Reporting Issues Under the Home Mortgage Disclosure Act

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October 24, 2008

Congressional Research Service
7-5700
www.crs.gov
RL34720

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

Recent developments in the subprime home loan market have triggered concern in Congress and the public at large as to whether borrowers were fully informed about the terms of their mortgage loans. Some observers have suggested that some borrowers in the subprime market may have been victims of predatory lending practices or other discriminatory activity. Bills introduced in the 110th Congress, such as S. 1299 (Senator Charles Schumer et al.) and S. 2452 (Senator Christopher Dodd et al.) would seek to remedy perceived abuses particularly with higher-priced mortgage lending.

This report describes current issues and recent changes to the Home Mortgage Disclosure Act (HMDA) of 1975. Also included are brief explanations of how recent reporting revisions may affect the reporting of loans covered by the Home Ownership and Equity Protection Act of 1994 as well as those insured by the Federal Housing Administration.

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Introduction

Recent mortgage repayment problems and subsequent increases in foreclosures have generated concern in Congress as to whether borrowers are taking out high interest loans that they cannot afford.[1] There are at least four possible explanations why some borrowers receive higher-priced loans. First, borrowers with weak credit histories may face higher borrowing costs than borrowers with better credit histories if lenders require more compensation for taking on greater credit or default risks. Second, the actual costs of the mortgage may have been hidden or simply not transparent when borrowers entered into the lending transaction. Hidden costs can surprise a borrower and cause financial distress, which may lead to foreclosure. Third, borrowers may have entered into high cost loans as a result of discrimination. According to the Federal Reserve Board, minorities are still more likely to pay rates above specified pricing thresholds (prior to controlling for some related borrower characteristics).[2] Fourth, recent mortgage repayment problems may reflect a rise in various forms of predatory lending. In short, borrowers may have obtained expensive mortgage loans for a variety of reasons, which may have resulted in recent repayment problems.

Various legislation has been enacted to oversee lending practices in the mortgage market. The Home Mortgage Disclosure Act (HMDA) of 1975 requires the disclosure of mortgage loan information so regulators can monitor mortgage lending activity.[3] In addition, the 1994 Home Ownership Equity Protection Act (HOEPA), enacted as an amendment to the Truth-In-Lending Act (TILA) of 1968, requires additional disclosures to consumers for high cost refinance and other non-purchase loans secured by their principal residences.[4] The Real Estate Settlement Procedures Act (RESPA) of 1974 is designed to protect mortgage borrowers from paying excessive fees related to real estate transactions. RESPA requires standardized disclosures about the settlement or closing costs of residential mortgages.

This report briefly describes the role of HMDA reporting for monitoring higher-priced lending activities, discusses policy issues, and summarizes recent regulatory decisions made by the Federal Reserve Board, the agency that implements these statutes.[5] This report also discusses how HOEPA and federally insured mortgage loans may be affected by recent regulatory changes.

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[1] For more detailed information on subprime lending, see CRS Report RL33930, *Subprime Mortgages: Primer on Current Lending and Foreclosure Issues*, by (name redacted).

[2] See Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, "Higher-Priced Home Lending and the 2006 HMDA Data," *Federal Reserve Bulletin*, September 2006.

[3] P.L. 94-200, 12 U.S.C. Sections 2801-2809.

[4] TILA is contained in Title I of the Consumer Credit Protection Act, P.L. 90-301, 81 Stat. 146, as amended by 15 U.S.C. Section 1601 et seq. TILA requires lenders to disclose the cost of credit and repayment terms of mortgage loans before borrowers enter into any transactions. The Federal Reserve Board implements TILA through Regulation Z.

[5] The Real Estate Settlement Procedures Act (RESPA), which was enacted in 1974 under P.L. 93-533, 88 Stat. 1724, 12 U.S.C. Sections 2601-2617, is another piece of legislation designed to protect mortgage borrowers from paying excessive fees related to real estate transactions. RESPA requires standardized disclosures about the settlement or closing costs of residential mortgages. See CRS Report RL34442, *HUD Proposes Administrative Modifications to the Real Estate Settlement Procedures Act*, by (name redacted).

Background on HMDA Reporting

HMDA was enacted in 1975 to assist government regulators and the private sector with the monitoring of anti-discriminatory practices.[6] HMDA is implemented by the Federal Reserve Board via Regulation C (12 CFR Part 203), and the public loan data set is available at the Federal Financial Institutions Examination Council's website.[7] HMDA data is used to assist with the supervision and enforcement of fair lending compliance.[8] The Office of the Comptroller of the Currency (OCC), for example, is a federal agency that uses the HMDA data to assist with its fair lending and Community Reinvestment Act (CRA) examinations of nationally chartered banks.[9]

Reporting Issues Prior to 2008

Redlining and Frequency of Rejection

When HMDA was enacted, there was concern that less affluent and minority neighborhoods did not enjoy the same access to financial services as do other neighborhoods. Financial institutions allegedly accepted deposits but did not make mortgage loans in certain neighborhoods, and these lending practices were viewed as contributing to further neighborhood deterioration. HMDA required institutions covered under the law to report home mortgage originations by geographic area, financial institution type, borrower race, sex, income, and whether the loans were for home purchase or refinance.[10] This information would show geographical patterns of mortgage originations and help regulators determine where further investigation of redlining, or geographical discrimination, was necessary.

In 1989, Congress expanded HMDA to include the race, sex, and borrower income of those applicants that were *rejected* as well as those who were approved.[11] This change allowed regulators to monitor the frequency that applicants from certain groups were denied mortgage loans relative to other groups.[12] The HMDA data could then be used to track any differences in denial rates by income, race, and gender.

[6] P.L. 94-200, 12 U.S.C. Sections 2801-2809.

[7] See http://www.ffiec.gov/hmda/.

[8] Reference to fair lending laws and regulations typically encompasses enforcement of the Fair Housing Act, which is Title VIII, Section 800 of the Civil Rights Act of 1968 (P.L. 90-284, 82 Stat. 73, 81-89). For more information on fair lending examination procedures as well as definitions of discrimination types, see http://www.occ.treas.gov/handbook/fairlep.pdf.

[9] See http://www.occ.treas.gov/handbook/hmda.pdf. The Community Reinvestment Act of 1977 is Title VII of P.L. 95-128, 12 U.S.C. 2901. Regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities where they are chartered to do business. See http://www.bos.frb.org/commdev/commaff/cra.pdf and CRS Report RL34049, *Community Reinvestment Act: Regulation and Legislation*, by (name redacted).

[10] See http://www.fdic.gov/news/news/press/2005/pr3005a.html.

[11] P.L. 101-73, 103 Stat 183. Sections 1211(d) and 1212.

[12] See http://www.federalreserve.gov/boarddocs/speeches/2005/20050603/default.htm.

Risk-Based Pricing

Beginning in the 1990s, credit became increasingly available for less creditworthy borrowers. Instead of turning down loan requests for borrowers of lower credit quality, lenders began charging these borrowers higher interest rates to compensate for the additional risk. As a result, regulators monitoring discrimination began to show greater concern about the mortgage loan rates charged to different groups of borrowers.

Congress expanded HMDA in 2002 to include *rate-spread* information. At the time, the rate-spread was defined as the difference between the annual percentage rate (APR), which is the annual *total* cost of a loan, and the rate on U.S. Treasury securities of comparable maturity. The *flat* mortgage interest rate was not chosen because, by definition, it contains only the cost of the principal loan amount expressed as a percentage. The APR, however, includes the cost of the principal loan amount, insurance, and other fees—all expressed as a percentage. The law requiring rate-spread information was implemented in 2004.[13]

Reporting Requirements and Coverage

All home-secured mortgage loans do not get reported under HMDA, for at least three reasons. First, covered institutions, or those subject to HMDA reporting requirements, include only those banks, savings and loans, credit unions, and mortgage and consumer finance companies that meet thresholds regarding asset size or percentage of business related to housing-lending activity. Lenders that do not have offices in metropolitan statistical areas are also not required to report HMDA data. Second, Regulation C requires lenders to report only loans that meet certain rate-spread thresholds. The reporting thresholds for first mortgage loans had been those with a spread of 3 percentage points; for the second mortgage loans, the reporting threshold was 5 percentage points. Loans not meeting these rate-spread thresholds would not be reported. Third, home equity loans taken out for purposes other than home improvements or other home related purposes are not reported under HMDA. Given that only loans meeting statutory requirements are reported, HMDA currently covers approximately 80% of the national mortgage market.[14]

Difficulties Identifying High-Priced Lending Abuses

The HMDA data, like all databases, has its caveats. When using the HMDA data to identify high-priced lending activity, understanding data limitations is important to correctly interpret the empirical findings. Key issues are presented below.

Lack of Credit History Information

The HMDA data has been criticized for not including more variables that could be used to either verify or rule out discrimination. An example of a relevant variable is borrower credit history information. Some borrowers pay more for their loans relative to others because they exhibit higher levels of credit risk. Having credit history information would be necessary to determine if observed pricing differentials reflect differences in financial risk or discrimination. Other useful

[13] P.L. 107-155, 116 Stat 81.

[14] See http://www.federalreserve.gov/BoardDocs/Speeches/2005/20050331/default.htm and http://www.frbatlanta.org/invoke.cfm?objectid=37B810A9-5056-9F12-12E8EB312FB291A7&method=display_body.

variables include borrower characteristics, such as total assets and debts, and loan characteristics, such as the loan-to-value ratio. Given that HMDA data do not include all relevant information that bears on lender risk, the basis for individual lending decisions is portrayed incompletely.

Lenders are not required to report every variable used to evaluate applicants because the HMDA data is released to the public, which could compromise the privacy of individuals holding reported loans. It is possible that public users of HMDA data would be able to match collected information with local records and determine the identity of individuals. Because federal regulator agencies can obtain loan data from financial institutions they wish to examine more closely, the reporting of all borrower information to HMDA is not necessary for those agencies that enforce fair lending and fair housing laws.

Federal agencies also follow Interagency Fair Lending Examination Procedures, provided by the Federal Financial Institutions Examination Council (FFIEC), to evaluate unlawful discrimination in the prime market.[15] These procedures include review of (1) sample bank loan files; (2) loan prices relative to compensation of brokers; (3) whether the institutions use pricing models that are empirically based and statistically sound; and (4) whether the disparities are substantial.[16] Hence, even if more variables were collected, HMDA data are intended for use in targeting institutions for closer examination but not as the sole basis for enforcing anti-discrimination laws in individual cases.[17]

Reporting Problems with the APR

With greater usage of complex non-traditional mortgage loan products, the APR may become increasingly difficult indicator to interpret.[18] The APR tells nothing about balloon payments, prepayment options, or the length of term that an adjustable interest rate is locked.[19] In addition, closing costs vary by state, which means local differences will always persist. Hence, the APR measure may provide little information about relative pricing, because the underlying loan products and terms vary substantially.

Movements in Interest Rates

Changes in short-term relative to long-term rates, also known as yield curve rotations, may affect loan reporting to HMDA. Given that mortgage loans are often priced on rates that better reflect the expected life-span of the loan (as opposed to rates that match the entire mortgage term), the HMDA data can reflect a *duration-matching* problem rather than a problem of excessive higher-priced lending.[20] For example, borrowers often sell their homes or refinance into a new mortgage

[15] See http://www.dallasfed.org/ca/pubs/fair.html and http://www.ffiec.gov/PDF/fairlend.pdf.

[16] The Department of Justice, which investigates fair lending cases, establishes a *pattern and practice* of discrimination before it charges lenders with violating federal discrimination laws. See http://www.usdoj.gov/crt/housing/housing_pattern.htm.

[17] See http://www.federalreserve.gov/newsevents/press/bcreg/20070412a.htm.

[18] For more information on non-traditional mortgage products, see CRS Report RL33775, *Alternative Mortgages: Causes and Policy Implications of Troubled Mortgage Resets in the Subprime and Alt-A Markets*, by (name reda cted).

[19] Regulation Z requires lenders to assume the interest rate situation at the time of origination will continue for the term of the loan when calculating the APR for adjustable-rate loans.

[20] If investors (lenders) are promised returns associated with longer-term loans but receive returns associated with (continued...)

before their existing mortgage expires. Regulation C, however, had required the rate-spread calculation for 30-year (fixed or adjustable rate) mortgage loans to use the 30-year Treasury yield as the benchmark rate. Suppose Treasury market interest rates change so that shorter-term rates rise relative to longer-term rates. The rate-spreads calculations, which may have even been negative under a steeper yield curve, will increase and may become positive, potentially resulting in more loans meeting the HMDA thresholds. Consequently, such timing or duration mismatches captured by the rate-spread calculations, which increase when the differences in duration between APR and benchmark rates are large, could result in more 30-year fixed rate mortgages reported as HMDA rate-spread loans.

Interest rate changes may also affect the reporting of higher-priced lending in particular if the proportion of adjustable-rate mortgages (ARMs) relative to fixed-rate mortgages increases. A flattening of the yield curve is likely to cause the rate-spreads on both fixed rate mortgages and ARMs to be similar in size. As a result, ARMs would have higher rate spreads relative to those computed under steeper yield curves, and there would be an increase in the number of ARMS reported as high-priced loans.[21]

Recent Modifications to Regulation C

To address some concerns described above, the Federal Reserve has changed the benchmark rate used to calculate the rate-spread for reporting HMDA loans.[22] The Federal Reserve proposes use of the average mortgage rates found in the Primary Mortgage Market Survey (PMMS) conducted by Freddie Mac as the benchmark rates for rate-spread calculations.[23] The reporting thresholds for first mortgage loans will now be those with a spread equal to or greater than 1.5 percentage points; for the second mortgage loans, the reporting threshold will be equal to or greater than 3.5 percentage points. The use of an average prime mortgage rate, which the PMMS reports on a weekly basis, is likely to follow the rates of prime mortgage rates more closely than Treasury rates. Whenever the yield curve changes, a rate-spread computed as the difference between a mortgage rate and an average prime mortgage rate is likely to show less volatility than one computed as the difference between a mortgage rate and a Treasury rate. As a result of this regulatory change, it may become easier to attribute an observable increase in rate-spread reported loans to actual changes in lending practices, which ultimately is the objective for HMDA reporting.

(...continued)

shorter-term loans, they may be unwilling to make future loans, especially if yields consistently fail to meet expectations. Hence, mortgage originators price mortgages using rates that closely match the expected duration or mortgage life. Lenders may account for prepayment or early termination risk by pricing mortgages using Treasury rates equal to or less than 10 years.

[21] For a formal analysis concerning the extent to which the increase in HMDA reportable rate-spread loans between 2004-2006 can be attributed to the flattening of the yield curve, see Chau Do and Irina Paley, "Explaining the Growth of Higher-Priced Loans in HMDA: A Decomposition Approach," Journal of Real Estate Research, Vol. 29, No. 4 (2007) pp. 441-447.

[22] See http://www.federalreserve.gov/newsevents/press/bcreg/20081020b.htm.pdf.

[23] See http://www.freddiemac.com/.

Implications for HOEPA Loans

The 1994 Home Ownership Equity Protection Act (HOEPA) is an amendment to the Truth-In-Lending Act (TILA) of 1968. TILA requires lenders to disclose the cost of credit and repayment terms of all consumer loans before borrowers enter into any transactions.[24] HOEPA imposes additional disclosure requirements for consumers obtaining high cost refinance and other non-purchase (closed-ended second) loans secured by their principal residences. A loan is considered to be a HOEPA loan if either the APR exceeds the rate of a comparable Treasury security by more than 8 percentage points on a first mortgage, 10 percentage points on a second mortgage, or if the consumer pays total points and fees exceeding the *larger* of $561 or 8% of the total loan amount.[25] Should a loan satisfy any of these criteria, the borrower must be provided with disclosures three days before the loan is closed in addition to the three-day right of rescission generally required by TILA, which means a total of six days to decide whether or not to enter into the transaction. In 2002, revisions to Regulation C required lenders to report HOEPA loans in HMDA, and they must also identify such loans as being subject to HOEPA requirements.[26] HOEPA, however, is implemented via Regulation Z (12 CFR Part 226, sections 31, 32, and 34).

HOEPA has been extended to cover more loans.[27] Since 2002, coverage has been extended by lowering the price trigger from 10 to the current 8 percentage points above a comparable Treasury security. The Federal Reserve Board has also amended Regulation Z to apply HOEPA rules to all mortgage lenders (and not just those supervised and examined by the Federal Reserve).[28] The amended rule added four key protections. The first protection prohibits lenders from making loans based upon the home value without regard for the borrower's ability to repay the loan from income and assets. Second, verification of income and assets will be required for determining repayment ability. Third, higher-cost loans may not have prepayment penalties that last for more than two years, and prepayment penalties are not allowed for loans in which the monthly payment can change during the initial four years. Finally, escrow accounts for property taxes and homeowners' insurance must be established for all first lien mortgages. Additional protections covered in the rule are described in the Federal Reserve announcement.[29]

HOEPA loans may have been considered a subset of the larger set of HMDA loans when both rate spread calculations relied upon comparable U.S. Treasury securities for the benchmark rates. Now that the Federal Reserve has modified the benchmark rates used to compute HMDA rate spreads, HMDA and HOEPA rate spreads will be calculated under separate methods. The benchmark rate for computing HOEPA loans is defined by federal statute, and modification of the benchmark rate for HOEPA loans would be left for Congress to decide. Loans meeting the existing HOEPA thresholds may still simultaneously meet the newly adopted HMDA thresholds.

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[24] TILA is contained in Title I of the Consumer Credit Protection Act, P.L. 90-301, 81 Stat. 146, as amended by 15 U.S.C. Section 1601 et seq. The Federal Reserve Board implements TILA through Regulation Z.

[25] The $561 figure is for 2008. The Federal Reserve Board adjusts this number annually based upon changes to the Consumer Price Index. See http://www.occ.treas.gov/ftp/bulletin/2007-32a.pdf and http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea19.shtm. The figure for 2009 will be $589. See http://www.federalreserve.gov/newsevents/press/bcreg/20080805a.htm.

[26] See http://www.federalreserve.gov/boarddocs/press/bcreg/2002/20020621/default.htm and http://www.bankersonline.com/lending/jh_regc.html.

[27] See http://www.federalreserve.gov/boarddocs/press/boardacts/2001/200112142/attachment.pdf.

[28] See http://www.federalreserve.gov/newsevents/press/bcreg/20080714a.htm.

[29] For more detailed information about HOEPA, see CRS Report RL34259, *A Predatory Lending Primer: The Home Ownership and Equity Protection Act (HOEPA)*, by (name redacted).

HOEPA rate spreads, however, will now be more sensitive to Treasury yield curve movements than HMDA rate spreads.

Implications for FHA-Insured Loans

Mortgage insurance is usually required for borrowers lacking either a downpayment or home equity of at least 20% of the property value. Prime (or conventional) as well as subprime homebuyers may purchase private mortgage insurance. The Federal Housing Administration (FHA) is a federally operated mortgage insurance program that primarily serves first-time and less creditworthy borrowers.[30] Should the borrower default on a FHA-insured mortgage loan obligation, the lender will be reimbursed for the loss. The FHA is a self-financing program under which premiums must be sufficient to cover its costs and expected losses. FHA fees are collected via an upfront premium charge when the loan is originated and an annual premium charge thereafter.

After passage of the Housing and Economic Act of 2008, FHA received the statutory authority to charge up to 3% in its upfront premium and 0.55% annually.[31] Consequently, the bulk of the total mortgage insurance premium must be collected upfront, and FHA has little flexibility to collect a larger portion of the insurance fees via the annual premium mechanism. FHA-insured mortgage loans, therefore, run the risk of hitting the 1.5% threshold of reportable HMDA rate-spread loans. The FHA upfront premium charges would likely be calculated in the APR of the mortgage loan, which would cause the rate-spread to be higher.

The flexibility to shift how the FHA insurance fees are collected or, more specifically, to make greater use of the annual premium mechanism, arguably has at least three advantages. First, annual premium collections would reduce the risk of FHA loans being incorrectly identified as higher-priced loans under HMDA reporting requirements. Second, computing refunds or premium reductions via the annual premium may arguably be easier should FHA borrowers become eligible for rebates.[32] Third, under certain circumstances, an annual premium mechanism may also reduce financial burdens on FHA borrowers. For example, borrowers planning to reside in their homes for a relatively short period of time would not incur additional interest costs due to financing large insurance premiums into their mortgage loans.

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[30] For an introduction to the FHA program, please see CRS Report RS20530, *FHA-Insured Home Loans: An Overview*, by (name redacted) and (name redacted).

[31] P.L. 110-289, 122 Stat. 2654. For the current FHA premium pricing structure, see http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/0822ml.doc.

[32] See letter that discusses FHA having to resume payment of distributed shares to customers when a surplus of reserves had accumulated in the Money Market Insurance Fund at http://www.gao.gov/archive/2000/rc00280r.pdf.