Testimony of Bill Himpler for the American Financial Services Association

Before

The Subcommittee on Oversight and Investigations of
The House of Representatives Financial Services Committee

For the Hearing Entitled
Rooting Out Discrimination in Mortgage Lending: Using HMDA as a Tool for Fair Lending Enforcement

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Good Afternoon, Chairman Watt, Ranking Member Miller and Members of the Subcommittee. My name is Bill Himpler and I am Executive Vice President for Federal Affairs at the American Financial Services Association located here in Washington, DC. AFSA's 350 member companies include consumer and commercial finance companies, "captive" auto finance companies, credit card issuers, mortgage lenders, industrial banks and other financial service firms that lend to consumers and small businesses.

I commend you, Mr. Chairman, and your colleagues for holding this hearing today on how Home Mortgage Disclosure Act (HMDA) is being used to meet the objectives of our country's fair lending laws. We believe recent events have shown that HMDA is already working as intended. While other laws – such as the Equal Credit Opportunity Act -- provide a means for enforcement action against lending discrimination, HMDA serves as an "early warning system" by identifying lending patterns that warrant additional investigation.

<u>The Importance of the Subprime Market</u>
At the outset, let me state that the mortgage sector -- indeed, the entire financial services industry -- stands shoulder to shoulder with you in its commitment to the principle that any disparity in lending that is based on race or ethnicity is unacceptable, period.
To that end, AFSA believes the industry has a very good story to tell.

Responding to challenges from federal, state and local governments to address redlining concerns in the 1960s and 1970s, our companies worked with Congress, regulators and others to bring access to credit into every neighborhood. But we haven't stopped there.

Together, over the last twenty years, the industry has worked with policymakers and consumer groups as we developed and embraced new technology that has allowed us to better serve more consumers. Prior to the 1990s, a consumer with blemishes on his or her credit record was essentially shut out from the dream of home ownership. No one can argue that is the case today.

In response to calls for increased minority home ownership, AFSA member companies have played a critical role in the nation's record level of home ownership, with the greatest growth seen among minorities. Since 2002, 2.8 million families became first-time home owners.[1]

At the same time, the mortgage industry is working with community partners to meet a new challenge: rising defaults and foreclosures. As part of my testimony, I have attached a summary of initiatives undertaken by AFSA's member companies to help borrowers avoid losing their homes.

While all of us should be concerned about foreclosures, we must not lose sight of the fact that more than four out of five subprime borrowers are making timely payments and

[1] John M. Robbins, Chairman of the Mortgage Bankers Association, speech to the National Press Club. Washington, DC. May 22, 2007.

managing their credit effectively.[2] As we discuss the HMDA data and ways to make our credit system even better, we must be mindful how any changes might affect liquidity. More importantly, we cannot cripple the industry's ability to provide manageable borrowing options for borrowers facing reset or the possibility of foreclosure.

Results from Analysis of the 2004 HMDA Data

The analysis of the 2004 HMDA data by Federal Reserve Board authors Robert Avery, Glenn Canner and Robert Cook was published in their September, 2005 Federal Reserve Bulletin article.[3] They focused on differences across racial groups in 1) loan rejection rates, 2) incidence of higher-priced (reportable) loans, and 3) the average price paid by those who receive higher-priced (reportable) loans.

The 2004 data (unadjusted for risk characteristics associated with the borrower or loan) show that African- American and Hispanic borrowers have a higher incidence of higher priced loans relative to non-Hispanic whites (and Asians). In the category of purchase money first liens, 32.5 percent of African American borrowers received higher-priced loans, compared to 20.3 percent of Hispanic borrowers and 8.7 percent of non-Hispanic white borrowers.

Yet, the authors are clear that comparing raw incidence data can provide an incomplete and misleading picture because they don't account for differences in the risk of either borrowers or loans. While the HMDA data are limited, they do contain information on borrower income, location of the property, property type and the identity of the lender. After adjusting for those factors, contained in the HMDA reports, the percentages of purchase money first liens made as "higher priced" fall to 15.7 percent for African American borrowers and 11.5 percent for Hispanic borrowers, as compared to 8.7 percent for non-Hispanic white borrowers.

Regarding the remaining incidence differential, the authors remind the reader that "We emphasize that the Federal Reserve's statistical analysis system is only a screening tool. The HMDA data alone, no matter how much they are manipulated, cannot be used to conclude whether a particular applicant was treated adversely . . . The data reveal little about an individual's financial circumstances [e.g., borrower risk score, total debt, loan-to-value ratio, documentation and stability of income] and nothing about the condition or value of the property offered as collateral."[4]

Let me be perfectly clear here. No study based on HMDA data alone can generate a conclusion that any lending institution has violated fair lending laws. The only reliable way to reach defensible conclusions about fair lending practices is through a combination of statistical analysis and loan file review through the examination process, the approach that is used by the Federal Reserve.

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[2] Robbins, May 22, 2007.

[3] Robert Avery and Glenn Canner, *New Information Reported under HMDA and Its Application in Fair Lending Enforcement.* Federal Reserve Bulletin. Summer 2005. p 344-394.

[4] Avery and Canner, p 389-390.

2005 HMDA Data and Analysis

The Federal Reserve staff noted that the incidence of higher-priced lending was significantly greater in 2005 than in 2004. The authors attribute at least three effects contributed to this increased incidence of higher-priced lending.

The flattening of the yield curve and its relationship to fixed-rate loans is identified as having a critical effect. The spread between the APRs on thirty-year fixed-rate mortgages and the yield on the thirty-year Treasury security used to compute the threshold for HMDA reportable loans narrowed over the 2004-05 period.[5]

The second effect was a combination of the flattening of the yield curve and the APRs used to determine whether adjustable-rate loans met the threshold for being reported as higher priced under HMDA were artificially low in 2004. This stems from the relationship between the formula used to construct APRs for such loans and the interest rate situation that prevailed during the year. By the beginning of 2005, this effect had been largely eliminated because of the flattening yield curve. Consequently, ARM loans with the same credit-risk characteristics, would have had higher APRs in 2005 than in 2004, and therefore some of them would have surpassed the HMDA threshold in 2005, whereas a loan with the same risk characteristics would not have been reported as higher priced in 2004.[6]

Finally, the authors noted that the change in incidence reflected changes in the risk characteristics of lending due in large part to substantial house-price appreciation in some locales, and likely caused more borrowers to stretch financially to obtain loans.

Allocating the increase in the incidence of higher-priced lending across these three effects is difficult. Analysis of the 2004 HMDA data revealed substantial disparities in the incidence of higher-priced lending across racial and ethnic lines and further showed that such differences could not be fully explained by factors included in the HMDA data. The 2005 data show similar patterns.

Concerns About Expanding HMDA Data

Recognizing that the HMDA data is incomplete begs the question as to why Congress doesn't expand it to include borrower risk factors which would provide a more complete picture. There are four principal arguments against such an expansion.

First and foremost, an expansion would raise additional privacy concerns for consumers. Between existing HMDA data and other publicly available data, the identity of borrowers can already be determined. Many people would prefer that their neighbors not know their credit score.

Second, a requirement to collect credit scores in the HMDA data would raise the question of which credit scoring system to include. Fair Isaac's FICO score is the best known, but

[5] Robert Avery, Kenneth Brevoort, and Glenn Canner, *Higher-Priced Home Lending and the 2005 HMDA Data.* Federal Reserve Bulletin. September 8, 2005.
[6] Avery, Brevoort, and Canner.

it is certainly not the only one used. Indeed, many creditors make lending decisions based upon their own proprietary scoring systems in addition to a FICO score.

Third, lenders would have to divulge the weight they give to different risk factors in pricing their loans, thereby eliminating any trade secrets that allow for vibrant competition.

And fourth, an expansion of HMDA wouldn't necessarily increase its effectiveness as a screening tool and is likely to cause the negative results just mentioned.

Recommendations

So if an expansion of the HMDA data is not the way to go, what do we recommend?

For one thing, we should recognize that the process is working as it should. Following the analysis of loan pricing data in both the 2004 and 2005 data sets, the Federal Reserve made referrals to fellow regulators at the federal state levels. Investigations are underway as we speak. Should this committee decide to make changes to HMDA or other fair lending provisions, it should do so only after reviewing all the facts that the regulators have to report.

We also must not forget that conclusions can only be drawn by looking at individual loan files, which regulators at the federal and state level already have the authority to do.

In addition, we must be mindful of how any changes to HMDA might affect the industry's ability to provide borrowing options for borrowers facing reset or foreclosure.

Finally, it's worth repeating that -- no matter how small -- pricing disparities between borrowers who have different racial or ethnic backgrounds but identical economic risk profiles and types of loans are unacceptable. Going forward, Congress, regulators, the mortgage lending industry and others committed to affordable lending should work together to determine why any disparities exist so that we can take the necessary steps to eliminate them.

Mr. Chairman, I want to thank you again for inviting me to participate in this important hearing. That concludes my statement and I would be happy to answer any questions the Members of the Subcommittee may have.