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Statement of

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Office of Thrift Supervision

concerning

**Rooting Out Discrimination in Mortgage Lending:
Using HMDA as a Tool for Fair Lending Enforcement**

before the

Subcommittee on Oversight and Investigations of the
Committee on Financial Services
United States House of Representatives

July 25, 2007

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I. Introduction

Good afternoon, Chairman Watt, Ranking Member Miller, and Members of the Subcommittee. Thank you for the opportunity to present information regarding the activities of the Office of Thrift Supervision (OTS) on issues related to the Home Mortgage Disclosure Act (HMDA) and fair lending enforcement. Consumer protection, maintaining the safety and soundness of the thrift industry, and ensuring the continued availability of affordable housing credit are the three primary responsibilities of the OTS.

In my testimony today, I will describe the OTS's fair lending oversight program, including the resources we devote to this critical function; our use of HMDA data to conduct fair lending assessments and to enforce fair lending laws; and an overview of our fair lending priorities going forward. I will also address the various questions raised in the Chairman's invitation letter and attempt to provide you with the sense of purpose and priority with which OTS Director Reich has charged our Compliance and Consumer Protection Division proactively to address fair lending and related issues.

II. The OTS Fair Lending Program and Agency Resource Commitments

Among Director Reich's top priorities the past two years has been overhauling, upgrading and strengthening the resources in the OTS's Compliance and Consumer Protection Division. During the past year, the OTS re-established a centralized direction at our Washington headquarters for our compliance function, including fair lending oversight and enforcement. At the direction of Director Reich, the agency created new managerial positions and filled key vacancies within our Compliance and Consumer Protection Division. I was one of the senior managers hired in this effort. We also hired a Director of Consumer Regulations, primarily responsible for developing guidance for examiners and the industry regarding consumer compliance regulations, and an agency Fair Lending Specialist, who is primarily responsible for coordinating our national fair lending examination program.



In 2006, we hired 80 new examiners and we are in the process of hiring approximately 40 more this year. We are continuing to enhance our training and professional development programs, and we recently created five new positions for experienced Compliance Examination Specialists – one for each of our regional offices.

OTS examiners conduct comprehensive examinations every 12-18 months (depending on the asset size of the institution) that consist of an assessment of risk management and compliance risk. OTS examiners are cross trained in both disciplines. As of June 30, 2007, the OTS had approximately 556 examiners, specialists and managers. In addition, the OTS currently has a team of 65 examiners and supervisors with advanced knowledge and expertise in fair lending compliance.

These specialists are based in each of our five regional offices and we call upon them to analyze HMDA data and provide direction on the areas in which examiners should focus during each particular exam. These specialists also participate in fair lending exams and assist our other examiners in conducting fair lending assessments, particularly for institutions that present potential heightened levels of fair lending risk. OTS fair lending specialists supplement the talent and expertise of our examiners.

During the past year, the OTS expanded and refined its resources in the consumer protection area, and we will continue to supplement our number of fair lending specialists with additional hiring in this area.

A longstanding component of the OTS's fair lending oversight program is an examination process that begins at the point at which an institution first files for a charter from the OTS. During the application process, the most recent reports of examination by an applicant's federal regulator are reviewed for violations of fair lending regulations and/or weaknesses in the institution's compliance program. If problems or weaknesses are identified, an applicant must provide the OTS with sufficient evidence of corrective action before the agency will act affirmatively on the application. An applicant's inability to demonstrate that it has an effective compliance program will generally result in an unfavorable finding with respect to its managerial resources and a denial of the application.

Most types of OTS applications are also subject, pursuant to our regulations, to publication requirements that provide an opportunity for public comment on an applicant's fair lending activities and practices. Comments received by the OTS are considered during the application review process. Applicants with a less than satisfactory compliance rating also do not qualify for expedited treatment of their applications and, instead, must satisfy standard application filing requirements.

The OTS also educates and trains thrift institutions regarding new or emerging fair lending issues and trends. In our experience, communication and training facilitates



strong overall compliance risk management systems and controls within the industry that we regulate. This is consistent with the fundamental goal of our fair lending and overall compliance and consumer protection program to address potential problems before they arise.

III. Overview of Fair Lending Laws and OTS Oversight and Enforcement

OTS examiners utilize comprehensive interagency fair lending examination procedures to assess compliance with the Equal Credit Opportunity Act (ECOA), as implemented by Regulation B and the Fair Housing Act (FHA). ECOA prohibits discrimination based on race or color, religion, national origin, marital status, age, an applicant's receipt of income derived from public assistance, and an applicant's exercise of any right under the Consumer Credit Protection Act.

The FHA, implemented through the Department of Housing and Urban Development (HUD) regulations, prohibits discrimination based on race or color, national origin, religion, sex, familial status, or handicap. The FHA prohibits discrimination in transactions involving residential real estate including making a loan to buy, build, repair or improve a dwelling; purchasing real estate loans; selling, brokering or appraising residential real estate; or selling or renting a dwelling.

The existing examination process based on the interagency procedures enables us to identify and monitor potential or existing risks relating to fair lending compliance. In between the regularly scheduled exams that occur every 12 to 18 months, we engage in off-site monitoring that includes following-up on any issues raised during previous examinations and monitoring for changes in products, management, or services.

Pursuant to our examination procedures, OTS examiners evaluate whether savings associations discriminate against any group or groups covered by the fair lending laws in or by:

- failing to provide information or services – or providing different information or services regarding any aspect of the lending process. This includes communications about credit availability, application procedures, or lending standards;
- discouraging or selectively encouraging applicants with respect to inquiries about or applications for credit;
- refusing to extend credit or using different standards in determining whether to extend credit;
- varying the terms of credit offered including the amount, interest rate, duration, or loan type; or
- using different standards to evaluate collateral and related factors.



A. OTS's Fair Lending Oversight Program

Fair lending reviews are an integral part of OTS supervision to determine compliance with consumer protection laws and regulations. OTS examiners conduct a fair lending assessment during each comprehensive examination. In addition, examiners may conduct targeted fair lending reviews whenever circumstances warrant. The OTS examines institutions for compliance with fair lending laws regardless of whether the institution is required to report mortgage loan data under the HMDA. OTS examination procedures require our examiners to examine savings associations for various indications of discrimination, including potential discriminatory treatment in pricing. Although the current pricing analysis is primarily focused on higher-priced loans, examiners look for unlawful pricing discrimination at any pricing level.

In addition to HMDA data, OTS examiners incorporate other information in their investigations, such as 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 or other incentives 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 identified by the institution or whether they may be due, even in part, to unlawful discrimination.

OTS examiners also seek to detect other forms of discrimination, such as underwriting discrimination (denying credit on the basis of the applicant's race), marketing discrimination (advertising only in media serving nonminority areas or market), or redlining (denying credit on the basis of the racial characteristics of an applicant's neighborhood).

If unlawful discrimination is found, the institution is referred to the Department of Justice or HUD, in accordance with federal fair lending laws. Depending on the outcome of the referral and the nature of the violation, the OTS may take other action to resolve the matter fully. For example, the OTS may direct an institution to provide remedies to harmed parties and improve its fair lending compliance controls and policies.

B. OTS Use of HMDA Data for Fair Lending Assessments

Home loan data collected, reported, and publicly disclosed by OTS-regulated institutions under the HMDA plays a significant role in the OTS fair lending review of our institutions. Our HMDA review of individual institutions involves a multi-step process that I will describe more fully in the discussion below on what the 2004 and 2005 HMDA data revealed about patterns of mortgage lending to minority borrowers.



The HMDA requires all home lenders that are subject to its provisions annually to disclose specific data about mortgage transactions including applications received and loans originated, withdrawn or denied. This information is publicly available and can be used to aid in fair lending reviews and enforcement of lender programs.

The HMDA's goal is disclosure, not prohibition or restriction. The act does not require that any loan be made or refused. Instead, HMDA prescribes lender disclosures that make up a data set about lending activities. In 2006, OTS regulated institutions reported approximately 4 million 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 financed property.

OTS examiners use an institution's HMDA data, including denial data for loan applications and pricing data for loan originations, along with other information about an institution to determine our supervisory focus during the institution's fair lending examination. In some instances, the HMDA data are incorporated into statistical management systems to help determine whether race or national origin was a factor in credit decisions. Beginning with the 2004 HMDA data, these analyses incorporated additional loan-price data to provide information on annual percentage rate (APR) spreads on particular loans and lien status, among other items.

The effective use of HMDA data depends on a full understanding of the inherent limitations of those data. The HMDA data includes valuable information, but it does not include all of the 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, among many other lawful items that are factored into a final loan decision. However, HMDA involves a limited data collection that does not include the collection of such extra information. Thus, we cannot conclude from HMDA data alone that an observed racial or ethnic difference in loan pricing at an institution is the result of unlawful discrimination. This is the reason that OTS examiners consider additional information about a lender's underwriting and approval practices before coming to a conclusion about a lender's fair lending compliance record.

In order to more effectively target its examination resources, the OTS identifies "outlier" institutions that warrant special scrutiny because of larger pricing disparities for particular groups in one or more loan product areas than are evident for other OTS - supervised institutions. Institutions identified as outliers are asked to identify the mechanism through which borrowers obtain mortgage loans and the underwriting procedures and factors the institution considers in making pricing decisions for the loan product under review. As necessary, further analysis is used to determine the proper use of the pricing factors identified by an institution.



As described in the OTS's response to the Subcommittee's July 2, 2007, inquiry, the agency reviewed HMDA data for 2004 to 2006 for many institutions, including those identified as having statistically significant disparities in one or more mortgage product groups. In order to determine whether any fair lending issues were present, the OTS: (1) discussed the initial analysis with institution management staff and asked them to respond to us concerning their evaluation of the data; (2) requested and reviewed institution internal assessments as well as third party assessments of institutions' compliance with fair lending laws and regulations; and (3) requested and received additional data considered by the institutions to make their underwriting and pricing decisions.

In conducting our HMDA-based review of an institution, the specific factors we evaluate include, but are not limited to, loan-to-value ratios, credit scores, debt-to-income ratios, and APR analyses. We conduct our HMDA analysis on a nationwide basis, utilizing analytical tools and the additional data fields described here to evaluate institutions' HMDA data in connection with our overall assessment of institutions' fair lending activities and compliance.

We also strive to update and improve our review, as appropriate, in connection with our utilization of the HMDA data. For example, in connection with our HMDA follow-up evaluations the last two years, we built upon an evaluation framework previously developed in this area. OTS staff submitted data requests to institutions identified as having the potential for disparities in pricing or loan decisions. OTS staff then met in Washington to receive advanced training in analytical tools and to coordinate a nationwide strategy for our industry analysis. Each region investigated its institutions and performed on-site visits to conduct comparative file reviews. In some instances, we requested additional data from institutions to ensure comprehensive assessment of their fair lending program.

Our analysis of HMDA data from 2004 and 2005 led to targeted, additional, on-site examinations of approximately 25 institutions in 2005 and 2006. Our analysis of the 2006 HMDA data is ongoing, including on-site reviews and follow-up with particular institutions. On-site reviews based on the 2004-2005 HMDA data supplemented regularly scheduled fair lending reviews to determine the possibility of discriminatory pricing or application denial rates because of race or other factors. The OTS has completed assessment of the institutions based on the 2004 HMDA data and most of the institutions screened as having potential pricing disparities based on the 2005 HMDA data; however, several reviews based on the 2005 data are still ongoing.

Our analysis of the 2004 HMDA data did not reveal any fair lending violations representing a "pattern or practice" requiring a referral to the Department of Justice. However, our analysis did reveal areas where institutions need to address potential weaknesses that, if left unchecked, could result in future violations. The actions that we advised institutions to take to address potential problems included the following:



- Adding specific questions to a Quality Assurance pricing checklist to determine if the underwriter properly priced the loans;
- Conducting extended, targeted fair lending training;
- Enhancing fair lending analysis as part of normal business operations;
- Enhancing a monitoring program for brokers and correspondents;
- Augmenting an internal fair lending review process with review techniques suggested in the Interagency Fair Lending Examination Procedures;
- Implementing more detailed underwriting standards to ensure that exceptions and compensating factors are applied consistently to all applicants; and
- Monitoring application disparities on a monthly basis and ensuring that loan officers are notified of disparities on a regular basis.

In all cases, OTS examiners work with institutions to assist in their fair lending training, monitoring and/or tracking of mortgage brokers and loan personnel in order to strengthen institutions' fair lending compliance programs.

OTS examiners have also conducted exhaustive analysis of most of the 2005 HMDA data as described previously, and analysis of the 2006 data is in progress. As this work continues and our analyses are finalized on the remaining 2005 data and the 2006 HMDA data, we will take all appropriate actions, including referrals to the Department of Justice, wherever our examination findings reveal referable violations of the fair lending laws.

C OTS Use of Consumer Complaint Information

Effective fair lending enforcement also requires a robust consumer complaint mechanism to address issues as they arise. This involves timely and effective handling of fair lending issues with the regulated entity that is the subject of a complaint. It also requires using information collected in the complaint process to improve consumer protection monitoring, oversight and enforcement of regulated institutions and the industry. In addition to monitoring consumer complaint activity at individual institutions to address potential issues during on-site examinations, OTS consumer complaint staff assists in identifying trends that may suggest the need for industry guidance.

The OTS continually tracks, investigates and responds to consumer complaints involving thrift institutions with respect to loan and deposit product offerings and services. Consumer complaint staff and managers prepare summaries of consumer complaints for the use of OTS examiners during on-site examinations. For example, institution consumer complaint records are an integral part of the OTS individualized Pre-Examination Response Kits (PERK), our request for data to be used during the exam. This data plays a significant role in identifying areas for examiner focus during on-site



examinations. These records also play a critical role in assessing the adequacy of an institution's overall compliance management program and in pursuing corrective action that may be appropriate to address programmatic weaknesses or deficiencies.

D. OTS Training Activities and Programs

Another aspect of the OTS fair lending program involves comprehensive and effective training and continuing education of examiners, including supervisory and compliance staff regarding fair lending issues. As previously highlighted, the agency also educates and trains institutions and the industry regarding new or emerging fair lending issues and trends.

E. Recent OTS Fair Lending Enforcement Actions

Regarding formal fair lending enforcement actions, the OTS has undertaken ten enforcement actions involving ECOA issues, and nine actions involving HMDA issues since January 1, 2004. These cases have resulted in three Cease and Desist Orders and Civil Money Penalties totaling \$117,500, as well as other institutional changes sought by the OTS.¹

The OTS is committed to active and ongoing fair lending supervision of the institutions we regulate. We will undertake enforcement actions, when and as appropriate, to address fair lending deficiencies among our supervised institutions. We will also continue strive to ensure that borrowers at OTS-regulated thrifts enjoy a lending environment free from unlawful discrimination.

IV. Interagency Pilot Project to Expand Fair Lending Reviews at Depository Institution Holding Company Subsidiaries and Affiliates

The OTS continues to expand the tools and supervisory approaches we utilize in our fair lending compliance and oversight of the thrift industry. One example of our efforts in this area is a pilot project we recently announced involving both depository institution holding company regulators, the OTS and Federal Reserve Board (FRB), as well as the Federal Trade Commission (FTC) and several state banking departments, as facilitated by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR). This effort complements our existing oversight programs by enabling targeted consumer protection compliance

1. Among the institutions receiving cease and desist orders in conjunction with a finding under ECOA, one institution was cited for not using its rate sheets and not having written guidelines to govern the assignment of interest rates to its residential customers. In addition, no documentation for pricing decisions was found in the loan files of that institution, and a significant number of HMDA reporting errors were identified. Another institution was cited for an ECOA violation for not advising applicants of their right to receive a copy of the appraisal report used in conjunction with applications for secured credit, and for the erroneous collection of monitoring information.



reviews of selected non-depository lenders with significant subprime mortgage operations.

This collaborative state/federal pilot project is scheduled to begin in the fourth quarter of this year and will focus on non-depository subsidiaries of bank and thrift holding companies, as well as mortgage brokers doing business with, or working for, these entities. In addition, the states will conduct coordinated examinations of independent state-licensed subprime lenders and their associated mortgage brokers. The agencies will investigate a sample of entities subject to their oversight and review. The agencies will share information about their reviews and investigations, collaborate on the lessons learned, and seek ways to improve cooperation in ensuring effective and consistent reviews of these institutions.

By joining together in applying a coordinated review program, the agencies will be better positioned to evaluate and more consistently assess subprime mortgage lending practices across a broad range of mortgage lenders and other participants within the industry.

In connection with the pilot project, the agencies will evaluate companies' underwriting standards, as well as senior management oversight of the risk management practices used for ensuring compliance with state and federal consumer protection regulations and laws, including HMDA, ECOA, the Truth in Lending Act, the Real Estate Settlement Procedures Act, the Federal Trade Commission Act (FTC Act), and the Home Ownership and Equity Protection Act. The agencies will also initiate appropriate corrective or enforcement action, as warranted by the findings of the reviews or investigations.

At the conclusion of the reviews, the agencies will analyze the results of the pilot project and determine whether the project will be continued. If so, the agencies will determine the focus of future reviews at that time.

V. OTS Proposed Rulemaking on Unfair or Deceptive Acts or Practices

Another critical aspect of the OTS's compliance program is ensuring that our authority is clear and unambiguous; that the entities that we regulate understand the laws under which we expect them to operate; and that we consistently apply these standards to all segments of the industry we regulate.

Consistent with our commitment to ensuring that our institutions understand what is expected of them with regard to compliance with federal consumer protection statutes and rules, the OTS is developing an advanced notice of proposed rulemaking (ANPR) that will seek comment on various issues involving unfair or deceptive acts and practices (UDAPs). Our goal in pursuing an ANPR is to solicit public comment on whether the



OTS should expand its current prohibitions against UDAPs and provide greater clarity regarding how we will make UDAP determinations going forward.

Pursuant to the ANPR, we hope to solicit comment on our authority to promulgate rules under the FTC Act and the Home Owners' Loan Act; identify existing OTS rules on UDAPs; solicit input on various approaches the OTS should consider in a UDAP rule, including existing guidance the FTC has adopted, approaches taken by various states through anti-predatory lending laws, and various models other federal agencies taken to define and prohibit unfair or abusive lending practices. We expect that the ANPR will also solicit comment on the principles the OTS should consider in determining whether a product or practice is unfair or deceptive and whether the agency should consider various practices unfair or deceptive.

Finally, we recognize that the financial services industry and consumers benefit from consistent rules and guidance in the oversight of similar areas and activities. The federal banking agencies (FBAs) have adopted uniform or similar rules in many areas, and we hope to solicit comment in the ANPR regarding the application of consistent interagency UDAP standards among the FBAs. We anticipate a 90 comment period and expect the ANPR to appear in the Federal Register during the coming weeks. We look forward to receiving public comments from consumer advocates, the financial services industry and other members of the public.

VI. Conclusion

The OTS is committed to effective fair lending supervision and enforcement on an industry-wide basis. Consumers clearly benefit from transparency and industry-wide compliance with fair lending and other consumer protection laws. We are committed to ensuring that the institutions we regulate understand our commitment to enforcement of fair lending laws, and that consumers of the institutions we regulate are treated fairly and equitably under all applicable fair lending and consumer protection statutes.

Thank you, Mr. Chairman, Ranking Member Miller, and Members of the Subcommittee for the opportunity to present the views of the OTS on the critical subject of fair lending and consumer protection. I look forward to your questions.