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The Fair Lending Implications of the New Home Mortgage Disclosure Act Data

BY WARREN W. TRAIGER AND JOSEPH CALLUORI

For the first time, pricing information on mortgage loans made by essentially every U.S. lender is about to be made public.[1] The 2004 data, collected pursuant to the Home Mortgage Disclosure Act (HMDA),[2] will show the extent to which each lender made higher-priced loans, as well as the volume and cost of such loans by borrower race, ethnicity, and sex. Because preliminary analyses of data released by individual lenders have shown that minority and women borrowers were more likely to receive higher-priced mortgages,[3] many have predicted, and some advocacy groups have called for, enforcement actions by government regulators and private lawsuits brought by aggrieved borrowers. In this article, we will examine these accusations and expectations while attempting to answer the following questions:

- Did regulators initially intend that data collected pursuant to the new HMDA regulation would be used as evidence of discrimination?
- To what extent are the new HMDA data reliable evidence of lending discrimination?
- How are federal and state regulators likely to use the new HMDA data, and would the public be better served if regulators followed a different course?
- Are dire predictions about the new HMDA data fostering a wave of private lawsuits well-founded, and how much does the new data really help the plaintiff's bar?
- How should lenders, particularly banks, prepare to meet these challenges?

What Did the Regulators Envision?

In 2000, the Federal Reserve Board first proposed expanding the information reported under HMDA to include pricing. The 2000 proposal would have required lenders to report each loan's annual percentage rate (APR). The Board noted that such information would help identify higher-priced or "subprime" loans and might "also help the public and supervisory agencies identify practices that potentially raise fair lending concerns and warrant further investigation."[4]

Based on comments received on the 2000 proposal, the Board modified its approach to require that lenders report the spread between a loan's APR and the comparable Treasury yield, only when that spread is at least

[1] The Federal Financial Institution Examination Council is expected to publish 2004 HMDA data in September 2005 at http://www.ffiec.gov/hmda/publicdata.htm.

[2] 12 U.S.C. §§ 2801-2810

[3] Pricing data from individual lenders has been available upon request since March 31, and the media, advocacy organizations, and others, including our law firm, have analyzed the data and publicized their conclusions.

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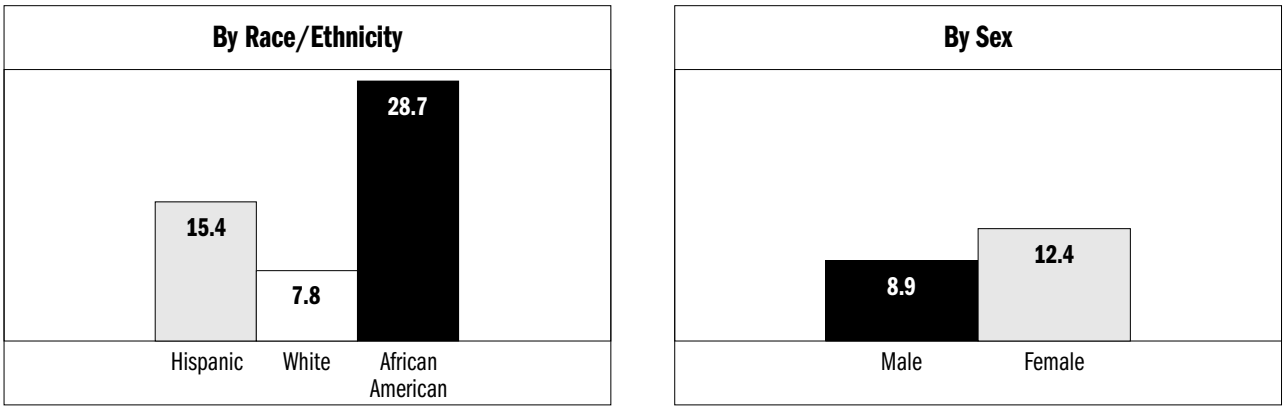
[4] 65 Fed.Reg. 78,661 (December 15, 2000).

Proportion of Higher-Priced Loans for First Lien Home Purchase Loans for Leading National Mortgage Lenders



Source: National Community Reinvestment Coalition, Preapprovals and Pricing Disparities in the Mortgage Marketplace: A NCRC Follow-Up Report for National Homeownership Month, June 2005, available at http://www.ncrc.org/pressandpubs/press_releases/documents/Preapproval_Report_June05.pdf. de5166g1

three percentage points for first-lien loans and five percentage points for junior-lien loans. The Board again noted that ''[o]btaining loan pricing data is critical to address fair lending concerns related to loan pricing and to better understand the mortgage market.''[5] The revised regulation took effect on January 1, 2004.

While the revised regulation was prompted by fair lending concerns related to loan pricing, a strong case can be made that the new HMDA data are not a reliable indicator of discrimination. Both regulators and the courts have stated repeatedly that HMDA data alone can never conclusively prove or disprove discrimination.[6]

Moreover, the regulators themselves have consistently stated that compliance with the anti-discrimination laws can only be assessed through extensive statistical analyses of borrower credit quality and other loan particulars, followed by a case-by-case review of credit decisions made on individual loans.[7] Given the state of the law, the regulators should not be stampeded into bringing enforcement actions based on the new HMDA data alone, especially since the meaning of the HMDA data is still far from clear. The reasons for disparities in the distribution of higher-priced loans are manifold; the disparities may be the result of a combination of factors which cannot all be identified; and at least some of the factors contributing to these disparities will vary from lender to lender and from region to region.

What Do the New HMDA Data Actually Show?

Depending upon which aspect of the preliminary data one focuses, the data suggest diametrically opposed conclusions. As Federal Reserve Board Governor Edward M. Gramlich noted in a June speech:

The initial data also suggest that prevalence of higher-priced loans differs notably across racial and ethnic groups. As some press accounts have implied, the data indicate that blacks and Hispanics are more likely to take out higher-priced loans than non-Hispanic whites, and that Asians are the least likely to have higher-priced loans. These preliminary data also seem to indicate that the actual prices paid by those taking out higher-priced loans are about the same for different racial groups.[8]

Emphasizing the greater likelihood of blacks and Hispanics to have higher priced loans, borrower advocates have declared the new HMDA data to be evidence of widespread lending discrimination. For example, based on data it received from leading mortgage lenders summarized in the chart below, the National Community Reinvestment Coalition concluded that ''price discrimination and widespread price disparities are present in minority and working class communities.''[9]

Source: National Community Reinvestment Coalition, *Preapprovals and Pricing Disparities in the Mortgage Marketplace: A NCRC Follow-Up Report for National Homeownership Month*, June 2005, available at http://www.ncrc.org/pressandpubs/press_releases/documents/Preapproval_Report_June05.pdf.

In contrast, a Traiger & Hinckley LLP study of leading mortgage lenders supported Governor Gramlich's second observation that the cost of higher-priced loans was essentially the same for all borrowers. Based on data received from leading mortgage lenders summa-

[5] 67 Fed.Reg. 7,228 (February 15, 2002).

[6] *Lee v. Bd. of Governors*, 118 F.3d 905,915 (2d. Cir. 1997).

[7] *See*, Board of Governors of the Federal Reserve System, Department of Housing and Urban Development, Federal Deposit Insurance Corporation, National Credit Union Administration, Office Of The Comptroller of the Currency, Office of Thrift Supervision, ''Answers to Frequently Asked Questions About New HMDA Data'' Q.14 at 5 (March 31, 2005), available at http://www.federalreserve.gov/boarddocs/press/bcreg/2005/20050331/attachment.pdf.

[8] Remarks by Governor Edward M. Gramlich to the National Association of Real Estate Editors, Washington, D.C., June 3, 2005, available at http://www.federalreserve.gov/boarddocs/speeches/2005/20050603/default.htm.

[9] *Testimony of National Community Reinvestment Coalition: Before the Congressional Black Caucus Regarding the New HMDA Data*, June 27, 2005, available at http://www.ncrc.org/pressandpubs/press_releases/documents/Henderson_CBC_Testimony_June05.

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rized in the chart below, we concluded that ''among first lien home purchase borrowers with rate spreads, lenders are treating minority and female homebuyers fairly.''[10]

Source: Traiger & Hinckley LLP, *A Study of Reported Rate Spreads by Borrower Race and Sex*, May 31, 2005, available at http://www.traigerlaw.com/includes/hdma/hdma_rate_spread_study.pdf .

Federal Regulators Likely Use for the Data

Despite the conflicting inferences one can draw from the new HMDA data, federal regulators have announced their intent to use this data as a ''screening tool'':

Though the price data do not support definitive conclusions, they are a useful screen, previously unavailable, to identify lenders, products, applicants, and geographic markets where price differences among racial or other groups are sufficiently large to warrant further investigation. Enforcement and supervisory agencies can use this screen to better target their resources. HMDA price data can also be a valuable part of any mortgage lender's self-evaluation program.[11]

The screening tool analogy may underestimate the impact the new HMDA data will have upon regulators' interactions with lenders. For example, the Office of the Comptroller of the Currency's Senior Counsel has told lenders that even ''if the new data does nothing more than show concentrations of high cost loans in minority neighborhoods'' a lender will bear the burden of showing that ''this result was the product of nondiscriminatory lending decisions.''[12] These comments appear to shift to lenders the burden of proving that disparities reflected in their HMDA data are not the result of discrimination.

Accordingly, we anticipate that some lenders will face tough scrutiny from regulators intent on identifying a discriminatory practice or policy that explains the distribution of a lender's higher-priced loans. Indeed, the OCC has suggested that it already has made some preliminary decisions on which lenders will receive heightened scrutiny.[13] Dire consequences await those whose lending activities are suspect. The worst case scenario would occur under a provision of Federal Reserve Board Regulation B which mandates referral to the Attorney General if a regulator has ''reason to believe that one or more creditors engaged in a pattern or practice of discouraging or denying applications in violation of the [Equal Credit Opportunity Act], the agency shall refer the matter to the Attorney General.''[14] Regulators also have the option of a referral to the Attorney General for lesser violations.

Even if the new data do not lead regulators to conclude that a violation of the Equal Credit Opportunity Act or the Fair Housing Act has occurred, they could use the Community Reinvestment Act (CRA) to penalize banks that fail to present a persuasive explanation for disparities in the distribution of higher-priced loans. For example, a regulator might find an extreme concentration of higher-priced loans in a lower-income neighborhood in a bank's assessment area, but a file review and interviews may fail to establish a causal link between that statistical disparity and a discriminatory policy. Although these circumstances would militate against a finding of discrimination, a regulator could still conclude that the bank had not done enough to meet the credit needs of the neighborhood where the higher-priced loans are concentrated. The latter conclusion could adversely impact the bank's CRA rating.

How Are State Regulators Likely to Use the Data?

Like their federal counterparts, state regulators will likely to use the new HMDA data as a screening tool for identifying lenders that warrant more extensive scrutiny. The new HMDA data could also affect evaluations under state analogues of the CRA.

For example, shortly after the release of the preliminary data, New York Attorney General Eliot Spitzer, invoking his authority to enforce state anti-discrimination law,[15] sent letters to several banks asking for information regarding their lending practices and policies, and for their 2004 HMDA data. Both the OCC and the Clearinghouse Association, acting on behalf of its member banks, responded with lawsuits for injunctive relief,[16] arguing that compliance with New York's requests would contravene 12 U.S.C. § 484, which, according to the OCC's interpretation, grants the OCC exclusive ''visitorial'' authority over national banks and their operating subsidiaries. The case is still pending in the district court. However, we believe that *Wachovia v. Burke*,[17] a recent case in which the Second Circuit essentially deferred to the OCC's broad interpretation of its authority to preempt state law, prefigures a victory for the OCC and Clearinghouse Association.

Although the OCC's opponents argue that a ruling in its favor will seriously undercut the enforcement of fair lending laws, such ominous predictions are probably just rhetorical excess. While the turf war between the OCC and the state attorneys general does raise some important issues of statutory construction and the future of the dual state and federal banking system, the reality is that regardless of the outcome of the lawsuits, state attorneys general will still have substantial authority to inquire into the lending activities of a host of banks and bank subsidiaries that are not regulated by the OCC. For example, there are 5,265 banks that fall

[10] Traiger & Hinckley LLP, *A Study of Reported Rate Spreads by Borrower Race and Sex*, May 31, 2005, at 8, available at http://www.traigerlaw.com/includes/hdma/hdma_rate_spread_study.pdf .

[11] Board of Governors of the Federal Reserve System, Department of Housing and Urban Development, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, Office of Thrift Supervision, ''Answers to Frequently Asked Questions About New HMDA Data,'' Q.16 at 5-6 (March 31, 2005) *supra*..

[12] ''OCC Vows Early Activist Stance on HMDA,'' *BNA Banking Report*, Vol. 83 No. 12, p. 501 (October 4, 2004).

[13] *Id*., (noting that the OCC ''is already contacting a group of banks that includes high-volume home mortgage lenders, institutions with a heavy focus on subprime lending, and banks with previously identified compliance weaknesses in their mortgage lending business'').

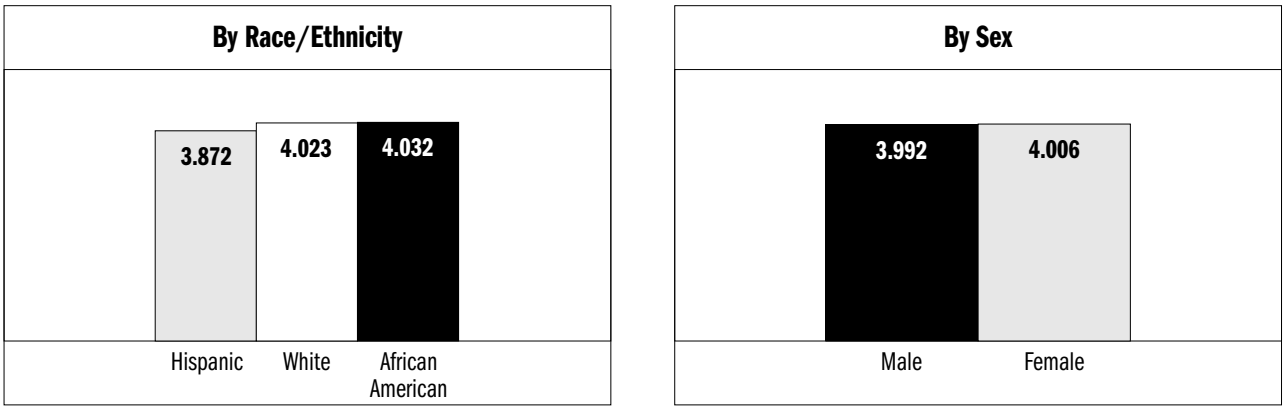
[14] 12 C.F.R. § 202.17(b)(3).

[15] N.Y. Exec. Law § 296-a (unlawful discriminatory practices in relation to credit).

[16] *Office of the Comptroller of the Currency v. Eliot Spitzer*, No. 05 Civ. 5636 (S.D.N.Y.) (SHS); *The Clearing House Association, L.L.C. v. Eliot Spitzer*, No. 05 Civ. 5629 (S.D.N.Y.) (SHS).

[17] No. 04-3770-cv, 2005 U.S. App. LEXIS 13904 (2d Cir. July 11, 2005).

Average Rate Spreads for First Lien Home Purchase Loans for Leading National Mortgage Lenders



Source: Traiger & Hinckley LLP, A Study of Reported Rate Spreads by Borrower Race and Sex, May 31, 2005, available at http://www.traigerlaw.com/includes/hdma/hdma_rate_spread_study.pdf . de5166g2

under the jurisdiction of the Federal Deposit Insurance Corporation, the primary federal regulator of federally insured state-chartered banks that are not members of the Federal Reserve System.[18] The Federal Reserve Board is the primary federal regulator for another 926 banks. All of these banks are fair game for states attorneys general.

Moreover, the states are in many instances the primary or sole regulator of other major participants in the mortgage lending industry, for example mortgage companies not affiliated with banks and mortgage brokers. Although some of these entities also fall within the jurisdiction of United States Department of Housing and Urban Development (HUD), these non-bank entities have for the most part operated ''under the radar.''

The failure of both state and federal regulators to subject mortgage brokers and non-bank lenders to the same sort of scrutiny that banks receive on a regular basis in all likelihood contributes to the higher price of credit for certain protected classes. For example, in 2000, the United States Treasury Department and HUD concluded:

The subprime mortgage and finance companies that dominate mortgage lending in many low–income and minority communities, while subject to the same consumer protection laws, are not subject to as much federal oversight as their prime market counterparts—who are largely federally supervised banks, thrifts, and credit unions. The absence of such accountability may create an environment where predatory practices flourish because they are unlikely to be detected.[19]

The new HMDA data could serve as both an incentive to state regulators to take a closer look at non-bank participants in the home mortgage market and as a screening tool to target those lenders whose activities warrant closer scrutiny.

How Are Private Litigants Likely to Use the Data?

A recent series of lawsuits alleging that automobile financing companies unjustifiably charged higher rates to blacks and Hispanics[20] suggests that the new HMDA data may lead to a wave of class action lawsuits against banks and other mortgage lenders. However, while the new HMDA data do provide potential litigants with important information that the plaintiffs in the automobile finance cases had to work very hard to acquire, it is far from certain that the data will spawn massive private litigation over home mortgage lending.

In the automobile lending cases, plaintiffs' lawyers argued that blacks and Hispanics routinely paid substantially higher interest rates as a result of automobile lenders' tactics, in particular ''dealer markups'' that were often split between the dealer and the lender. Unlike mortgage lenders, automobile finance companies are not required to keep records of a borrower's race or ethnicity. To the contrary, outside the home mortgage context, the collection of such data is expressly prohibited by Regulation B.[21] Therefore, to prove that black and Hispanic borrowers suffered an adverse impact as a consequence of the dealer markups, plaintiffs' attorneys would have had to employ other means to obtain

[18] http://www.fdic.gov/about/strategic/strategic/bankingindustry.html

[19] Departments of Housing and Urban Development and the Treasury, ''Curbing Predatory Home Mortgage Lending: A Joint Report'' 17–18 (June 2000), available at http://www.treas.gov/press/releases/report3076.htm.

[20] *See, e.g., Claybrooks v. PRIMUS Automotive Financial Services, Inc.*, Civil No. 3:02-0382 (M.D. Tenn. Jan. 18, 2005) (Trauger, J.); *Coleman v. General Motors Acceptance Corp.*, 220 F.R.D. 64, 73-74 (M.D. Tenn. 2004) (disparate impact challenge to GMAC's markup policy presented common issues of law and fact); *Cason v. Nissan Motor Acceptance Corp.*, 212 F.R.D. 518, 520 (M.D. Tenn., 2002) (disparate impact challenge to NMAC's markup); *Jones v. Ford Motor Credit Co.*, 00 Civ. 8330 (RJH) (KNF) 2005 U.S. Dist. LEXIS 5381 (S.D.N.Y. March 31, 2005)

Rodriguez v. Ford Motor Credit Co., 2002 U.S. Dist. LEXIS 7280, 2002 WL 655679, at *3 (N.D. Ill. 2002) (Rule 23(a)(2) (allegation that Ford's finance company allowed dealers to impose higher finance charge markups on Hispanic customers)

[21] 12 C.F.R. § 202.5(b).

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borrower race, including combing loan files for photocopies of drivers licenses. Obviously, the new HMDA data will save time and effort for lawyers seeking to demonstrate a disparate impact on protected class home mortgage borrowers.

However, the new HMDA data do not establish a prima facie case with respect to each and every element of a disparate impact claim. The data do not establish a causal link between higher credit costs for protected class borrowers and a particular practice or policy. As the Supreme Court recently reminded plaintiffs in an age discrimination suit, it is not enough to simply allege that there is a disparate impact on a particular protected class ''or point to a generalized policy that leads to such an impact.''[22] Rather, the plaintiff is ''responsible for isolating and identifying the specific. . .employment practices that are allegedly responsible for any observed statistical disparities.''[23]

In addition, a variety of nondiscriminatory factors including FICO scores, loan-to-value ratios, and debt-to-income ratios may explain at least some of the disparities indicated by the new HMDA data. However, none of this information is reflected in the new HMDA data. Thus, a reasonably prudent plaintiff's lawyer is unlikely to conclude on the basis of the new HMDA data alone that there is a viable fair lending claim against a particular lender. On the other hand, undertaking the sort of statistical analysis that is necessary to help prove that discriminatory factors are the cause of disparities in a lender's HMDA data is a formidable task, especially since much of this information is not publicly available.

Furthermore, notwithstanding the apparent successes of the plaintiffs' bar in class actions against automobile finances companies, class actions may have lost some of their luster for plaintiffs' lawyers. Obtaining class action certification in the automobile lending lawsuits was often fraught with difficulty, and plaintiffs had mixed success. Even when they succeeded in obtaining class certification, some plaintiffs found the relief available to them limited. For example, in *Coleman v. General Motors Acceptance Corp*,[24] the Sixth Circuit held that class certification was improper because the plaintiffs sought monetary relief, a request which, because it required individualized determinations of fact, ''was fatal to class certification under Federal Rule of Civil Procedure 23(b)(2).'' The plaintiffs ultimately gained class certification by limiting themselves to declaratory and injunctive relief.[25]

Thus, while the new HMDA data may in some instances help plaintiffs define a class, the limited availability of monetary damages[26] may still be a significant economic disincentive to federal class action lawsuits. One strategy plaintiffs have utilized to overcome the pitfalls of and restrictions on federal class lawsuits is to file suit in state court where the law is often more favorable.[27] However, the Class Action Fairness Act of 2005[28] makes it easier for defendants to remove a state class action to federal court, and consequently, state class actions may become a less effective strategy for plaintiffs' lawyers.

Lenders Need to Analyze the New HMDA Data The need for lenders to analyze their own HMDA data cannot be emphasized too strongly.[29] Federal and state regulators and the public will soon have ready access to essentially every lender's 2004 data sorted by state, metropolitan statistical area, county, and census tract.[30] Rightly or wrongly, regulators will impose on the regulated the burden of proving that disparities are the result of nondiscriminatory factors. Lenders can prepare to meet this challenge by analyzing their HMDA data. Moreover, such analyses will aid a lender in assessing its vulnerability to lawsuits, and, assuming they refute discrimination, provide strong defenses against potential lawsuits.

To start, lenders should heed regulators' exhortations to examine their data, focusing on the proportion of higher-priced loans made to protected class borrowers and the average rate spreads for those loans. Appropriate control groups should be selected and a lender's performance should be contrasted to that of its peers.[31] Distinct analyses should be performed for each geographic area in which the lender does a meaningful amount of business.

A lender with a greater proportion of higher-priced loans and/or higher average rate spreads to protected class borrowers should investigate the reasons for the disparities, particularly if they exceed those of its peers. A lender's investigation should include statistical analyses (such as multiple linear regressions) of its proprietary data affecting loan pricing, like credit scores,

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[22] *Smith v. Jackson*, 125 S. Ct. 1536; 161 L. Ed. 2d 410, 422 (2005), citing *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642, 656 (1989).

[23] *Id.*

[24] 296 F.3d 443, 449 (6th Cir. 2002).

[25] *Coleman v. General Motors Acceptance Corp.,* 220 F.R.D. 64 (M.D. Tenn. 2004).

[26] This factor may, however, vary depending upon the federal court where the action is brought. Some circuits employ a ''bright line'' test, where certification under Fed. R. Civ. Pro. 23(b)(2) is limited to claims involving no more than ''incidental damages.'' *See, e.g., Allison v. Citgo Petroleum Corp*., 151 F.3d 402, 415 (5th Cir. 1998); *see also Barabin v. Aramark Corp*., 2003 U.S. App. LEXIS 3532, 2003 WL 355417, at *1-*2 (3d Cir. 2003) (adopting the *Allison* approach to incidental damages); *Jefferson v. Ingersoll International Inc*., 195 F.3d 894, 898 (7th Cir. 1999) (same). In the Second Circuit, however, compensatory damages (and by implication, disgorgement) remain available in a (b)(2) action where the ''positive weight or value [to the plaintiffs] of the injunctive or declaratory relief sought is predominant even though compensatory . . . damages are also claimed.'' *Robinson v. Metro-North Commuter R.R. Co*., 267 F.3d 147, 164. n19 (2d Cir. 2001).

[27] For example, in California a demand for damages is not fatal to class certification. *See, e.g, Daar v. Yellow Cab* Co., 67 Cal.2d 695 (1967) (discussing difference between California and federal class action law on this point).

[28] P.L. 109-2, § 2, 119 Stat. 4.

[29] Although the scope of this article is limited to the new pricing data, a lender's analysis should also focus on the HMDA data relating to the source of applications and application outcome. A lender should compute its share of applications and denial rates for protected classes and control groups and compare them to peer figures and to its own performance over the past several years. A significantly lower share of applications from protected classes than peers and higher denial rates to protected classes than control groups, especially as compared with peers, may be indicia of discrimination.

[30] The Federal Financial Institution Examination Council is expected to publish this data in September 2005 at http://www.ffiec.gov/hmda/publicdata.htm.

[31] Prior to public release of HMDA data, lenders can compare their data to the already available analyses performed by such sources as the *Wall Street Journal*, Traiger & Hinckley LLP, and the National Community Reinvestment Coalition.

loan-to-value ratios, debt-to-income ratios, and prevailing interest rates. The purpose of these analyses is to determine whether, after controlling for borrower qualifications and relevant loan characteristics, protected class and similarly-qualified control group borrowers paid comparable average APRs. If the statistical results indicate that a protected class paid meaningfully higher average APRs, then the lender will need to dig deeper.

A lender should test negative statistical findings by reviewing a sample of loan files involving similarly-qualified protected class and control group borrowers, where the protected class borrowers paid higher APRs. For each of these loans, the reason for and magnitude of the unexplained pricing disparity should be recorded. Those pricing adjustments resulting from factors that were not, or could not, be included in the statistical analysis should be identified and their fair lending ramifications evaluated. If the file review indicates that a protected class paid higher APRs based on prohibited factors, a lender will need to expeditiously change its policies and procedures.

More Constructive Approach Needed

The accusations of discrimination that accompanied the preliminary release of the new HMDA data are particularly troubling, because the actual reasons why certain protected class borrowers were more likely to take out higher-priced loans have yet to be determined. Moreover, these accusations are contradicted, at least in part, by analyses of the new HMDA data which show that the cost of higher-priced loans was essentially the same for all borrowers. Hopefully, a more constructive approach will prevail when all the data are released. Most importantly, regulators and credit advocacy groups need to acknowledge that banks are not the only participants in the home mortgage industry, and that the vast majority of abuses in the lending market are committed by other participants that seem almost perennially immune to regulatory scrutiny.

Decades of fair lending enforcement should have taught regulators that a coordinated approach by federal and state agencies is necessary to address unfairness in the lending industry. Instead, the release of the new HMDA data precipitated a lawsuit over whether the OCC or the states should have the right to investigate and sanction certain lenders. Given the shrinking resources available to government generally and the enormous challenges involved in making sure that all persons have equal access to credit, federal and state regulators ought to coordinate their efforts to insure proper scrutiny of all participants in the lending process.

Finally, although the fallout from public release of the new HMDA data will create more burdens for lenders, it may also open new opportunities if, as credit advocates seem to suggest, there are substantial numbers of protected class borrowers who are sufficiently creditworthy to qualify for prime mortgages. Lenders ought to be able to devise a way to penetrate this market, and those lenders who move first are likely to reap the greatest rewards.

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