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Home Mortgage Disclosure Act 2004 Report: Opening the Floodgates

by [Steve Laitinen](#) and [Jane Hill](#)

Recently, data disclosed under the Home Mortgage Disclosure Act ("HMDA") has placed mortgage lenders under the proverbial microscope. The Federal Reserve Board's 2004 Home Mortgage Disclosure Act Report to federal banking regulators revealed apparent widespread pricing disparities among racial and ethnic groups. The Fed and other regulatory agencies are trying to find a better explanation for why minority groups received a disproportionate share of higher cost home loans in the 2004 HMDA data. To that end, the Federal Reserve Board has asked a number of state member banks (reportedly 25) to explain their lending practices. Understandably, this news has mortgage lenders concerned about negative public perception and media backlash, potential class-action lawsuits, and anticipated audits of lending practices. In order to help alleviate the concerns of financial institution clients, it is prudent to understand the history and purposes of HMDA, and the ways in which such data is disclosed and reported.

HMDA Overview

Congress enacted HMDA in 1975 and made it permanent in 1988. The scope of covered institutions expanded significantly from 1988 to 1992 and again in 1993. HMDA requires depository and non-depository lenders to collect and publicly disclose information about housing related loans and applications for such loans, including several applicant or borrower characteristics. HMDA is implemented by the Federal Reserve Board's Regulation C (12 CFR Part 203) and a staff commentary (12 CFR Part 203, Supp. I).

HMDA resulted from public concern over credit shortages in certain urban neighborhoods. Congress believed that some financial institutions had contributed to the decline of some geographic areas by failing to provide adequate and reasonable home financing to qualified applicants. The goals of HMDA and Regulation C are: (1) to provide the public with information that will help show whether the housing credit needs of the financial institution's neighborhoods and communities are actually being met; (2) to aid public officials in directing public investments from the private sector to areas where they are needed; and (3) to collect and disclose data about applicant/borrower

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characteristics to identify possible discriminatory lending patterns and enforce anti-discrimination statutes. In 2002, additional HMDA disclosure requirements arose from concerns about predatory and discriminatory lending and the booming sub-prime market. The additional HMDA disclosures, including loan pricing, were enacted to get a better picture of where and to whom sub-prime loans are being targeted. The loan pricing data was first reported in the highly publicized 2004 HMDA report.

As the name implies, HMDA is a disclosure law. It does not prohibit any specific lender activity, nor does it establish a mortgage loan quota system for statistical metropolitan or other geographic areas. Instead, HMDA relies upon public scrutiny for its effectiveness.

For each calendar year, a financial institution covered under HMDA and Regulation C must collect and publicly disclose data regarding its applications, originations, and purchases of home purchase loans, home improvement loans and refinancing. An institution's size, location and whether it is in the business of residential mortgage lending generally determines whether it is covered. Home purchase loans, home improvement loans and re-financings each are specifically defined under the Act. Every loan application, origination, and purchase that falls into one of the three categories must be reported. Data must also be given for loan applications that did not result in origination, including applications that were denied, withdrawn or closed for incompleteness, as well as applications approved by the institution but not accepted by the applicant.

With some exceptions, for each transaction the lender reports data about the loan, such as its type and amount; the property, such as its location and type; the disposition of the application, such as whether it was denied or resulted in an origination; and the applicant (namely ethnicity, race, sex and income). For each application or loan, institutions are required to identify the purpose (home purchase, home improvement, or refinancing), lien status, and whether the property relating to the loan or loan application is to be owner-occupied as a principal dwelling. The regulation requires financial institutions to identify the following general loan types: conventional, FHA-insured, VA-guaranteed, and FSA/RHS (Farm Service Agency/Rural Housing Service) guaranteed. Lenders must also report information regarding the pricing of the loan. Additionally, lenders must identify the type of purchaser for mortgage loans that they sell. The form used to report this information is known as the HMDA loan/application register (or the HMDA-LAR, LAR or the Register).

Predatory/Discriminatory Lending Practices

HMDA's new disclosures are meant to help regulators determine the probability of predatory or discriminatory lending, based on where and to whom higher-priced mortgage loans are being made. Mortgage lenders have generally praised the Fed

for its efforts to warn people against unwarranted accusations of bias, and that the data cannot be manipulated in a way that would lead to such conclusions. Despite the fact that the Fed has warned against drawing incorrect conclusions from the 2004 HMDA data, industry insiders nonetheless believe that numerous class action lawsuits loom on the horizon.

As but one example, HMDA recently gained the attention of New York's Attorney General, Eliot Spitzer. Spitzer's failed attempt to force a handful of banks to submit to state investigation was precipitated by a preliminary review of the HMDA raw data, which, as stated above, contained pricing data for the first time. Spitzer notified several banks that significant pricing differences in their HMDA reports may have been racially based and could be in violation of federal and state fair lending laws and the federal Equal Credit Opportunity Act. Despite recent court decisions upholding the Office of the Comptroller of the Currency's (OCC's) exclusive regulatory authority over national banks, Spitzer asked the banks to voluntarily submit the information he had requested. The banks refused to comply with Spitzer's instruction and successfully brought, along with the OCC, a petition to halt all state enforcement actions. This is likely not the last we will hear from Spitzer or other state attorney generals or regulators on the matter.

Mortgage Lending Audits

Mortgage lenders with multiple loan origination channels should expect a full fair lending compliance review if any of those channels show pricing disparities based on the 2004 HMDA data. The Fed has stated that pricing disparities that involve indirect loans, such as those generated by mortgage brokers, will be subject to closer scrutiny. Federal examiners ordinarily request a bank explain any remaining pricing differences after borrower and lender-related factors have clarified other disparities. These differences often arise in institutions that use discretionary pricing to adjust for a competitor's pricing, a borrower's credit risk, a borrower's negotiating skill, and other pricing factors. The Fed has made clear that these justifications will need supporting evidence in the future. For example, a lender whose various lending channels serve either borrowers or geographic areas that differ by race, ethnicity, or other prohibited characteristics is likely to be subject to further review, especially if these different channels produce loan pricing that also differs by race or ethnicity or other prohibited characteristics.

HMDA: Bad Press, and Spinning It Your Way

Not surprisingly, class-action attorneys, among others, are studying the recently released 2004 HMDA data as the bases for potential lawsuits. There is concern that the data and/or the (mis)interpretation of the data and public perception may harm the reputation of lenders. This fear is heightened by the new format in which the data is being reported. Mortgage lenders

are required to report in a “geocoded” manner, broken down by categories including race and ethnicity. The geocoding of the raw data permits comparisons between factors such as mortgage rates for residential home loans located in minority population areas with comparable rates in non-minority areas to be more easily done. The media will likely increase their coverage of discriminatory lending actions facilitated by this more user friendly 2004 HMDA software. Additionally, it is feared that reporters who lack industry knowledge may attack fair lenders by unintentionally misinterpreting the HMDA data. Clearly, media attention and public perception, and the effect the two may have in pressuring legal settlements, are of key importance.

Lenders that report HMDA data should carefully examine their data and be prepared to respond to inquiries from the media, community groups and regulators. There are certain things that lending institutions can do to use the data effectively. Lenders should handle these issues through a designated representative, so to better control what information might be used by the press. Additionally, lenders should develop a plan for addressing regulatory investigations and a global strategy for defending civil lawsuits. Lenders should also be mindful of ways in which to spin the data in a positive light, whether by properly emphasizing the constructive aspects, or by communicating through journalists who are likely to paint a more helpful picture. In these more focused communications to the public, care should be taken so as to not be overly optimistic, so as to potentially violate securities laws through a valuation of the data that could be considered a material misstatement. Additionally, care should be taken not to mistakenly waive the privilege on an otherwise confidential analysis of lender data, for example, a regression analysis.

Furthermore, lenders can use the HMDA data to identify possible red flags and to improve their own lending programs. The lender’s own data can highlight the channels that are working and those that are not. As a marketing tool, the HMDA data can help identify loan products that could be developed to address needs of groups receiving higher priced loans. Or, the data could be used to identify which geographic areas or groups are potential growth areas for the lender’s business.

Conclusion

The real impact of the expanded 2004 HMDA disclosures remains to be seen. As discussed above, counsel’s efforts to develop a working understanding of HMDA and the potential ramifications of the Federal Reserve Board’s 2004 Home Mortgage Disclosure Act Report will hopefully provide counsel with the opportunity to guide and protect financial institution clients in the future.

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