



August 10, 2004

Federal Trade Commission/Office of the Secretary
Room H-159 (Annex N)
600 Pennsylvania Avenue, NW
Washington DC 20580

RE: FACT Act Scores Study, Matter No. P044804

To Whom it May Concern:

The National Community Reinvestment Coalition (NCRC), the nation's economic justice trade association of 600 community organizations, urges the Federal Trade Commission (FTC) and the Federal Reserve Board (FRB) to conduct a comprehensive study on the impacts of credit scores on the availability and affordability of loans and insurance products for African Americans and Latino individuals and communities. An impartial and rigorous study should influence public policy regarding if and how to change the nation's credit scoring system in order to promote fairer access to credit and insurance.

NCRC recently conducted a study, the *Broken Credit System*, that assessed the relationship among creditworthiness, neighborhood racial and age composition, and housing stock characteristics (we have attached a copy of the study for your reference). NCRC obtained credit score information on a census tract level on a one-time basis from one of the three major credit bureaus. The study used proxies for race, income, and age of the borrower since NCRC is not aware of any database that merges Home Mortgage Disclosure Act (HMDA) data and credit scores. The proxies in the study were the race and age composition of census tracts. We believe that the proxies were reasonable and suggested a pervasive problem of price discrimination.

NCRC found that after controlling for creditworthiness and housing stock characteristics, the percentage of Subprime loans increased as the percentage of African-American and elderly residents increased in a census tract. These results occurred in ten large metropolitan areas and were particularly strong for African-Americans. We also found that Subprime lending increased as the percentage of neighborhood residents with supposedly higher credit risks increased.

Although the supposed higher risk translated into higher levels of Subprime lending, NCRC's study reveals a basic unfairness in the financial system in America. High cost loans surged in minority and elderly neighborhoods even after controlling for

creditworthiness. This finding is consistent with a study conducted by a Federal Reserve economist using creditworthiness information similar to the data NCRC used.¹

Nationwide testing conducted by NCRC of Subprime lenders revealed that African American loan applicants were steered to higher priced loans despite the fact that they indicated that they had higher credit scores than their White counterparts. The results of this testing and the above mentioned studies indicate that African Americans are both steered to, and targeted for higher priced loans than their credit scores would qualify them.

The FTC and the FRB study will make a positive contribution if it thoroughly investigates the factors in credit score systems and alternatives to credit scoring. Firstly, we urge the FTC and FRB to work with the credit bureaus to create a publicly available database with the major factors or variables used by credit scoring systems. These variables can then be included in multivariate equations similar to those in the NCRC and FRB studies. An analysis can be undertaken to determine which variables in credit score systems have the most influence on the availability of prime and sub-prime credit. Policy judgments should then be made regarding the variables with statistically significant impacts. For example, it has been revealed that credit score systems negatively consider consumers' use of finance companies. If the use of finance companies is a statistically significant variable in credit score systems, this would not be fair since finance companies are disproportionately located in minority neighborhoods, and represent the major choice for too many consumers. A second important example is that it has been revealed that the neighborhood of residence affects ones credit score. If true, we believe that this would have a negative and disparate impact based on race and national origin.

The FTC and FRB study should explore alternatives to credit scores. Some banks have expanded prime lending to traditionally underserved borrowers by using rental and utility payment histories, which are not variables included in credit scores. The FTC and FRB should survey banks using flexible underwriting and then assess if the replication of these approaches can increase fair access to credit.

Another major area of concern for us is that the Fair Isaac Corporation recently created a new Subprime credit score designed specifically for the "underserved market". Fair Isaac also created a new subsidiary to implement this new system in the underserved marketplace. The underserved market encompasses approximately 54 million Americans who have no credit records on file that will allow financial institutions to quickly evaluate the risk of lending to them. Usually, these populations lack credit history, and consequently are not eligible or qualified to obtain credit cards, mortgages and/or loans. Included in this group are recent immigrants, members of ethnic groups that traditionally have not used credit, the newly divorced or widowed, and the young.

¹ Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. Available via pcalem@frb.gov.

This new “FICO Expansion score” for the underserved population’s credit score is based on FICO’s terminology “nontraditional data sources”. The criteria used ranges from how effective consumers handle payday loans and retail payment plans to whether they used overdraft protection on their checking accounts responsibly. NCRC believes that the use of these inherently negative, abusive, wealth-stripping products, (particularly payday loans and bounced check/loan protection services) to determine credit worthiness is problematic at best and more than likely will have a disparate impact on the basis of race and national origin and perhaps other classes protected by ECOA and the Fair Housing Act.

Let’s explore bounced check/loan protection services as an example. These loans disproportionately impact a small percentage of consumers who are usually minority, low-income and vulnerable. According to a survey conducted by the Consumer Federation of America (CFA) 28% of consumers overdraw their accounts. Of those who were most likely to overdraw their bank accounts, the results reflected the following: (1) African Americans (45%); 2) Moderate income consumers with household incomes of \$25,000 to \$50,000 (37%); 3) Those 25 to 44 years of age (36%) were most likely to have done so.

In reviewing this data alone, consumers most likely to be hurt by this new Subprime credit score product will be minorities, the young, and the poor and vulnerable. Lenders recognize that there is extensive growth in this underserved market (70%). Fair Isaac appears to have produced a Subprime product that bases its standards on negative products that strip equity from this population of people. The impetus driving this force appears to be increased revenues. Fair Isaac has come up with a quick fix solution to tap a potentially lucrative underserved population and make them the new high cost Subprime consumers. Fair Isaac has already marketed this design to auto and mortgage lenders who offer sub-prime products.

This arbitrary and capricious credit scoring design will adversely impact the minority, young, poor, and otherwise underserved populations. This population has little understanding of such a system, no voice to oppose it, and no input into a credit score system, which will ultimately control not only their access to credit, but also their access to insurance, employment, and housing as well.

The credit scoring industry argues that their systems are proprietary and the value and weight used in determining credit scores is proprietary as well. This argument for protecting the proprietary interests of the credit scoring industry rings hollow when we consider that every American’s future is determined by the use of some variation of a credit score. Clearly a consumers right to know how this important score is computed and weighted, outweighs any proprietary claims of the credit scoring industry.

In order for the FRB to have an effective study, full disclosure by the credit scoring industry as well as industry data must be included to assess the viability of their system. The Federal government has the right to demand full disclosure from all credit reporting agencies and the Fair Isaac Corporation regarding how an individual’s credit history is

assessed and quantified, and the value and weight of the factors, which ultimately translate into a credit score, are calculated.

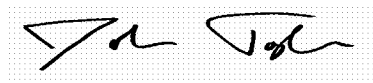
Finally, the FTC and FRB should expand their inquiries into credit-based insurance scores. A study by the state of Missouri has revealed a relationship between credit-based insurance scores and race of neighborhoods. Interestingly, some companies' credit scores were significantly less negative than others for residents in minority areas. Thus, credit scores of some insurance companies may not restrict choices of minorities as much as other companies' credit scores (the Missouri study is attached for your consideration). This suggests important differences in credit scoring systems that must be further investigated by the FTC and FRB study. Thirteen states, including Missouri, are about to embark upon an investigation of the credit-based insurance scores and the availability of insurance. NCRC urges cooperation between these states and the FTC and FRB.

In conclusion, NCRC shares the concerns of many other civil rights and consumer protection groups who fear that credit scores have become an increasingly dangerous tool which has been used by the lending industry to create a dual lending market. We remain concerned about the increasing incursion of a credit scoring system, which still remains secretive, into other industries including insurance, employment, and housing. We oppose the approach of creating a Subprime entry system through the use of a Subprime credit scoring system for those first entering the American credit system.

We strongly urge the FTC and the FRB to work for full public disclosure of the credit scoring models, and to thoroughly investigate the factors in the credit scoring system as well as alternatives to credit scoring.

Thank you for providing us with the opportunity to comment on this important matter. Please feel free to contact me on (202) 628-8866 if we can be of further assistance.

Sincerely,

A handwritten signature in black ink, appearing to read "John Taylor", is displayed on a light gray grid background.

John Taylor
President and CEO

credit score	discrimination	redlining	
	subprime lending	demographic variables	potential risk
advocate	counseling	unfair practices	community
enhance opportunity	data	African American	
investment	regression analysis		
	elderly	neighborhood	

**The Broken Credit System:
Discrimination and Unequal Access to Affordable Loans by Race and Age**

Subprime Lending in Ten Large Metropolitan Areas

The National Community Reinvestment Coalition (NCRC) is the nation's trade association for economic justice whose members consist of local community based organizations. Since its inception in 1990, NCRC has spearheaded the economic justice movement. NCRC's mission is to build wealth in traditionally underserved communities and bring low- and moderate-income populations across the country into the financial mainstream. NCRC members have constituents in every state in America, in both rural and urban areas.

The Board of Directors would like to express their appreciation to the NCRC professional staff who contributed to this publication and serve as a resource to all of us in the public and private sector who are committed to responsible lending. For more information, please contact:

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A special word of thanks to Mark Treskon, Milena Kornil, Josh Silver, and Dan Immergluck. As a former NCRC Research Analyst, Mark started this report and conducted the initial analysis that informed the methodology. Josh Silver and Milena Kornil teamed up to complete the data analysis and write the report narrative. Without their invaluable contributions, this report would not be as timely or comprehensive. Dr. Dan Immergluck, a professor at Grand Valley State University, provided expert peer review, consulting, and quick and thorough proofreading. His skilled assistance augmented the statistical rigor and meaning of the report.

NCRC

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