Consumer Financial Protection Bureau

1700 G Street, N.W., Washington, DC 20552

July 26, 2013

Decision memorandum for the Director

FROM	Patrice Ficklin, [redacted] Rebecca Gelfond, [redacted] Brian Kreiswirth, [redacted]
THROUGH	Steve Antonakes
SUBJECT	Potential methodological announcement: proxy methodology

RECOMMENDATION

The Bureau should publish a compliance bulletin about our proxy methodology for use in the supervisory arena within the next few months, making clear that the bulletin is limited to the supervisory context in order to appropriately preserve enforcement and litigation flexibility. Publishing such a bulletin does pose some risks to our auto lending initiative. On balance, however, the supervisory and transparency benefits outweigh the risks. We recommend making our announcement after further progress is made on our investigations and we have had an opportunity to discuss disclosure with our sister agencies. We might also consider waiting until after industry publishes an anticipated white paper on proxying.

_________ Approve _________ Disapprove _________ Let's discuss

BACKGROUND ON PROXIES

The ECOA forbids creditors from inquiring about an applicant's demographic information, with very limited exceptions.[1] One important exception is the Home Mortgage Disclosure Act, which requires the collection and reporting of data on sex, race, and ethnicity by most mortgage

[1] 12 CFR § 1002.5(a), (b). The administrative history establishes that while several proposals have been made to lift this general prohibition on collecting applicant characteristic data in the nonmortgage context, the final rule has retained this general prohibition. This prohibition was intended to discourage discrimination, based on the premise that if creditors cannot inquire about or note applicants' personal characteristics, such as race or national origin, they are less likely unlawfully to consider such information in connection with a credit transaction. In both 1995 and 1999, however, the Federal Reserve Board specifically proposed removing this general prohibition against inquiring about or collecting data on the personal characteristics of applicants in the nonmortgage context. Each time, after notice and comment, the Board retained the prohibition. The Board did, however, create an exception to permit the collection of personal characteristics for the purpose of conducting a self-test. A formal change to Regulation B would be required to permit broader collection of this data.

originators. But outside of mortgage lending, fair lending statistical analyses must rely on proxies to assign race, ethnicity, or sex.[2]

A proxy is a statistical method that uses available information to estimate unavailable information. For instance, a proxy might use an applicant's address to generate a probability that the applicant is of a certain race.[3] Proxies are a common statistical technique used by social scientists and economists,[4] and using proxies rather than reported demographic data does not undermine their ability to meaningfully estimate racial or other differences in outcomes.[5] The federal banking regulators have made clear that proxy methods may be used in fair lending exams to estimate protected characteristics where direct evidence of the protected characteristic is unavailable.[6] Courts have accepted the use of reliable proxy methods in a variety of discrimination suits for decades, including ECOA actions,[7] Voting Rights Act suits,[8] employment discrimination actions,[9] and constitutional challenges to jury pool selections.[10] At the same time

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[2] *See* GOV'T ACCOUNTABILITY OFC., *Race and Gender Data Are Limited for Nonmortgage Lending*, July 2008, at 3 ("In summary, we found that 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.").

[3] This memorandum does not discuss how proxy-generated probabilities are used in regression modeling, although that is a separate area of methodological choice relevant to compliance management.

[4] *See, e.g.*, Marc N. Elliott et al., *A New Method for Estimating Race/Ethnicity and Associated Disparities Where Administrative Records Lack Self-Reported Race/Ethnicity*, HEALTH SERVICES RESEARCH 43:5, Part I (Oct. 2008); *see infra* notes 7-11 (citing cases in which proxies have been used).

[5] Thus, for example, a statistical finding that outcomes for two groups differ by X basis points at the 95% confidence level has the same meaning whether proxies or self-reported data are used. At the same time, proxying necessarily introduces imprecision and may impact the output of statistical analyses. Because proxies do not perfectly predict reported race and ethnicity, estimations using proxies are typically less likely to find statistically significant differences in outcomes than estimations using reported characteristics. *See* Daniel F. McCaffrey & Marc N. Elliott, *Power of Tests for a Dichotomous Independent Variable Measured with Error*, HEALTH RESEARCH & EDUCATIONAL TRUST (June 2008). Also, because proxies may be correlated with unobserved characteristics that are also correlated with the very outcomes being evaluated—here, geography may be correlated with socioeconomic characteristics that are correlated with dealer markup—it is possible that a proxy analysis could overestimate or underestimate a difference. *See* Arlene T. Geronimus et al., *On the Validity of Using Census Geocode Characteristics to Proxy Individual Socioeconomic Characteristics*, JOURNAL OF THE AMERICAN STATISTICAL ASSOCIATION (June 1996), at 536. However, all of this counsels in favor of exercising caution—for example, testing the robustness of our results by employing multiple proxy methods and estimation approaches—rather than abandoning the project altogether.

[6] *See Interagency Fair Lending Examination Procedures*, at 12-13, *available at* http://www.ffiec.gov/PDF/fairlend.pdf (explaining that "[a] surrogate for a prohibited basis group may be used" in a comparative file review and providing examples of surname proxies for race/ethnicity and first name proxies for sex); *CFPB Supervision and Examination Manual*, at Procedures 19, *available at* http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf (temporarily adopting the FFIEC Interagency Fair Lending Examination Procedures). We also have anecdotal evidence that other regulators use statistical proxies in their regression analyses, and we are currently in the process of speaking to them to confirm this and to ascertain the full variety of those methods.

[7] *See, e.g., United States v. Union Auto Sales, Inc.*, 490 F. App'x 847, 849 (9th Cir. 2012) ("classification of 'Asians' and 'non-Asians' did not render the ECOA claim any less plausible" because "[t]he link between names and racial categorization for the purposes of both antidiscrimination law and discriminatory conduct is well-established").

[8] *See, e.g., Benavidez v. City of Irving*, 638 F. Supp. 2d 709, 717 (N.D. Tex. 2009) ("The Spanish surname may be used as a proxy for Hispanic ethnicity when self-identification is not practical."); *United States v. Vill. of Port Chester*, No. 06 Civ. 15173(SCR), 2008 WL 190502, at *9 n.13 (S.D.N.Y. Jan. 17, 2008) ("Experts for both parties used the Census Bureau List of Spanish Surnames to calculate the number of Hispanic voters in a particular area . . . Neither party disputes that Spanish Surname Analysis is an accepted methodology.").

[9] *See, e.g., E.E.O.C. v. Autozone, Inc.*, No. 00-2923 Ma/A, 2006 WL 2524093, at *5 (W.D. Tenn. Aug. 29, 2006) (finding that "it was reasonable for [the government's expert] to use census proxy data rather than the actual applicant data"); *I.M.A.G.E. v. Bailar*, 518 F. Supp. 800, 807 (N.D. Cal. 1981) ("[M]any Title VII discrimination suits have relied on Spanish surnames as an identifier for evaluating adverse impact and for affecting relief."); *Guardians Ass'n of New York City Police Dep't, Inc. v. Civil Serv. Comm'n of City of New York*, 431 F. Supp. 526, 530 (S.D.N.Y.

courts have recognized that proxies are merely estimations of protected characteristics and their predictive power may be limited in some circumstances.[11]

The precise proxy methodology will differ based on the characteristic being proxied. Proxying for sex, for example, most commonly relies on a name database from the Social Security Administration, which reports counts of individuals by sex and birth year for first names occurring at least five times for a particular sex in a birth year.[12] That proxy method assigns a probability that a particular applicant is female based on the distribution of the population[13] across sex categories (male or female) for a given first name.

A greater variety of methods are used to proxy for race and ethnicity.[14] The most common methods use the borrower's surname, the borrower's residence (geocoding), or a combination of the two. Other methods use nonpublic information to proxy for race and ethnicity, such as data or photographs from Department of Motor Vehicle (DMV) databases or proprietary databases matching first or middle names to certain racial or ethnic groups.

Methods using surnames are most commonly used to proxy race or ethnicity for Hispanics and Asians, based on the full count of Hispanics and Asians using those surnames published by the Census Bureau.[15] Surname analysis alone does not tend to be as effective a proxy for African Americans, because surnames for that population are not as readily distinguished from surnames for non-Hispanic Whites.

A second type of race/ethnicity proxy—typically referred to as geocoding—uses the demographics of the census tract in which an individual's residence is located, and assigns probabilities about the individual's race or ethnicity based on the demographics of that census tract. Depending on the methodology, an individual may be assigned one probability (if the analysis is comparing only two groups, e.g., African Americans versus non-African Americans) or multiple probabilities (if the analysis is comparing multiple groups, e.g., African Americans,

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1977), *vacated and remanded on other grounds*, 562 F.2d 38 (2d Cir. 1977) (holding that the use of three statistical methods to estimate race and national origin, including the proxy methods of surname analysis and geocoding, was "clearly trustworthy"); *Com. of Pa. v. O'Neill*, 348 F. Supp. 1084, 1086 (E.D. Pa. 1972), *aff'd in relevant part, vacated in part on other grounds*, 473 F.2d 1029 (3d Cir. 1973) (finding expert's race estimations from geocoding "reasonable").

[10] *United States v. Reyes*, 934 F. Supp. 553, 560-62 (S.D.N.Y. 1996) (accepting the use of geocoding to estimate race and noting that an expert explained that the method is "commonly used"); *United States v. Gerena*, 677 F. Supp. 1266, 1270 (D. Conn. 1987), *aff'd sub nom. United States v. Maldonado-Rivera*, 922 F.2d 934 (2d Cir. 1990) (criminal defendant's expert and federal government's expert agreed that Spanish surname analysis "is an accepted method of identifying individuals of Hispanic origin").

[11] Some courts have expressed skepticism of surname analysis where its accuracy was called into question in that particular instance. *See, e.g., I.M.A.G.E.*, 518 F. Supp. at 806-07 (questioning the probative value of defendant's surname analysis because of, among other reasons, a large population of Portuguese and Filipinos residents in the area with names on the Spanish surname list). Even where courts are skeptical of surname analysis, they may consider it as evidence if its usefulness can be shown. *See, e.g., Rodriguez v. Bexar Cnty.*, 385 F.3d 853, 866, n.18 (5th Cir. 2004) (expressing its opinion that Spanish surname analysis is "novel and highly problematic," but upholding the district court's consideration of it and allowing it in future cases upon a "strict showing of its probativeness").

[12] http://www.ssa.gov/oact/babynames/limits.html.

[13] The probability is based on the population with a Social Security number, rather than the total U.S. population (as with the Census-based estimates).

[14] *See* Kevin Fiscella & Allen M. Fremont, *Use of Geocoding and Surname Analysis to Estimate Race and Ethnicity*, HEALTH SERVICES RESEARCH 41:4, Part I (Aug. 2006), 1483-84.

[15] http://www.census.gov/genealogy/www/data/2000surnames/index.html.

Hispanics, Asians, and Whites). Geocoding methodologies have been used, for example, in impartial jury cases to determine the racial composition of the jury pool.[16]

Over the last decade, another method of proxying race and ethnicity has been developed that integrates the surname and geographical approaches. This method was developed by health research economists at RAND,[17] and it combines the respective probabilities generated by the surname and geographical proxies. Published research on this proxy methodology finds that, when compared against actual reported race and ethnicity data, it consistently outperforms proxies using only surname or geography in isolation. The integrated approach has been found to correlate highly with self-reported race and ethnicity data and to be more efficient in this respect than using surname or geography alone.[18] Preliminary work conducted by our Office of Research has found similar results by using self-reported race and ethnicity data from HMDA to compare the relative performance of the integrated proxy against proxies using only surname or geography. For these reasons, the Bureau is generally using the integrated proxy as the primary method in our nonmortgage analyses, though we are also testing the robustness of our findings using alternative methods, such as surname or geography individually.[19] As discussed below, our peer agencies do not use an integrated surname and geography method and, therefore, we are breaking new ground in that context.

In designing our proxy methodology, we intentionally chose a method that uses publicly available data sources so that lenders could replicate our methods in analyzing their own portfolios without the expenditure of funds to purchase proprietary databases. However, other methods of proxying for race or ethnicity may further improve on proxy estimates by using proprietary sources of information.[20] For instance, some companies that specialize in data proxying use nonpublic databases that match first (or even middle) names to race/ethnicity.[21] Another way of obtaining racial or ethnic data is to gather information from state DMV records, either through actual data fields collected by the state or by a visual assessment based on the borrower's driver's license photograph. The DOJ has used DMV data in isolated cases,[22] but those data are not generally available because state agencies are not always amenable to releasing racial/ethnic data or may not keep such data at all. These proprietary methods might be more capable of identifying the race/ethnicity of particular individuals[23] but we have chosen not to use them in order to maximize the industry's ability to follow suit.

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[16] *See, e.g., United States v. Reyes*, 934 F. Supp. 553, 560-62 (S.D.N.Y. 1996) (citing an expert saying that "geocoding is 'commonly used'" and deciding that "[o]nly the geocoded data from the Jury Wheel study will be considered").
[17] Marc N. Elliott et al., *A New Method for Estimating Race/Ethnicity and Associated Disparities Where Administrative Records Lack Self-Reported Race/Ethnicity*, HEALTH SERVICES RESEARCH 43:5, Part I (Oct. 2008).
[18]. Marc N. Elliott et al., *Using the Census Bureau's Surname List to Improve Estimates of Race/Ethnicity and Associated Disparities*, HEALTH SERVICES & OUTCOMES RESEARCH METHODOLOGY (2009) 9:69-83.
[19] We also consider threshold-based classification rules that assign an application to a single racial or ethnic group by determining whether the probability associated with each classification meets or exceeds a particular threshold. For example, those borrowers whose probability of being African American is 80% or greater are considered African American; those whose probability of being Hispanic is 80% or greater are considered Hispanic; and so on.
[20] As discussed further below, we may use such other methods in the context of litigation to the extent they may be more capable of identifying the race/ethnicity of particular individuals.
[21] In a recent meeting with [redacted], a market research company, they explained that their method uses first, middle, and last names along with geography and information from over 100 other proprietary sources.
[22] Confirmed in May 16, 2013 meeting with DOJ. In addition, it is our understanding that DOJ has never relied solely on a statistically-based proxy of race and ethnicity, but rather has augmented its statistical proxy analysis with other types of evidence, such as drivers' license photos or lender employee assessments.
[23] Moreover, these alternative methods are not necessarily more accurate or reliable. *See, e.g., E.E.O.C. v. Kaplan Higher Learning Educ. Corp.*, No. 1:10 CV 2882, 2013 WL 322116, at *5-10 (N.D.Ohio Jan. 28, 2013) (finding the

Many auto industry players, including many of the large banks, use proxies to conduct internal nonmortgage fair lending analyses. Our supervisory experience has been that gender proxies using first name and race/ethnicity proxies using surname (for Hispanics and Asians) and geocoding (for African Americans or "minorities" more generally) are the most common. In addition, many industry players, including dealers, use marketing data about customers that is generated using proxies, although that information is often provided by third parties.

PEER APPROACHES TO PROXY METHODOLOGY

The Bureau's peer agencies (DOJ, FTC, OCC, FRB, FDIC, NCUA, HUD) have not, to date, made public announcements regarding the proxy methodology they use. We have begun a survey of these agencies to determine what methodology they use; what, if anything, they publicize about their methodology; and their reasoning for disclosing or withholding this information. Here is an agency-by-agency summary of our current understanding with respect to use and disclosure of proxies, although we are still in the process of gathering this information:

- The **DOJ** does not conduct supervisory work and in its enforcement role, conducts a case-by-case analysis of potential discrimination. Thus, DOJ does not have an overall proxy methodology, though they have used Hispanic and Asian surnames to proxy in prior nonmortgage cases. We have conferred with DOJ,[24] however, and they support a public announcement of our methodology for purposes of informing the industry of the approach we use in the supervisory context and that industry can apply in its own compliance management.

- The **FRB** uses a less complex methodology than the CFPB—specifically, a surname proxy for Hispanics and Asians and a geographic proxy for African Americans or "minorities" more generally, as opposed to our combined method, which integrates both surname and geography. FRB fair lending staff have informed us that they plan to discuss their proxy methodology in detail in an upcoming webinar this Summer.[25]

- The **FDIC**, like the FRB, uses a less complex methodology than the CFPB, including only surnames (for Hispanics and, more recently, Asians), with no geographic component. The FDIC economists with whom we spoke indicated that they supported a public announcement of our methodology, though we do not know whether this view is shared more widely within the agency.

- It is our understanding that the **OCC** has not published its proxy methodology and, in any event, has only rarely used proxies for race and ethnicity in its supervisory work,

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conclusions based on the judgments of "race raters," who assessed individuals' race/ethnicity based on driver's license photographs, to be unreliable and inadmissible under *Daubert*).

[24] DOJ's Civil Rights Division is concurrently conducting investigations into indirect auto lending with us.

[25] The FRB has previously disclosed their proxy method at a very high level. *See* Maureen Yap, "Fair Lending Webinar Questions and Answers," Consumer Compliance Outlook: First Quarter 2012, *available at* http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/2012/first-quarter/fair-lending-webinar.cfm ("For nonmortgage loans, we may determine ethnicity and gender using the U.S. Census Bureau's Spanish surname list and female first name list. For both mortgage and nonmortgage products, we also use census data to identify majority-minority census tracts and to determine whether disparities exist between minority and nonminority areas.").

even when it had ECOA jurisdiction over large national banks.[26]

- The **FTC** has reported to us that their current fair lending work is limited and has not involved the use of proxies.

In sum, we have determined that our peer agencies do not use the integrated proxy method or currently publicize their own methods in detail, though the FRB intends to do so shortly.

BENEFITS AND RISKS OF PUBLISHING OUR METHODOLOGY

Several institutions and industry groups have asked the Bureau to publish the methodology it uses for proxying in its auto lending analyses. We recommend publishing the proxy methodology we use in our supervisory work and that industry can apply to its own compliance management, while making clear that we make determinations of discrimination on a case-by-case basis and that all available enforcement and litigation tools remain open and are not bound by the announcement. This will enhance responsible lenders' ability to conduct self-analyses on their own portfolios, allowing them to identify and address issues before a CFPB exam or investigation commences, while maintaining the flexibility to tailor our proxy methodology in specific enforcement matters, particularly in litigation.

Because our sister regulatory and enforcement agencies have not yet publicly announced the methodologies they use in fair lending analyses, we recommend continuing our inter-agency discussions on this topic and making our disclosure within the next few months.[27]

Benefits

The primary benefit of publishing information about proxy methodologies is that it will improve the ability of lenders to assess compliance in nonmortgage lending. A published proxy methodology will enhance lenders' ability to conduct self-analyses on their own portfolios, allowing them to identify and address issues before a CFPB exam or investigation commences. Some lenders may be ready to adopt a proxy method for their compliance management program if it can be translated into actionable steps.[28] Other lenders that already use proxies may be willing to alter their methods if they are shown the advantages of a new method. An announcement would potentially precipitate adoption of the integrated proxy method, simply because that method would carry the imprimatur of our agency. All of this will benefit both lenders and the Bureau. Lenders benefit by using the information gleaned from the proxy to target their finite compliance resources to the areas of greatest fair lending risk, thus better

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[26] We have reached out to the OCC to clarify their use and disclosure of proxies and have not yet had the opportunity to hold these discussions. We also have not yet discussed this issue with HUD or the NCUA. However, HUD's fair lending authority under the Fair Housing Act is limited to mortgage lending, for which the availability of HMDA data generally obviates the need to proxy. Similarly, we believe NCUA's fair lending work has focused on HMDA data and thus is unlikely to have involved proxies.

[27] The FRB does not conduct public enforcement activities and, therefore, does not have the same concerns that we do that such a disclosure could restrict our ability to apply a different, potentially more precise, proxy methodology in an enforcement matter or litigation. However, the fact that the FRB plans to share the methodology it uses to conduct examinations is a strong argument in favor of our doing the same.

[28] As some lenders roll out dealer monitoring programs in response to our bulletin, it is possible that some auto *dealers* may use our proxy method to conduct analyses of their own portfolios, further enhancing overall ECOA compliance. While the Bureau's ECOA authority generally does not extend to dealers (with certain exceptions), better compliance at the dealer level should improve outcomes at the lender level where we do have authority.

protecting themselves from potential claims of discrimination. The Bureau benefits by inducing voluntary compliance activity and potential corrective action by the industry.

Another related benefit of publishing our methodology is that it fulfills our goals of transparency with financial institutions. Transparency is a value, but it also fulfills many objectives. Publication would relieve some uncertainty about how we assign race and ethnicity. In light of our bulletin urging indirect auto lenders to adopt compliance management systems that necessarily rely on proxying, publication would also provide additional information as to how to implement our guidance and respond to industry concerns about the lack of specifics with respect to what the Bureau is expecting. It would also encourage dialogue about proxy methodologies and might potentially spur further methodological enhancements to proxying. Because proxies are currently an important means of conducting statistical fair lending analyses in nonmortgage lending, if executed appropriately, a publication could prompt supportive messages from other agencies, consumer and civil rights advocates, and academics.

Finally, we have already informed several institutions in PARR letters that we are using a proxy methodology that combines both surname and geocoding, including citations to the academic literature discussing this methodology. These institutions are thus aware of our approach, and publication would provide that information to the rest of the industry.

Risks

There are risks to publishing our proxy methodology in the current environment. First, publicizing our methodology opens it up to attack. News reports are already labeling it as racial profiling and junk science, and these aspersions may increase if we reveal greater specificity. Of course, those attacks may also continue regardless, and publishing our methodology may actually provide us with ammunition to counter such charges. As noted above, however, other proxy methods that rely on proprietary data may be more precise than ours, and we could open ourselves up to criticism of our proxy methodology. We understand that a prominent industry law firm will soon be publishing a white paper criticizing the integrated method of proxying and possibly criticizing proxying more generally. Also, we recently received a letter from several Democrats on the House Financial Services Committee asking for details on our methods, and, after responding, received a letter from 35 House Republicans requesting further information and clarification on our proxy methodology and tolerances. We would expect further requests (and perhaps even a Congressional hearing) to explain any announcement about methodology. We might want to assess the white paper and its impact on our methodology prior to a public announcement so as to allow the Bureau's announcement to address any arguments raised in the white paper rather than play catch-up after-the-fact. If we publish our method in detail, moreover, we risk encouraging yet more questions on more complicated, fact-specific subjects, such as our regression modeling.

Second, a methods announcement could also endanger our Track 1 work by tying us to methods that we may prefer to use only for conducting examinations, rather than litigation. To lessen this risk, any such announcement should make clear that it is limited to the approach we take in conducting examinations, that we may use other approaches in enforcement matters and potential litigation as the particular facts of the case warrant, and that all available tools remain at our disposal, including developing or utilizing more advanced proxy methodologies as they may evolve down the road. Proxying remains an evolving area in statistical methods and we expect that conversations with other federal agencies and experts may further inform our thinking. For example, we have reason to believe that our proxy is less capable of identifying the race/ethnicity of particular individuals than some proprietary proxy methods that use nonpublic data. If we publish a certain method and then feel compelled to use it in litigation, a defendant could request the deliberative and developmental information behind that method through discovery; while this information is arguably protected by the Deliberative Process or Examination privileges, a court could potentially decide otherwise. We could also be disadvantaged in litigation by the fact that the agency took a public position on the "correct" methodology for this type of analysis, calling into question any alternative approaches that we may want to apply in the future.

Third, our Track 2 work is focused on encouraging lenders to consider carefully the relative costs and benefits of the options outlined by the Bureau's auto lending ECOA compliance bulletin for addressing fair lending risk, and also on assisting indirect auto lenders that desire to adopt nondiscretionary forms of dealer compensation. An announcement on proxy methodology at this time may interfere with this effort. Publishing our methodology may suggest that we are not neutral as to the outcome (and are pro-CMS), while our bulletin was neutral as to how to solve the problem. Such an announcement will generate significant public discussion, and the discussion likely will be centered on only one of the options from the bulletin, namely the implementation of robust CMS, and will not address the other option, namely the adoption of nondiscretionary compensation systems. This focus on CMS may cause lenders to believe erroneously that the Bureau necessarily prefers the CMS solution, especially as it is a commonly-used solution in this space. The focus on CMS also may discourage lenders from considering the costs and benefits of both options; because much of the discussion likely will jump directly to questions of how to implement a CMS, lenders may gloss over the root question of whether a CMS solution is the best solution for them in this context. For example, one lender has expressed interest in Track 2 because it believes that, after careful consideration of the issues raised by the bulletin, a nondiscretionary compensation system is a better method for addressing the risk. That lender, however, also has expressed concern that other lenders appear not to be considering the issues raised by the bulletin as carefully and may not be weighing the relative costs and benefits of the options suggested. A public announcement on proxy methodology without a concomitant discussion of other possible solutions may convince those lenders not to engage in a careful consideration of options other than robust CMS.

Finally, publishing our proxy methodology in the short term highlights potential conflicts with our peer regulators. Those agencies do not currently publish their methodologies, although the FRB plans to do so this Summer.[29] We are continuing our discussions with our sister agencies, who apparently use related but not identical methods to those we use or would publish.[30] Our publication might implicitly suggest that other methods are inferior, and it is our understanding that some fair lending enforcement agencies have been using other proxy methods for many years. Even though we have no authority to decide methodologies for other regulators, a court might reasonably inquire why such methods would differ among federal regulators enforcing the same fair lending laws. We plan to continue to engage with other regulatory and enforcement agencies over the next few months to better understand their research methods.

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[29] An FRB announcement, however, does not carry the same risk for that agency as a similar announcement would for us. The FRB does not entertain enforcement actions and, instead, refers them to the DOJ, which has a "clean" review of the matter and is not bound by FRB's prior actions. We could, from a public perception viewpoint, be seen as bound by our own prior announcement. At the same time, the very fact that the FRB announces its methodology publicly will likely put additional pressure on us to do the same.

[30] The FRB uses a less complex methodology (surname for Hispanics and Asians and geography for African Americans, as opposed to our combined method), while the FDIC uses only surnames with no geographic component.

CONCLUSION

In light of these risks, we recommend publication within the next few months, preferably after we have completed our discussions with our sister agencies to fully understand differences in our methods. (We might also consider waiting until after we have had a chance to review the anticipated industry white paper.) When making such an announcement, we can mitigate some of the risks described above by: (1) simultaneously reminding lenders about other (non-CMS) options for managing the fair lending risk created by dealer markup; (2) clarifying that the announcement applies exclusively to our supervisory work, thus fully reserving enforcement/litigation flexibility; and (3) emphasizing the importance of proxying more generally and the multitude of possible approaches to it, even as we publish details about our current method.[31]

Decision Memo Clearance Sheet

Document:	Subject/Title	Potential methodological announcement: proxy methodology				
Owner:	Name	Patrice Ficklin	Office	Fair Lending	Tel. Ext.	7205
Approved:	Name of Associate or Assistant Director			Steve Antonakes		

Legal Division		Name of clearer	Christine Ladd	Date	June 28, 2013
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Office	Supervision	Name of clearer	[redacted]	Date	June 27, 2013
Office	Enforcement	Name of clearer	[redacted]	Date	June 26, 2013
Office	ILL Markets	Name of clearer	[redacted]	Date	June 7, 2013
Office		Name of clearer		Date	

[31] We understand from the OCC that smaller banks would appreciate guidance on the legality under ECOA of proxying, and a general endorsement of proxying would address this concern.