Considerations in Disclosing the Bureau's Fair Lending Methodology

<table>
<tr><td>Audience</td><td colspan="2">Intended: compliance officers, consulting firms, compliance attorneys
Additional: defense bar, Department of Justice, Federal Trade Commission, prudential regulators, press, Hill, academia, consumer groups, other government economists</td></tr>
<tr><td>First Topics</td><td colspan="2">Proxies: method of estimating the probability of a borrower's gender, race, ethnicity
Tolerances: the Bureau's first product- and activity-specific (i.e., auto interest rate mark-up) definition of "materially insignificant" disparities</td></tr>
<tr><td>Proxies and Tolerances: Key Messages</td><td>Proxies
• While not perfect, proxies are reliable and widely-accepted methods for performing key fair lending analyses
• We use first name and Social Security databases to create a probability of a borrower's sex
• We use surname, home address and Census databases to create a probability of a borrower's race and ethnicity
• The race/ethnicity method is a refinement of earlier methods because it integrates the use of surname and geography, and weights each loan in proportion to the exact probabilities
• Published research and the Bureau's analyses have demonstrated that this method consistently outperforms other proxy methods when compared to reported race/ethnicity</td><td>Tolerance for Auto Mark-up Disparities
• Focus is on the Bureau's supervisory activity; not enforcement thresholds
• Tolerances appropriately recognize the limitations of statistical analyses, even at the 95% confidence level
• Tolerances allow for the efficient allocation of resources to areas of greater fair lending risk
• Tolerances will vary by product and by type of fair lending analysis
• The Bureau will view statistically significant disparities in auto interest rate mark-up of 5bps or less as "materially insignificant"
• Because dealer mark-ups occur post-underwriting, our expectation is that in most circumstances controls will consist solely of mark-up program parameters, but we are open to considering additional explanatory variables consistent with the applicable theories of legal liability</td></tr>
<tr><td>Format(s)</td><td colspan="2">research paper, bulletin, blog</td></tr>
<tr><td>Process / Timing</td><td colspan="2">1. interagency briefings
2. possible response to Skadden whitepaper
3. complementary to the cadence of Tracks 1 and 2</td></tr>
<tr><td>Benefits</td><td colspan="2">• demonstrates Bureau transparency
• translates the complexity of disparate impact compliance into actionable steps
• aids the efforts of lenders who are committed to strong compliance mgmt systems
• aligns finite compliance resources with the areas of greater fair lending risk
• could prompt supportive messages from other agencies, advocates, academics</td></tr>
<tr><td>Risks</td><td colspan="2">• locking into particular empirical methods when they are continually evolving
• could give the defense bar a toe-hold for attacks based on methodology
• CMS-oriented message may dampen Track 2 efforts
• could prompt criticism from other agencies, advocates, Hill, academics, industry
• fodder for inflammatory soundbytes; our messaging is nuanced and complex</td></tr>
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