

From Red-Lining to Reverse-Red-Lining, Disparate Treatment and Disparate Impact Data – are you prepared for release of the expanded 2004 HMDA data this September?

By Wesley Few

In 1975, Congress enacted the Home Mortgage Disclosure Act (“HMDA”). The stated purposes of the HMDA are to: (1) provide public information to determine if lenders are servicing their communities; (2) enhance enforcement of laws prohibiting discrimination in lending, such as the Fair Housing Act (“FHA”) and the Equal Credit Opportunity Act (“ECOA”); and (3) provide data to enable interested parties to identify opportunities for investments. 12 C.F.R. Part 203.1(1).

HMDA data is reported on a lender’s Loan Application Register (“LAR”). For 2004, HMDA data generally includes information related to: (1) the loan application, including loan number, application date, owner occupancy, and loan amount; (2) action taken on the application, whether originated, denied, etc.; (3) property location, including census tract; (4) applicant’s ethnicity, race, gender, and income; (5) purchaser of the loan, e.g., Fannie Mae or Freddie Mac; (6) reasons for denial; (7) rate spread versus APR; and (8) lien status. For more detailed information on HMDA compliance, see A Guide to HMDA Reporting – Getting it Right!, at <http://www.ffiec.gov/hmda/pdf/2004guide.pdf>.

Congress delegated regulatory authority for the HMDA to the Federal Reserve. HMDA regulations, also known as Regulation C (12 C.F.R. Part 203) are on the Federal Reserve’s Banking Regulations web-site. <http://www.federalreserve.gov/banknreg.htm>. As a general rule, for 2004 HMDA reporting, only lenders with assets greater than \$33 million (as of December 31, 2003) and offices in Metropolitan Statistical Areas (“MSA”) are required to report HMDA data. 12 C.F.R. Part 203.2(e). For 2005 HMDA reporting, the asset size threshold is \$34 million. MSA’s, as of November 2004, are identified in OMB Bulletin No. 05-02.ⁱ First lien loans having an APR of less than three percentage points over the applicable Treasury yield and subordinate lien loans with an APR less than five percentage points over the applicable Treasury yield do not have to be reported under HMDA. 12 C.F.R. Part 203.4(12).

In the 1970’s, regulators and consumer groups argued borrowers in certain communities had no meaningful access to credit. Lenders were accused of red-lining if they were not servicing certain communities, based upon a perceived practice of drawing red lines on maps around areas for which they would not make loans. With the evolution of the sub-prime mortgage market in the 1990’s, credit was greatly expanded to riskier borrowers in certain areas.

Ironically, lenders today are defending allegations from regulators and others of reverse red-lining based upon accusations of over-servicing certain communities via high-interest non-prime loans. See e.g., Hargraves v. Capital City Mortgage Corp., 140 F. Supp.2d 7, 21-22 (D.D.C. 2000) (denying summary judgment on Fair Housing Act reverse redlining claim and concluding statistical data showing defendant “made a greater percentage of its loans in majority black census tracts than other subprime lenders,” together with a picture of one defendant and Mayor

Marion Barry and Jesse Jackson was sufficient to create material issue of fact showing that defendant “acted on the basis of race”).

HMDA’s enabling regulations initially required lenders to report only the geographic location of originated and purchased loans in MSA with census tract information. In 1989, the HMDA was amended and the required data expanded to include race, gender, and income for all loan applicants, including those denied access to credit. The purpose of this expanded HMDA reporting was to identify disparities in rejection rates by race, gender, or national origin. In 2002, the Federal Reserve amended the HMDA regulations for 2004 reporting to require rate spread price information for higher-priced loans, and to identify manufactured home loans and lien status.

The 2004 HMDA data still does not include several significant credit risk factors, such as credit history, debt-to-income ratios, and loan-to-value ratios. Therefore, a review of only the 2004 HMDA data may show skewed results not reflective of the reality of lending patterns. In fact, regulatory agencies have stated HMDA data will be used to identify lenders requiring further investigation, but acknowledge that discrimination cannot be proven by HMDA data alone. Federal Reserve Board, Frequently Asked Questions About New HMDA Data, March 31, 2005, at ¶ 14.

Reported 2003 HMDA data is available online at http://www.ffiec.gov/hmda/online_rpts.htm, and expanded 2004 data will be available from the Federal Reserve in September 2005. A complete set of the HMDA data is publicly available in digital format from the Federal Reserve. In the past few years, HMDA data has included approximately 45 million records. Accordingly, anybody can access the entire set of HMDA data and run any number of queries to identify suspected violations of the FHA, ECOA or other applicable laws.

This keystroke access to 2004 HMDA data and its facilitation of superficial comparisons of loan pricing based upon race and gender puts all financial institutions at risk for enhanced regulatory action and/or compliance reviews, public relations issues, lawsuits and more. No one wants to be in media headlines based upon a third-party’s unflattering comments about their HMDA data. In April of this year, one national bank lender was accused of “enforcing its own brand of economic apartheid and maintaining two separate and very unequal financial systems,” by the public interest group ACORN (emphasis added). Not surprisingly, the media seized upon this inflammatory language and reported it.

Based upon reputational and litigation risks, lenders need to review their HMDA data now to see what, if any, discrepancies may appear if and when a regulator, a public interest group, or a private attorney looking to file an individual or a class action suit begins reviewing it. Significantly, proof of an intent to discriminate, as required in employment cases under Title VII, is not required. As stated by the federal agencies’ joint Policy Statement on Discrimination in Lending, “evidence of discriminatory intent is not necessary to establish that a policy or practice adopted or implemented by a lender that has a disparate impact is in violation of the FHA or ECOA.” <http://www.fdic.gov/regulations/laws/rules/5000-3860.html>.

If your HMDA data raises questions, you may be put in the uncomfortable position of having to disprove any subjectively perceived disparate impact.

The expanded HMDA data that will be released in September 2005 enables instantaneous production of multiple and variant lists of lenders' track records appearing to show different treatment based upon race and/or gender. In fact, at American Conference Institute's HMDA Seminar in Washington, DC on June 13-15, 2005, the plaintiff's bar and public interest groups unequivocally stated that "there will be litigation" stemming from HMDA data release and aggregation.

The plaintiff's bar stated that cases will be brought under the FHA, 42 U.S.C. § 3601, which prohibits discrimination in all aspects of residential real-estate related transactions, including making loans, as well as purchasing, selling, brokering, appraising and renting property. The FHA provides for jury trials, compensatory damages, punitive damages, and attorneys' fees, perhaps even upon only nominal or injunctive relief. Though the individual nature of the loan application process should make class action certifications difficult, many of these cases will be plead as putative class actions.

If your HMDA data raises questions for regulators and others, you need to arrange for an in-depth analysis by statistical experts in this area. Software products are available to enable review of HMDA data and other non-HMDA data in almost any way imaginable. Because the HMDA only provides a piece of the puzzle, investigations will likely include data not required under HMDA such as loan-to-value ratios and/or debt-to-income. Numerous non-privileged reports could be generated in these investigations that may later be discoverable in litigation and/or sought by regulators. Accordingly, any such reviews should be protected by applicable privileges, including the self-testing privilege which has been narrowly defined in the applicable regulations, e.g., 12 C.F.R. Part 202.15(b), the attorney-client and/or work-product privileges, to ensure confidentiality of the analytical data.

Now is the time to make sure your company is ready for the potential fall-out from release of the expanded HMDA data in September by the Federal Reserve.

¹MSA's in South Carolina per OMB Bulletin No. 05-02, are identified as Aiken-Augusta (Aiken and Edgefield Counties), Charleston-North Charleston (Charleston, Berkeley and Dorchester Counties), Rock Hill-Charlotte-Gastonia (Union and York Counties), Columbia (Calhoun, Fairfield, Kershaw, Lexington, Richland and Saluda Counties), Florence (Darlington and Florence Counties), Greenville (Greenville, Laurens and Pickens Counties), Myrtle Beach-Conway-North Myrtle Beach (Horry County), Spartanburg (Spartanburg County) and Sumter (Sumter County).