

Does Credit Scoring Produce a Disparate Impact?

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US consumer credit markets have become increasingly competitive as a result of the development of low-cost, statistically-derived credit scoring models. As the use of credit scoring has expanded, concerns have arisen about whether scoring has inappropriate adverse effects on certain populations, particularly minorities or those that rely more heavily on non-traditional sources of credit that may not report activity to credit reporting agencies. Despite these concerns, there has been virtually no research conducted on the issue. Except for limited self-testing purposes, Federal law prohibits the collection of racial data as part of a non-mortgage credit application. As a result, there is a lack of information available on the relationship between an individual's race or ethnicity and credit history score or on the potential for a racially disparate impact in their use.

In response to these concerns, the US Congress asked the Federal Reserve and the FTC to study the relationship between credit scoring and personal demographic characteristics, including race and ethnicity. In preparing the report, we compiled a new and unique dataset that combines racial and other demographic information obtained from Social Security Administration records with the complete credit records for a large nationally representative sample of approximately 300,000 individuals, drawn in June 2003 and again in December 2004. The individual credit records include two credit history scores. The result is a unique dataset that allows us, for the first time, to examine the relationships between credit scores, credit performance, and demographic characteristics.

Using this dataset, we examine how credit score distributions differ across demographic groups. We then examine the relationship between race or ethnicity, credit history score, and credit performance using our two industry credit scores to determine if scores do an equally good job in predicting performance for different racial or ethnic groups. We repeat this exercise controlling for other demographic characteristics such as age, gender, marital status, and non-racial neighborhood (census tract) characteristics to determine if it is race, per se, which is reflected in scores, or race as a proxy for other demographics. A finding that there was no systematic differences in the predictiveness of scores across racial groups would be inconsistent with the conjecture that scores have a disparate impact; a finding that there was a racial correlation would raise questions.

While the results of this analysis are largely complete, details of the results (or a summary thereof) cannot be released until the study has been delivered to the Congress this Spring.