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## BANK THINK

### Banks Should Steel Themselves for Fair Lending Game-Changer

By Warren W. Traiger

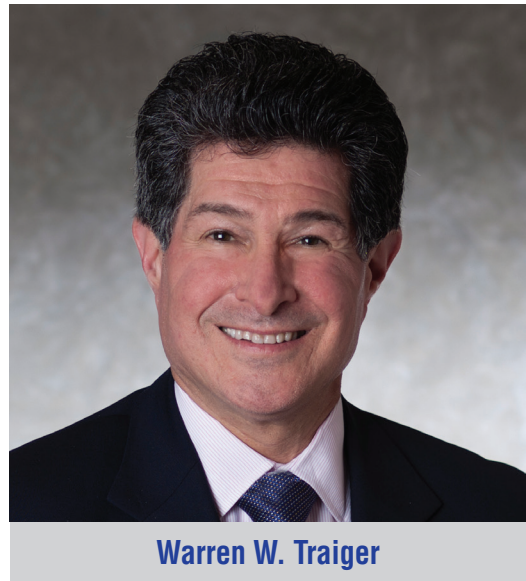
The Consumer Financial Protection Bureau's proposal to increase the categories of mortgage data collected and reported under the Home Mortgage Disclosure Act is, in the words of Yogi Berra, *déjà vu* all over again.

At least, it's *déjà vu* for those of us who have followed the HMDA since 1991, when the first reported data on mortgage applications and originations by race, ethnicity and sex was made public. That raw data, which did not take into account the credit quality of the applicants or proposed collateral, showed that black and Hispanic home loan applicants were, respectively, 2.4 and 1.5 times more likely to be rejected than white applicants. The findings ignited a firestorm of accusations about mortgage lending discrimination by public officials and advocacy organizations. Those accusations, which seemed to catch the industry by surprise, spawned the fair lending mortgage litigation and regulatory enforcement actions that continue unabated to this day.

The data to be reported under the CFPB's proposal is likely to further inflame the situation. Information that is currently proprietary, like applicants' credit scores and debt-to-income ratios and loan fees and interest rates, will now be shared annually with the CFPB and other regulators. The proposal will also allow regulators and potentially the public to analyze mortgage lending practices by applicants' age as well as by race, ethnicity and sex.

Make no mistake: this is a fair lending game-changer. Regulators will no longer need to wait until examination time to assess a lender's compliance with the anti-discrimination laws, since they will have annual access to a panoply of sensitive data from almost every mortgage lender. Agencies will be able to routinely crunch and compare data from across the industry and in any geographic area.

Moreover, it may be only a matter of time until the enhanced data becomes public. While the CFPB has delayed consideration of what data should be released, its proposal



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states that "public HMDA data [should] be modified only when the release of the unmodified data creates risks to applicant and borrower privacy interests that are not justified by the benefits of such release to the public." In other words, protecting the privacy of mortgage applicants will be the only limit on how the data is released.

This sets up the industry for 1991 redux. During the earlier period, many media outlets, advocacy groups and public officials concluded that loan denial disparities between white and minority applicants proved discrimination. This was notwithstanding the industry's assertion that HMDA data alone can never prove discrimination or, as the American Bankers Association put it, "any test for illegal discrimination in credit decisions that uses no control variables should be dismissed as incomplete, if not condemned outright as an attempt to mislead."

The industry's arguments in self-defense will be even less likely to resonate when calculations of raw denial disparities

by applicant race, ethnicity, sex and age are augmented with extensive information on an applicant's credit profile and the property to be mortgaged. With these additional data fields, the industry will no longer be able to argue there are no control variables.

The industry can take advantage of the proposal's comment period to attempt to limit the impact of certain of the CFPB's discretionary proposals, such as requiring quarterly HMDA reporting for high-volume institutions. But much of the proposal — particularly the enhanced data reporting — is mandated by the Dodd-Frank Act. This means that the CFPB's final regulation is unlikely to be very different from its proposal, particularly in terms of which additional fields of data must be reported.

However, unless the CFPB finalizes the rule by April 1 of next year, its effective date will not be earlier than January 1, 2017. This provides the industry with sufficient time to prepare for the new world of HMDA reporting. Here are three suggestions for using that time wisely.

First, analyze your application data as if the new rule was already in effect. Most lenders already routinely analyze their HMDA data and perform fair lending statistical analyses using data fields much like those that would be required by the proposal. As an experiment, analyze your lending data with just the fields mandated by the proposal and see whether the results show unexplained disparities in the approval of applications or pricing of loans.

Second, investigate any results that show unexplained disparities. If a statistical analysis using the enhanced HMDA data shows such disparities, consider modifying the analysis with additional explanatory data fields. If that doesn't help, dig deeper than the numbers by interviewing representatives of the business units responsible for underwriting and conducting appropriate file reviews.

Finally, address any remaining potential fair lending issues. If more in-depth statistical analysis and internal follow-up cannot explain disparities in decisions or pricing, consider whether additional training or changes to underwriting practices are necessary to eliminate unexplained disparities. It is preferable for a lender to find and address fair lending issues on its own, rather than have regulators, the media or advocacy groups uncover them.

In 1991, the industry was caught flat-footed by the release of mortgage application outcome data, and it continues to pay a price. This time, the industry can use the significant amount of time before the CFPB's new requirements take effect to understand and address any issues that may arise from the inclusion of new data fields. Put another way, the industry should keep in mind the words of another noted philosopher, George Santayana: "Those who cannot remember the past are condemned to repeat it." ■

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