BNA Insights

Mortgages

The authors help prepare lenders for the implementation of the newly issued final rule amending mortgage loan application data reporting requirements. They explain the types of institutions and transactions that are covered, the new data points that must be collected and reported, and the processes for reporting and disclosing this data, as well as concrete steps that should be taken to ensure compliance with the final rule.

BNA INSIGHTS: It's a New Dawn, New Day for HMDA Reporting

By Warren W. Traiger and Kari K. Hall

On Oct. 15, 2015, the Consumer Financial Protection Bureau (the CFPB or the Bureau) issued its long-awaited final rule amending and drastically expanding the mortgage loan application data reporting requirements under Regulation C and the Home Mortgage Disclosure Act (HMDA). Lenders that are subject to the CFPB's final rule — which weighs in at 797 pages — have their work cut out for them before it goes into effect on Jan. 1, 2018.

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The purpose of this article is to help prepare lenders for the implementation of this rule, not only by explaining the types of institutions and transactions that are covered, the new data points that must be collected and reported, and the processes for reporting and disclosing this data, but also by suggesting the concrete steps that should be taken to ensure compliance with the final rule.

The History of HMDA

The final rule is issued pursuant to the Bureau's authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which transferred rulemaking responsibility for HMDA from the Federal Reserve Board (FRB) to the CFPB. While certain comments and criticisms aimed at the CFPB's final rule suggest that it inappropriately expands the original purpose of the Act, a quick scan of the history of HMDA and Regulation C, its implementing regulation, reveals the Act's ever-evolving and expanding nature.

In 1975, Congress passed HMDA out of concern over credit shortages in certain urban neighborhoods and the possibility that some financial institutions may have

contributed to those shortages. HMDA's stated purposes were to assist regulators in determining whether financial institutions were appropriately serving the housing needs of their communities and to assist public officials in making housing-related investments.

HMDA remained largely unmodified for more than a decade until 1989, when the Federal Reserve Board revised Regulation C to incorporate amendments contained in the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), which was enacted by Congress earlier that year. These amendments required mortgage lenders to identify and report the race, sex, and income of mortgage loan applicants, as well as the outcome of their applications, and permitted lenders to explain the basis for their decisions. Senator Donald Riegle, a Michigan Democrat who sponsored the bill in the Senate, stressed that the purpose of these amendments was ''to determine the extent of discrimination in home mortgage lending'' and to ''provide a more accurate picture of lending patterns and the underlying reasons for denial of credit.''

Outcry quickly followed the 1991 release of this new data, which showed that Hispanic home loan applicants were 1.5 times more likely to be rejected than white applicants, and African-American home loan applicants were 2.4 times more likely to be rejected than white applicants. Despite pleas by those in the mortgage industry that unwarranted conclusions should not be drawn from limited data without context or commentary, the tide turned, and waves of fair lending lawsuits and regulatory enforcement actions, unabated to this day, crashed into them.

In May 2002, in an attempt to garner more information about how the new market for higher-priced mortgage loans was affecting minority and lower-income borrowers, the FRB amended Regulation C to require lenders to report data items related to loan pricing, including whether or not the annual percentage rate (APR) exceeded the yield for comparable Treasury securities by a specified amount or threshold and whether or not a loan was covered by the Home Ownership and Equity Protection Act (HOEPA). Once again, new data points, not explicitly stated in HMDA, nor likely envisioned by its drafters, became part of the reporting requirements.

Then, in direct response to the collapse of the subprime mortgage industry and the global financial crisis that followed in the late 2000s, Congress passed the expansive Dodd-Frank Act, which, in part, moved HMDA rulemaking authority from the FRB to the CFPB and directed the CFPB to expand the HMDA dataset, expressly mandating the inclusion of specific, additional information to better understand whether lenders were serving the needs of their communities. The Dodd-Frank Act also granted the CFPB broad authority to expand the dataset further as it saw fit. The CFPB, in keeping with the mandate and grant of authority, published its proposed rule on July 23, 2014, leaving it open for public comments until Oct. 29, 2014. While many organizations provided comments seeking changes to the proposed rule, the CFPB's final rule ultimately ended up looking very much like its proposed rule.

New Rule, New Data Points

As stressed above, the most notable amendments to Regulation C are those that add new data points and modify the already-existing data points that must be collected and reported by covered lenders. While the final rule's new requirements do not include some of the data points set forth in the CFPB's 2014 proposal — qualified mortgage status and risk-adjusted, prediscounted interest rate, for instance — the rule still more than doubles the number of required data points and modifies more than half of the already-required data points. In the interest of improving public access to HMDA data, at least some of this data, in a form yet to be determined, will be released to the public.

The new data points include (1) information about applicants, such as their age, credit score, and debt-to-income ratio, (2) information about the property securing the loan, such as its value and its construction method, (3) information about the features of the loan, such as the loan term, interest rate, and type of loan, and (4) certain unique identifiers, such as the universal loan identifier and the property address. Additionally, for applications not taken in person, the final rule requires financial institutions to report whether ethnicity, race, and sex information was collected on the basis of visual observation or surname. It also expands the required reporting of rate spreads to most originated loans and lines of credit, not just higher-cost closed-end loans.

Impact of New Data Points

These new requirements, which take effect in January of 2018, are intended to make mortgage industry underwriting practices and patterns more transparent, allow a better understanding of challenges to the access of credit, and improve the oversight and enforcement of fair lending laws. CFPB Director Richard Cordray explained that these new data points were in keeping with HMDA's goal of helping ''financial regulators, the public, housing officials, and even the industry itself to keep a watchful eye on emerging trends and problem areas in the nation's mortgage market,'' and that the availability of the new data would ''[shed] more light to foster better understanding of the market.''[1]

The goal of increasing mortgage lending transparency means that many lenders, whose data collection systems have been built around the previous requirements, will have to modify those systems, ensuring that they have the capacity to handle more than double the amount of data that they previously collected. And most significantly, regulators will now have access to a full array of data in the same format from almost every mortgage lender, making it easier than ever for them to analyze and compare data from across the industry more efficiently and quickly.

Because the new data points will provide increased context and control variables that were previously excluded from HMDA reporting, lenders will face even tougher questions when disparities are uncovered. As the information becomes public, facilitating increased scrutiny by advocacy groups and the media, regulators will have an eager group of volunteers to help them pore over every data detail, searching for the smallest

[1] Press Release, CFPB Finalizes Rule to Improve Information About Access to Credit in the Mortgage Market (Oct. 15, 2015), available at http://www.consumerfinance.gov/newsroom/cfpb-finalizes-rule-to-improve-information-about-access-to-credit-in-the-mortgage-market/.

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acorn that could quickly grow into a fair lending suit or government investigation. Even though the Supreme Court recently cautioned against the imposition of fair lending liability under the Fair Housing Act ''based solely on a showing of a statistical disparity,''[2] these new data points provide additional footholds for those seeking to challenge a mortgage lender's fair lending performance.

Additionally, the public release of this new sensitive mortgage data raises serious privacy concerns. If the complete dataset of information is released to the public without redaction, the risk that consumers could be ''re-identified'' — by the postal address of the property securing the covered loan, for instance — and become victims of identity theft is greatly increased. The CFPB, which received a multitude of comments on privacy issues, confidently responded that financial institutions need not fear that they will be held legally liable for the exposure of data due to a breach at a government agency or for reporting data to a government agency in accordance with applicable law. The Bureau also responded by stating that it will adopt a balancing test to determine whether and, if so, how HMDA data should be modified prior to its disclosure to the public. The CFPB plans to provide details about the process for the development of that test in the near future.

Covered Institutions

In an effort to ease the reporting requirements for some small banks and credit unions, the final rule exempts small depository institutions — those which have fewer than 25 closed-end mortgage loans and 100 open-end lines of credit in each of the two preceding calendar years — from HMDA's reporting requirements. The CFPB maintains that this will reduce the overall number of banks and credit unions required to report HMDA data by an estimated 22 percent and will significantly ease their compliance costs. Institutions whose loan volumes in 2015 and 2016 allow them to qualify for the new exemption will no longer have to report starting in 2017.

Conversely, the final rule will bring more non-depository institutions under the umbrella of Regulation C by removing many of the existing exemptions for those institutions, including asset size. The amendments also further enhance reporting requirements for large-volume institutions that received at least 60,000 – down from 75,000 in the proposed rule – total applications or covered loans, excluding purchased loans, in the preceding calendar year. These large institutions must not only produce annual reports with the new data points, but also quarterly reports starting with data collected in the first quarter of 2020, which will be due by May 30, 2020.

Covered Transactions

The CFPB's 2014 proposed rule expanded HMDA's coverage to all dwelling-secured loans, regardless of their purpose, removing the restriction of HMDA's applicability to mortgage loans for home purchase, refinance, and home improvement. While the Bureau walked back this expansion somewhat in the final rule by clarifying that business and commercial loans secured by a dwelling would only be made subject to Regulation C if they were used for a home purchase, home improvement, or refinancing, it did not acquiesce to comments from those in the industry who requested the continued exemption of closed-end home equity loans, home-equity lines of credit, and reverse mortgages.[3] All of those transactions are now included within the ambit of Regulation C. Even though these transactions seem to fall outside the scope of the original rationale behind HMDA, the CFPB has forcefully argued that new research shows the important part that many of these transactions, such as closed-end home equity loans, played in the buildup to the financial crisis.

Reporting Processes

In order to modernize the HMDA data submission process to collect information more efficiently, the Bureau is working with other government agencies and using feedback gathered from financial institutions and their vendors, to develop a new tool for electronic data submission. The CFPB has already completed a pilot of a new web-based tool to collect HMDA information more efficiently and has received positive feedback from the industry stakeholders who tested it. The CFPB's expectation is that the implementation of this tool will reduce the strain created by the continued use of manual and paper-based systems for reporting and will reduce associated compliance costs. The electronic submission tool will be available by January 2018, with the expectation that institutions report their 2017 data — which will still be governed by the current Regulation C — using the new tool.

Preparing for the Final Rule

The new data point reporting requirements do not become effective until January 2018, but lenders should start preparing for the final rule now to ensure that they have a system in place — and adequate resources and staffing to support that system — to record the newly required data points for transactions that were previously covered by Regulation C, as well as newly covered transactions. Modifications to tracking and reporting systems could require a significant investment of both time and money, and institutions not previously covered by Regulation C will have to build those systems from the ground up.

To ensure the technical reporting capabilities of their new or modified systems, mortgage lenders should begin collecting the new data points as if the final rule were already in effect. This preliminary step will allow lenders to ensure both consistency and accuracy in their reporting of the new data, particularly when they are collecting and reporting data through different channels. Significant quality control measures should be implemented at all points of the process, so that

[2] *Texas Dept. of Housing and Comm. Affairs v. Inclusive Comm. Project, Inc.*, 135 S.Ct. 2507, 2510.

[3] The application of these reporting requirements to the reverse mortgage industry, particularly the new requirement to report borrower age, will present new and unique problems for that industry, whose products have already been called ''complex'' and ''difficult for consumers to understand'' by the CFPB.

lenders can test and tweak their operational models, identify the source of any data errors, and correct deficiencies going forward.

After a new system with the technological capability to handle all of the changes is in place, lenders should begin conducting in-house analyses or engaging outside consultants to conduct analyses, potentially under attorney-client privilege, to review the fair lending implications of their data. Institutions should anticipate how the data will be viewed by others, focusing their attention on any disparities in decision-making and pricing and analyzing their lending patterns over time, across geographies, and as compared to the market and/or their peers. These analyses could help a lender uncover apparent disparities in pricing and underwriting prior to discovery by regulators, so that necessary and appropriate action can be taken. Any data that suggests potential fair lending issues should be reviewed carefully, exploring all possible non-discriminatory rationales. If unexplained disparities remain, the lender should immediately implement corrective action, such as enhanced training for its employees.

In spite of the CFPB's assurance that its forthcoming balancing test will ensure that all personal information remains private, lenders should also be prepared to respond to privacy complaints and concerns from consumers, as well as possible instances of identity theft and other potential ramifications of sensitive mortgage data being made publicly available. Additionally, covered institutions, particularly newly covered institutions or those who provide newly covered products, should carefully review their lending-related policies and procedures in search of any modifications that could be made to reduce potential fair lending risk.

Conclusion

The CFPB's final rule amending Regulation C will have a widespread impact on the mortgage lending industry by providing new data for regulators, advocacy organizations, and the media to comb through in search of evidence of mortgage lending discrimination. Additionally, new institutions and new transactions, which have never been subject to HMDA reporting requirements in the past, are being brought into the fold.

With so many changes and vague promises of things to come — a balancing test and an electronic submission tool that have received only cursory descriptions — it may be tempting for the industry to shrug its shoulders and wait for more details. However, one thing is clear: fair lending analyses will be easier than ever to conduct due to the final rule, and a proactive, immediate response to managing HMDA and fair lending compliance will go a long way toward ensuring that a financial institution does not become low-hanging fruit in regulatory or public efforts to root out discrimination.

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