costs associated with a requirement that regulated lenders collect and report data on the personal characteristics of those seeking nonmortgage loans would be to limit the requirement to certain types of loans, such as small business and/or automobile loans. As discussed previously, available research suggests that the potential for discrimination exists in both types of lending, and a data collection and reporting requirement would help in better understanding this issue than is possible with current data. Similar to mortgage loan applications, moreover, small business and automobile loan applications are often made on a face-to-face basis. Therefore, lenders would be in a position to record such information themselves based on visual observation, if applicants choose not to provide such data, as is currently required under the regulations implementing HMDA for loan applications made in-person. In contrast, lenders’ capacity to record data on personal characteristics for other types of nonmortgage applicants, such as applicants for credit card loans, may be limited by the fact that credit card loan applications and credit decisions are typically done by mail or over the Internet. As a result, limiting a data collection and reporting requirement to either small business or automobile lending, or both could focus attention on areas that appear to be at risk of discriminatory practices and potentially offset some of the costs to lenders associated with a broader requirement.

However, researchers, federal bank regulatory staff responsible for fair lending oversight, banking officials, and representatives from some consumer groups we contacted cautioned that there were still significant complexities and potential costs associated with a data collection and reporting requirement that was limited to small business lending. Unlike mortgage and automobile lending, which have relatively uniform underwriting criteria, these officials said that small business loan underwriting is heterogeneous and more complex. For example, while mortgage lending has become more complicated in recent years, the type of financing that applicants seek in order to buy homes is often more standardized (e.g., 30-year fixed rate loans or variable rate products) and the collateral securing mortgages, generally single-family residences, is well understood and generally more marketable. In contrast, the types of financing that small business typically seek can vary widely, ranging from revolving lines of credit to term loans, and the risk of the collateral pledged against loans may vary widely (i.e., from relatively secure real

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As discussed previously, moreover, studies on possible discrimination in small business lending that use SSBF data, consider a variety of other indicators of creditworthiness, such as applicants’ credit scores, personal wealth, and history of bankruptcy. Consequently, the officials said that lenders would have to collect and report significant additional information on a range of underwriting standards and data for small business lending in order to make the data on personal characteristics useful so that examiners, researchers, Congress, and others are in a better position to determine whether a particular lender’s practices may involve discrimination or not. Without the key underwriting variables, the officials said, research based on the reported data could be subject to significant controversy and potential misinterpretation, much like research based on HMDA data, which lack information on these variables. At the same time, costs for the necessary technology, employee training, and data verification would likely increase as the range of data that lenders were required to collect and report increases.

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

Assessing the potential for discrimination in nonmortgage lending is an important and complex issue. While current data sources, primarily FRB’s SSBF and SCF provide important insights into possible discrimination in certain types of lending, they both have limitations that may impede the
ability of researchers, regulators, Congress, and the public to further assess lender compliance with the fair lending laws. It is also not yet clear how FRB’s decision to discontinue the SSBF and incorporate elements of the survey into an expanded SCF beginning in 2010 will impact the already limited state of information about possible discrimination in nonmortgage lending. Therefore, from a public policy perspective, considering the trade-offs of various options to enhance available data, from a purely voluntary program to a data collection and reporting requirement, may be warranted.

Agency Comments and Our Evaluation

We provided a copy of a draft of this report to the Chairman of FRB, and the Director of the Division of Consumer and Community Affairs provided written comments that are reprinted in appendix II. In its written comments, FRB did not take a position on our analyses but restated one of its 2003 rationales for retaining Regulation B’s general prohibition on collecting data on personal characteristics for nonmortgage loan applicants. That is, FRB concluded that permitting voluntary data collection would not produce reliable or useful market-wide data. Moreover, FRB also summarized the draft report’s analysis that, while there was not full agreement among those that we contacted with all aspects of the FRB’s rationale for retaining the prohibition, there was widespread agreement that such voluntary data would have limited benefits. FRB also restated the draft report’s analysis that a data collection and reporting requirement could help address current data limitations and might enhance regulators’ ability to detect discriminatory practices. However, such a requirement would impose additional costs on lenders that could be partially passed along to borrowers. We note in the report that, from a public policy perspective, considering the trade-offs associated with various options to enhance available data on potential discrimination may be warranted. Finally, FRB provided technical comments on a draft of the report, which we incorporated as appropriate. We also sent a draft of this report to FDIC, OCC, and OTS, which provided technical comments that we incorporated into this report as appropriate. In addition, we requested comments on selected excerpts of a draft of this report from 12 researchers whose studies we cited. We received technical comments from 5 of the 12 researchers and incorporated their comments into this report as appropriate. The remaining 7 did not respond to our request.
As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies of this report to the Ranking Member of the Committee on Financial Services, House of Representatives; Chairman and Ranking Member of the Committee on Banking, Housing, and Urban Affairs, U.S. Senate; and other interested congressional committees. We are also sending copies to the Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Comptroller of the Currency, Office of the Comptroller of the Currency; Director, Office of Thrift Supervision; and other interested parties. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions regarding this report, please contact me at (202) 512-8678 or williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III.

Orice M. Williams
Director, Financial Markets and
Community Investment
Appendix I: Objectives, Scope, and Methodology

The objectives of our report were to discuss (1) available research on possible discrimination in nonmortgage lending and review the strengths and limitations of the data that researchers and regulators use to detect possible discrimination; (2) analyze the Federal Reserve Board’s (FRB) basis for largely retaining Regulation B’s prohibition against the voluntary collection of racial and gender data in 2003; and (3) assess the potential benefits and costs of requiring lenders to both collect and publicly report racial and gender data for nonmortgage loan applicants, as well as options to mitigate such costs.

To address objective one, we conducted a literature review to identify articles and studies using nationally recognized surveys or quantitative data, which examine the possibility of discrimination in nonmortgage lending (i.e., business loans, automobile loans, and credit card loans). We identified and selected a population of literature by searching electronic databases, using research from our past reports, and referrals from interviews with published researchers, federal government officials, and representatives from business and consumer, trade, industry and advocacy associations. We also performed a more limited review of literature on the possibility of discrimination in mortgage lending and assessed the strengths and weaknesses of data on personal characteristics that lenders are required to collect and report under the Home Mortgage Disclosure Act (HMDA) of 1975, as amended.

The majority of studies we reviewed focused on small businesses lending and used data from FRB’s Survey of Small Business Finances (SSBF). We conducted analysis to assess the strengths and weaknesses of SSBF as a data source by reviewing documents on the survey’s purpose, use, and limitations, and discussing the survey with researchers including FRB officials and compared SSBF data with HMDA data. We also (1) conducted a similar analysis regarding FRB’s Survey of Consumer Finances (SCF), which has been used to conduct studies on the potential for discrimination in automobile and credit card lending, and (2) reviewed publicly available information on litigation involving possible discrimination in automobile lending.

We also conducted interviews with a range of researchers, federal financial regulators and agencies, as well as consumer, business and banking trade groups, and lenders. We interviewed seven researchers who have published relevant works using statistical techniques to understand the extent to which possible discrimination may occur in nonmortgage lending. We selected researchers to interview based on the relevance of their published studies, widespread recognition in their professional
community, related experience, recommendations from peers, and their ability to represent a broad range of available perspectives. We also interviewed fair lending examiners, specialists, supervisors, directors, researchers, and counsel from four federal bank regulatory agencies, which are FRB, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision. In addition, we met with officials from the Small Business Administration (SBA), SBA’s independent Office of Advocacy, and the Department of Commerce’s Minority Business Development Agency to gather information regarding Objectives 1 and 3 for business lending.\(^1\) We conducted interviews with officials from nine lenders across the nation—both large and small—and banking industry representative organizations, including the American Bankers Association, Consumers Bankers Association, and Independent Community Bankers of America. We also interviewed officials from consumer, trade, industry and advocacy organizations including those that represent minority-owned and women-owned businesses such as the National Black Chamber of Commerce, Pan Asian American Chamber of Commerce, U.S. Hispanic Chamber of Commerce, Women’s Chamber of Commerce, National Association of Women’s Business Owners, and the Center for Women’s Business Research.

Further, we reviewed federal financial regulators’ examination procedures from the *Interagency Fair Lending Examination Procedures*, data from some of the regulators regarding complaints alleging possible discrimination by type of nonmortgage lending (e.g., small business or credit card), and the U.S. Department of Justice Annual Report to Congress Pursuant to the Equal Opportunity Credit Act Amendments of 1976 (April 2008) for the number of fair lending referrals from regulators regarding potential ECOA claims that DOJ had received in 2007.

To address Objective 2, we reviewed relevant FRB studies, proposed rulings, final rulings, meeting notes from its Consumer Advisory Council, congressional testimony, correspondence, a sample from the 600 plus comment letters that FRB received in 1999, and other internal documents assessing the 1999 proposal to amend Regulation B and permit lenders to collect data on personal characteristics for nonmortgage loan applicants on a voluntary basis. Additionally, we interviewed researchers who have assessed the potential for discrimination in nonmortgage lending and

\(^1\)The SBA’s Office of Advocacy works independently within the agency to advance the interests of small businesses within the federal government.
banking and representatives from business trade groups, banks, consumer groups, and groups that represent minority- and women-owned businesses representatives. We asked these researchers and officials to provide their views on FRB’s 2003 rationale for largely retaining Regulation B’s prohibition against collecting data on personal characteristics for nonmortgage lending except, as is discussed in the report, for the purposes of conducting a self-test for compliance with the Equal Credit Opportunity Act. We also asked researchers and officials their views on the extent to which, if at all, HMDA may have created a risk for discrimination in mortgage lending. We compared the reliability of voluntary data collection to the general data reliability standards that we and others have established.

To supplement our analysis of FRB’s 1999 proposed amendment to Regulation B, we conducted an independent review of the 600 public plus comment letters. To do so, we conducted an independent content analysis of a statistically valid random sample of these letters. To conduct our content analysis, we removed a total of 194 duplicates and ineligible comment letters from the original population of 608 and ultimately selected a sample of 90 letters to review. We summarized the key comments of each of these letters from our sample by categorizing the letters by: (1) type of respondent; (2) their position of support, opposition, or no opinion on voluntary and mandatory collection of data; and (3) reasoning offered for support or opposition of voluntary collection and mandatory data collection and reporting. We helped confirm that our categorizations were reliable by having two analysts independently categorize a small number of letters to determine if they were in agreement.

For Objective 3, we found that researchers had not produced studies or articles on the benefits and costs of requiring lenders to collect and report data on personal characteristics, such as race and gender, for nonmortgage loan applicants. Therefore, we spoke with a variety of researchers, government officials, and representatives from lending and business trade groups, including women- and minority-owned businesses, to offer perspectives and analysis on the benefits and costs of requiring the collection of racial and gender data for nonmortgage loan applicants. We asked these officials to compare and contrast the benefits and costs of collecting nonmortgage data with the benefits and costs of collecting HMDA data, as appropriate. We also reviewed and analyzed options to mitigate costs of a data collection and reporting requirement, as appropriate, for regulators, researchers, lenders, businesses, and consumers, such as limiting a possible collection and reporting
Appendix I: Objectives, Scope, and Methodology

requirement to apply to only small business and automobile lenders. We reviewed the Interagency Fair Lending Examination Procedures for mortgage and nonmortgage loans and interviewed regulators on the difference in which they perform fair lending examinations on mortgage and nonmortgage lending, such as business lending. We also examined available cost estimates for lenders and regulators to collect and process data for nonmortgage loan applicants from FRB, researchers, and lenders and compared and contrasted such estimates with HMDA cost estimates for collecting and processing additional data as appropriate.

We conducted this performance audit from September 2007 to June 2008 in Washington, D.C., in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.
June 12, 2008

Ms. Orice M. Williams
Director
Financial Markets and Community Investment
Government Accountability Office
Washington, DC 20548

Dear Ms. Williams:

Thank you for the opportunity to comment on the draft report entitled “Fair Lending: Race and Gender Data Are Limited for Nonmortgage Lending,” GAO-08-698. The draft report analyzes studies on possible discrimination in nonmortgage lending and the data used in them, the benefits and costs of a mandatory data collection and reporting requirement, and the Board’s decision to retain the regulatory prohibition on voluntary applicant data collection for nonmortgage loan applications.

As the report notes, the Federal Reserve Board’s (“Board”) Regulation B, which implements the Equal Credit Opportunity Act, generally prohibits lenders from collecting data on the personal characteristics of loan applicants, such as their race and gender, for nonmortgage loans. In 1999, the Board proposed to amend Regulation B to remove the general prohibition and to allow creditors to voluntarily collect these data. After thoroughly considering the issue, the Board in 2003 decided to retain the general prohibition, except if the creditor collects the data for the purpose of conducting a self-test. The Board concluded that lifting the prohibition and permitting voluntary data collection would not produce reliable or useful market-wide data.

The GAO’s draft report examines the rationale for the Board’s decision to retain the prohibition and not permit voluntary collection. The draft report finds that while there was not full agreement among those interviewed with all aspects of the Board’s rationale for retaining the prohibition, there was widespread agreement that such voluntary data would have limited benefits. The draft report also concludes that a mandatory data collection and public reporting requirement could help address current data limitations and might enhance regulators’ ability to detect discriminatory practices. However, such a requirement would impose additional costs on lenders that could be partially passed on to borrowers.

We are committed to ensuring that credit is made available to all qualified applicants for any kind of credit, including small business credit, in a fair and non-discriminatory manner. We appreciate the professionalism of the GAO’s review team in conducting this study.

Sincerely,

[Signature]

Ms. Orice M. Williams
Appendix III: GAO Contact and Staff Acknowledgments

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<tr>
<th>GAO Contact</th>
<th>Orice Williams, (202) 512-8678, or <a href="mailto:williamso@gao.gov">williamso@gao.gov</a></th>
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<td>Staff Acknowledgments</td>
<td>In addition to the contact named above, Wesley M. Phillips, Assistant Director; Benjamin Bolitzer; Emily Chalmers; Kimberly Cutright; John Forrester; Simin Ho; Omyra Ramsingh; Robert Pollard; Carl Ramirez; and Ethan Wozniak made major contributions to this report.</td>
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<td>Research on Discrimination in Nonmortgage Lending</td>
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