

## Mark W Olson: Home Mortgage Disclosure Act

Testimony by Mr Mark W Olson, Member of the Board of Governors of the US Federal Reserve System, before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, US House of Representatives, Washington DC, 13 June 2006.

\* \* \*

Chairman Bachus, Representative Sanders, and members of the subcommittee, I am pleased to be here to discuss the uses and significance of the home loan data that are collected, reported, and publicly disclosed under the Home Mortgage Disclosure Act.

The act, which I will refer to as HMDA, was enacted over thirty years ago. Since then, it has undergone major changes. Today, HMDA requires most home lenders, a substantial majority of the home loan market, to disclose selected information about the applications they receive and the loans they extend each year. This information can be used for at least three purposes: first, to help the public judge how well lenders are meeting the housing-credit needs of their communities; second, to facilitate efficient investment in housing and neighborhoods; and third, to enhance the enforcement of laws prohibiting discrimination in lending.

HMDA promotes these goals through disclosure rather than substantive mandates or restrictions. The act does not direct lenders to make loans to any particular areas or persons. Nor does it direct lenders to make particular kinds of loans or to refrain from any particular loan terms or practices.

Instead, HMDA prescribes lender disclosures that, taken together, form a public data set about lending patterns. Every reportable application for a loan occupies a unique line in the data set. In 2005, there were approximately 31 million reported loan applications. The information disclosed about each application includes the race, ethnicity, and income of the applicant, the type and amount of the loan applied for, whether the loan was originated or the application was denied, and the census tract of the property to be financed. For the public's convenience, summary reports of the data are published by metropolitan area and by institution - for almost 9,000 depository and nondepository institutions. These summary reports are compiled by the Federal Reserve Board on behalf of the agency members of the Federal Financial Institutions Examination Council (FFIEC). The Board also processes and edits the transaction-level data, which the FFIEC makes available to members of the public, who may analyze and compile the data as they see fit.

The information disclosed under HMDA constitutes a rich data set, but, of course, all data sets have their limitations. The HMDA data tell a great deal about lending patterns, but they do not tell the entire story. Nonetheless, by drawing attention to lending patterns, the data prompt discussion, investigation, analysis, and research that may deepen our understanding of why these patterns occur and allow us to increase fairness and efficiency in the home loan market. For example, in 1991, congressional amendments to HMDA resulted in the disclosure of data that, for the first time, revealed black and Hispanic applicants for mortgage loans were far more likely than non-Hispanic white applicants to have their applications denied. The publication of those data precipitated an important public discussion about the underlying causes - and about whether unlawful discrimination was one of the causes. That discussion helped bring about new initiatives for compliance and community development. Many lenders improved their lending policies and developed strong compliance and oversight programs. Lenders also expanded their outreach to underserved communities, often by strengthening ties with community-based organizations. The data also prompted supervisory and enforcement agencies to improve their fair lending oversight programs. In short, though denial disparities have persisted, HMDA's disclosure of those disparities has helped to increase the fairness and efficiency of the home loan market.

Last year we passed another HMDA milestone when the first loan-level information about mortgage loan prices was released. The public discussion that the release of these data has prompted is reminiscent of the discussion that took place after the initial release of loan-denial data fifteen years ago. Today, the focus of the discussion has shifted from *which consumers* get home loans to *the terms* on which consumers get home loans - but the essential concern about the possible role of illegal discrimination is the same. I believe that the current public discussion about the new data will ultimately further the goals of fairness and efficiency in the mortgage market by prompting additional research, enhanced compliance and enforcement efforts, and more-effective investment in community development and financial literacy.

The Federal Reserve has responsibilities that relate to each of these areas. In my testimony today, I will discuss four roles of the Federal Reserve that relate to the HMDA data. First, the Federal Reserve Board was entrusted by Congress to write implementing rules for HMDA. Acting in that capacity, the Board required lenders to report loan-price data. Second, as a supervisor of financial institutions, the Federal Reserve uses HMDA data, including the price data, to facilitate its supervision of institutions for compliance with laws prohibiting discrimination in home lending. Third, as a research institution, the Federal Reserve conducts and publishes analyses of the price data, and it encourages research by other parties as well. Fourth, the Federal Reserve supports efforts by other organizations to use the HMDA data to identify financial education and community development needs. The Federal Reserve also supports their efforts to respond to those needs.

### **The Board's decision to collect price information**

As I have said, it is a Board regulation, adopted under authority of HMDA, that requires lenders to disclose loan-price data. I will now provide some background on the Board's decision to amend that regulation to include price data. Advances in information processing technology have expanded access to credit and homeownership opportunities for consumers. In the past, individuals seeking credit to purchase a home, or seeking to borrow for some other reason, either did or did not meet the specific underwriting criteria for a particular loan product; if they did, everyone paid about the same price for that product. Today, in part because of advances in credit scoring and underwriting technology, lenders can price loans according to risk, charging different borrowers different prices on the basis of a borrower's estimated creditworthiness.

The enhanced ability of lenders to assess credit risk gave rise to a segment of the mortgage market often referred to as subprime lending. In the subprime market, higher-risk borrowers pay higher prices. Subprime lending has grown rapidly, from less than 5 percent of all mortgage lending in 1994 to an estimated 20 percent in 2005, or over \$600 billion. The wider range of loan pricing available in the subprime market helped to expand consumers' homeownership opportunities and to increase their access to home equity. But this same price variability has raised concerns about unequal treatment of borrowers. It also has raised concerns about whether certain loan terms and lending practices are appropriate, whether consumers have the ability and knowledge to shop for the most beneficial loan terms, and whether the subprime market is sufficiently competitive.

The Board responded to these concerns by amending Regulation C, the regulation that implements HMDA, to expand the available data on higher-priced lending. The data released by the FFIEC in September 2005, which covered lending activity in 2004, contained the first loan-level information on loan pricing ever available to the general public. The data contain price information for loans whose prices exceeded thresholds set by the Board. The thresholds were selected to target segments of the home loan market that have raised the most concern, taking into consideration the cost and burden of reporting. The thresholds generally correspond to an unofficial line separating the prime and subprime markets. But that line of separation is not always clear, and its correspondence with the reporting thresholds is in any event imprecise. Therefore, we call loans whose prices exceed the reporting threshold "higher-priced loans" rather than "subprime loans."

This is only the second year in which price data will be publicly available under the Board's regulation. The Board continues to monitor the effects of the regulation in an effort to understand both its benefits and costs.

### **The Federal Reserve's use of HMDA data in fair lending supervision**

I have spoken of the Federal Reserve's role as the agency charged with implementing HMDA through regulations. The Federal Reserve also has a role as a supervisor of bank holding companies and state-chartered banks that are members of the Federal Reserve System. In that role, the Federal Reserve has long used HMDA data to help it supervise financial institutions' compliance with fair lending laws. The new data on higher-priced loans are yet another "screen" to make our fair lending supervision more effective. The Federal Reserve also shared analyses of the 2004 price data with other supervisory and enforcement agencies to assist them with their oversight of the institutions they supervise.

Before I discuss how the HMDA screen fits into the process of fair lending supervision, I want to describe that process more generally. Fair lending reviews are an integral part of the Federal

Reserve's supervision for consumer compliance and are performed regularly within each examination cycle. In addition, examiners may conduct targeted fair lending reviews whenever circumstances warrant. Moreover, the Federal Reserve examines institutions' compliance with fair lending laws regardless of whether they report price data under HMDA. Indeed, the Federal Reserve was examining for potential price discrimination well before it adopted the HMDA price-reporting requirement. Although price reporting under HMDA is limited to higher-priced loans, examiners look for unlawful price discrimination at any pricing level. Furthermore, examiners seek to detect other forms of discrimination, such as underwriting discrimination (for example, denying credit on the basis of the applicant's race) or redlining (for example, denying credit on the basis of the racial characteristics of the applicant's neighborhood).

Federal Reserve examiners use an institution's HMDA data, including its accept-deny data for loan applications and any price data it may have reported on originations, in conjunction with other information about the institution to determine the focus of the institution's fair lending examination. The HMDA data are incorporated into statistical management systems that produce analyses of lending patterns that aid the examination process. Starting in 2005, these analyses incorporated loan-price data. Other information that examiners use includes consumer complaints, the likely risks of an institution's different business lines, and the adequacy of the institution's compliance-risk management system. To gauge the risk of price discrimination, examiners consider, among other types of information, the presence of broad employee or broker discretion in pricing and the relationship, if any, between pricing and the compensation of loan officers or brokers. When examiners determine that a fair lending examination should focus on pricing, they collect additional information from the institution to evaluate whether pricing disparities can be fully attributed to legitimate factors or whether they are due, even in part, to unlawful discrimination.

If unlawful discrimination is found, the institution is referred to the Department of Justice or the Department of Housing and Urban Development, as required by law. Depending on the outcome of the referral and the nature of the violation, the Federal Reserve may also take other action to fully resolve the matter. For example, the Federal Reserve may direct the institution to provide remedies to harmed parties and improve its fair lending compliance controls and policies.

As the Federal Reserve has stated repeatedly, using the price and other HMDA data effectively in the supervisory process depends on a full understanding of the inherent limitations of those data. The HMDA data include valuable information, such as applicant or borrower income, loan amount, and the location of the property to be financed, but the data do not include many factors that lenders routinely consider in loan underwriting and pricing. Some of the typical credit-risk factors not included in the HMDA data are credit scores and loan-to-value ratios. Because the HMDA data lack such information, we cannot conclude from the HMDA data alone that an observed racial or ethnic difference in the prices of loans is the result of unlawful discrimination. That is why Federal Reserve examiners consider additional information about a lender, including information about its loan products and lending practices and its borrowers' creditworthiness, before drawing conclusions about the lender's compliance record.

In addition to improving fair lending supervision and enforcement by government agencies, the new pricing data have spurred institutions to improve their own compliance. Although examiners have long considered institutions' mortgage pricing as part of the fair lending review process, public disclosure of this pricing data appears to have given additional impetus to institutions' compliance efforts. Many institutions have reexamined their pricing policies and procedures to ensure that they do not permit, even inadvertently, pricing differences that violate the fair lending laws. Many institutions have also reevaluated their controls to ensure that proper policies are followed. This increased attention by institutions to their own fair lending compliance is one of the principal benefits of HMDA.

### **Research by Federal Reserve staff and others**

Supervision for fair lending compliance deals with lending patterns at the institution level. But the HMDA data also reveal lending patterns at aggregate levels, across institutions. Disclosure of aggregate patterns can raise and focus attention on important policy questions concerning access to credit. To that end, researchers at the Federal Reserve have published numerous papers and articles.

Most recently, staff published an article about patterns in the new loan-pricing data.<sup>1</sup> I will review a few of their findings.

First, most home lenders make few, if any, higher-priced loans. In 2004, only about 500 out of the 8,850 reporting institutions made 100 or more higher-priced loans; the ten lenders with the largest volume of higher-priced loans accounted for about 40 percent of all such loans. (The FFIEC has not finished reviewing, processing, and editing the 2005 data, which were submitted in March of this year.)

The 2004 data also show that 16 percent of borrowers took out higher-priced loans that year in the nation as a whole. This proportion may have increased from 2004 to 2005. For most loans, the Board's regulation uses long-term interest rates to set the thresholds for reporting loan-price data, but mortgage loan rates more closely track short-term rates. Thus, a narrowing of the difference between short-term and long-term rates, such as occurred from 2004 to 2005, may increase the proportion of loans reported as higher-priced loans.

The proportion of borrowers obtaining higher-priced loans is not geographically uniform but varies widely by region and by city. For example, in many of the metropolitan areas of the South and the Southwest, 30 percent to 40 percent of homebuyers taking out conventional loans in 2004 took out higher-priced loans. In other areas of the country, the proportion was much smaller. These differences may not be that surprising - other data show that credit scores tend to be lower on average in the South and the Southwest than elsewhere - but they may nonetheless warrant further analysis.

Of course, public attention has focused on a notable variation in the incidence of higher-priced lending across racial and ethnic lines: blacks and Hispanics are much more likely than non-Hispanic whites to receive higher-priced loans. In 2004, 32 percent of black borrowers and 20 percent of Hispanic borrowers received higher-priced home purchase loans, but only 9 percent of non-Hispanic white borrowers did. In other words, black homebuyers received higher-priced loans more than three times as often as non-Hispanic white homebuyers, and Hispanic homebuyers received higher-priced loans more than twice as often as non-Hispanic whites.

Certainly, differences of this magnitude are disturbing and raise important public policy questions. They also have led some to conclude that racial discrimination must play a role in the pricing of home loans. However, for the reasons I have explained above, we cannot use HMDA data alone to judge whether an institution has discriminated unlawfully or, therefore, whether unlawful discrimination is present in the market.

Despite their limitations, the HMDA data supply a key insight into the aggregate disparities: they reflect in part a segmentation of the market by race and ethnicity. Black and Hispanic borrowers are more likely to obtain mortgage loans from institutions that tend to specialize in subprime lending. Now, at least part of this segmentation of the market by race and ethnicity may reflect objective differences in borrowers' preferences or differences in credit-risk indicators, such as credit scores, that are not included in the HMDA data. Yet the segmentation may have more troubling causes, at least in part. Segmentation may stem from borrowers being steered to lenders that charge higher prices than what is warranted by the credit characteristics of these borrowers. Borrowers may also have different levels of financial literacy, or their knowledge of the mortgage lending process may be uneven - for example, they may not understand the importance of shopping and negotiating for the best loan terms. Additional research is needed to explore all of these, and perhaps other, hypotheses.

The Board will continue to conduct and promote research that explores the racial and ethnic differences in the incidence of higher-priced lending. In June and July, the Board is conducting hearings on the home equity lending market. These hearings, which I am chairing, are intended to gather information about, among other things, how consumers select their lenders and loans. The Board's 2007 biennial community development research conference will also provide a forum for research that may help explain differences in the incidence of higher-priced lending.

---

<sup>1</sup> Robert B. Avery, Glenn B. Canner, and Robert E. Cook (2005), "[New Information Reported under HMDA and Its Application in Fair Lending Enforcement.](#)" *Federal Reserve Bulletin*, vol. 91 (Summer 2005), pp. 344-394.

## **The Federal Reserve's promotion of community development and financial literacy**

I have discussed the Federal Reserve's roles in regulation, supervision, and research. Now I will turn to its role in promoting community development and financial literacy. The Federal Reserve System uses HMDA data to help banks, community organizations, and other interested groups identify community development needs and opportunities. For example, the Federal Reserve Bank of Boston tabulates HMDA data for the New England region to help regional financial institutions, community organizations, and state and local governments access and use information about their area's regional lending patterns. In addition, the Community Affairs Offices of the Federal Reserve System encourage and facilitate collaboration among financial institutions, governments, and community organizations to improve access to mortgage credit in traditionally underserved communities.

The Federal Reserve also promotes financial literacy. Board staff provide strategic advice on developing financial literacy policies, programs, partnerships, and marketing to national initiatives, such as the Jump\$tart Coalition, Operation HOPE, and the DollarWi\$e Campaign of the Conference of Mayors. In a parallel effort, the Federal Reserve Banks support similar regional initiatives. The Federal Reserve also collaborates with other groups on research to develop successful financial education programs and identify the most effective way to deliver these programs to intended audiences. By these and other means, the Federal Reserve seeks to address gaps in consumers' understanding of not only home loan transactions but also financial management more broadly. These gaps in consumer understanding may be contributing to disparities in the availability and price of home loans.

In closing, I appreciate this opportunity to discuss the Federal Reserve's regulation requiring lenders to disclose price and other data on home loans; how the Federal Reserve uses the data to improve fair lending supervision; and the Federal Reserve's promotion of research, community development, and financial literacy.