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Statement by

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before the

Subcommittee on Consumer Affairs

of the

Committee on Banking, Currency and Housing

House of Representatives

April 22, 1975

I appreciate the opportunity to appear before the Subcommittee on Consumer Affairs to offer the views of the Federal Reserve Board on H.R. 3386, amending the Equal Credit Opportunity Act, which was introduced by you, Mr. Chairman, and cosponsored by other members of this Subcommittee. The Act forbids discrimination in the extension of credit on the basis of sex or marital status. The bill would add to these categories race, color, religion, national origin and age.

Let me begin by stating, as I did in testifying before this Subcommittee on June 20, last year, that the Board strongly favors the elimination of discrimination based on factors other than creditworthiness in credit transactions.

Although no legal right to receive credit exists and the creation of such a right would be inappropriate in our free enterprise system, the Board believes a great deal can be done to assure that there is access to credit on a just and fair basis for equally creditworthy people. The denial of credit based upon group identification without reference to creditworthiness works to the economic disadvantage of applicants and creditors alike. Nevertheless, the Board recommends that Congress delay enactment of this legislation until such time as experience is available to assess the impact of the present provisions of the Equal Credit Opportunity Act which go into effect later this year.

Our study of H.R. 3386 has come at a time when the Board and its staff are immersed in the preparation of regulations to implement the existing Act. In working on those regulations, we have come to appreciate more fully the many problems inherent in regulations of this nature and the serious possibility that without a thorough and detailed examination of these problems, such regulations may be ineffective or even counter-productive. There is always the risk that regulations in these areas might -- without intending to do so, and without accomplishing positive benefits -- so impede the credit-granting process as to significantly increase credit losses. The result of such increased losses would be either increased costs to other borrowers or a general raising of credit standards--with the resulting exclusion of some of the more marginal credit risks, typically among the disadvantaged, who are now able to obtain credit. Either kind of reallocation of credit risks, if at all extensive, would be contrary to the public interest.

We must say in all candor that even in the area of preventing credit discrimination on the basis of sex or marital status it will be extremely difficult to accomplish the worthy objectives while successfully avoiding the pitfalls along the way. Our best hope for achieving this will depend upon our efforts to study and understand the problems as thoroughly as possible, to consult as extensively as we can, to draft the regulations as carefully and objectively as we know how, and then to stand ready to amend them promptly as may prove necessary in the light of experience. Each of us at the Board is spurred by the keen realization of how much is at stake in this endeavor. Unless it is carried out in the best possible manner, we not only may fail to gain the positive benefits that are so earnestly sought, but we also may damage the credit machinery--and even bring discredit upon this and other laudable efforts to dispel bias and prejudice by reasoned and orderly developments in our legal system.

The experience with Truth in Lending--a subject that is inherently far less difficult and less controversial than that of discrimination in lending--can, we believe, be instructive here. Truth in Lending was discussed and debated in Congressional Committees over an extended period. Representatives of all points of view had ample opportunity to consider and present their positions. After carefully weighing the various presentations, Congress spelled out in the law a great portion of the principles and even the details that it wished to have followed. The Board was then given a year within which to write regulations filling in the remaining details.

I am convinced that a good part of whatever success has been achieved in administering Truth in Lending can be attributed to the thoroughness with which the subject was studied and the explicitness with which Congress set forth its intention.

Even though legislation on credit discrimination probably cannot be as explicit or detailed as that on Truth in Lending or Fair Credit Billing, we believe it is of vital importance that any extensions of the Equal Credit Opportunity Act be launched with optimal prospects for success. Crucial to such prospects will be the extent to which Congress identifies and analyzes the issues, sets forth its intentions in the statute, and allows adequate time for the writing of regulations.

In light of these considerations, we are convinced that further extension of the Equal Credit Opportunity Act should be preceded by extensive exploration, delineation, and resolution of the extremely complex issues that are inherent in this subject. In this connection, the category of "age", one of the additional categories which would be covered by H.R. 3386, poses unusually complex questions. For example, there is a very important issue as to what extent it may be valid to analogize statistical credit experience to the actuarial tables dealing with life expectancy that are used by insurance companies in setting premium rates. Should a creditor be permitted to take into account the borrower's statistically predicted life expectancy in making a long-term loan to an individual sixty-five or seventy years of age? Or should the creditor be restricted to an inquiry as to the probable stability of income of the particular applicant, an inquiry which might or might not properly include a question as to that individual's health and life expectancy?

At the other end of the spectrum, should a creditor in deciding whether to lend to a twenty-year old applicant be permitted to take into consideration the creditor's own experience in the particular geographical area with the payment record of persons in, say, the eighteen to twenty-five year age bracket? Or must the creditor restrict inquiry to the credit record--possibly quite a limited record--of the individual applicant? If the latter, then a further question arises as to whether alternative indices of stability are available which will make it possible for the creditor to distinguish between good and bad credit risks within a particular age bracket as effectively as it could do on the basis of statistics derived from its general experience. The creditor's cost of granting credit will be increased to the extent that such alternative tests do not eliminate bad credit risks as efficiently as can be done through statistically-based scoring (and offsetting benefits do not occur). The cost of credit will also be increased to the extent that the alternative tests are more expensive to apply. And any such increased costs, of course, will have to be borne by borrowers generally, unless the creditor chooses the alternative of raising credit standards. This, in turn, will have the effect of depriving marginal borrowers--often those in lower income brackets--of access to credit.

Even though different forms of discrimination require somewhat different remedies, we would hope that experience under the regulations to prevent discrimination on the basis of sex or marital status would be helpful to both the Board and Congress in formulating measures to deal with other forms of unfair discrimination. Accordingly, we would suggest that Congress continue its study of the problems involved in extending the Equal Credit Opportunity Act to cover the proposed new categories not only to permit full analysis of the issues, but also to get the benefit of experience under the regulations with respect to credit discrimination based on sex and marital status which we will issue this week for comment. We believe it essential for Congress to have the benefit of assessing the experience of consumers and creditors in living under the regulation in this particular area of credit discrimination before enlarging the scope of the Equal Credit Opportunity Act.

If Congress after considering these factors nevertheless chooses to proceed with the inclusion of additional categories under the Act, the Board would wish to emphasize the importance of adequate time in rulewriting in these new and little-studied areas in order to afford a suitable opportunity for public participation in the rule-writing process. Draft regulations must be prepared and submitted for public comment. This process in itself requires extensive informal consultation with consumer and creditor groups, as well as background economic studies wherever feasible, in the effort to illuminate some of the difficult trade-offs mentioned above. It may also be desirable to provide an opportunity for oral presentation of comments before the Board. Resulting comments must be analyzed, and the earlier draft revised.

In adopting the Equal Credit Opportunity Act, Congress deferred the effective date of the statute for one year in order to allow time for these procedures to be carried out in an orderly fashion. It is becoming evident that a year will provide a bare minimum of the time needed for writing rules in a single category of credit discrimination.

In view of the increased number and complexity of the issues which are likely to be inherent in the proposed extension of the Equal Credit Opportunity Act to cover discrimination on the basis of race, color, religion, national origin, and age, we believe that two years should be allowed for the difficult and vitally important task to be performed.