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CFPB Proposal Would Make 'HMDites' Of Us All

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On July 24, the Consumer Financial Protection Bureau published long-awaited proposed revisions to its Home Mortgage Disclosure Act rules. The 573-page proposed rule would make sweeping changes to Regulation C, which implements HMDA, dramatically expanding financial institutions' HMDA reporting and compliance obligations, as well as their fair lending work more broadly. The proposed changes include required reporting of 37 new data fields, 20 of which are not required by HMDA and represent additional information the CFPB would like to collect. In addition, the proposal would require "larger" HMDA reporters to report data every calendar quarter, rather than on an annual basis. We summarize here the key aspects of the proposal, how they compare to current HMDA requirements and what this all might mean for HMDA reporters in the future. Comments on the proposed rule are due by October 22, 2014.

Background

HMDA was enacted in 1975 and has been expanded over the years from a statute aimed at basic monitoring and redlining prevention to one widely used by regulators and consumer advocates as a fair lending tool. It requires many depository institutions and other lenders to report information about the home loans that they decision, originate or purchase. For 2012, 7,400 financial institutions reported HMDA data relating to about 18.7 million loans. The Dodd-Frank Act required the CFPB to expand HMDA data reporting to include additional information about the applicants, lenders and loans.

In February 2014, the CFPB announced it was beginning the required rulemaking process and was considering adopting not only the Dodd-Frank requirements, but also requiring reporting of extensive additional data. The CFPB also announced it was looking into ways to streamline HMDA reporting and reporting thresholds. As an initial step, the CFPB convened a Small Business Review Panel to seek early feedback. Since then, the CFPB has been largely mum about the rule, reporting in June only that it "has begun work in preparation" to implement the changes. Surprisingly, unlike other significant regulatory initiatives, the CFPB held no "field hearing" announcing its newly proposed rule with fanfare, it merely issued a dry press release on July 24 about the proposal.

What the Proposed Rule Would Change

On July 24, the CFPB published its extensive proposed HMDA rule, along with the Small Business Review Panel's detailed report. We provide a summary and comparison with the current rules below. The key differences are: (1) provisions addressing the thresholds for coverage of financial institutions and what types of loans are reported; (2) major additions to the data required to be reported; (3) an increase in the frequency of reporting for large institutions to quarterly reporting; and (4) technical but important changes aimed at streamlining how institutions report HMDA data.

Who Reports HMDA Data?

Currently, Regulation C provides different rules for determining whether a financial institution must report HMDA data, based on whether the institution is a depository institution or a nondepository institution. For depository institutions, currently, there are several elements to determine coverage, including asset size and other factors. One factor that determines coverage is whether, in the prior year, the depository institution made at least one home purchase loan (or refinancing of a home purchase loan), secured by a first lien on a one-to-four family dwelling.

Under the proposed rule, aside from meeting other factors in the existing rule, a depository institution would be required to collect and report data only if it originated 25 or more closed-end mortgage loans in the prior year (including closed-end reverse mortgages). The CFPB reports that this would reduce the number of reporting institutions by 25 percent. The CFPB further states that it is planning to conduct additional outreach regarding the proposed 25-loan threshold number. A number of smaller financial institutions have suggested that this threshold is too low and should be increased to exempt additional institutions.

The test for whether a nondepository institution must report HMDA data is likewise somewhat complex under the current rule. Aside from having a home or branch office in a metropolitan statistical area ("MSA"), in general, there are currently two elements to the coverage test. First, a nondepository institution is covered if it makes home purchase or refinanced home purchase loans that are at least 10 percent of its total loan originations in dollars, or if those home purchase/refinancings totaled at least $25 million in the prior year. Second, the entity is covered only if it has assets more than $10 million (counting the assets of any parent corporation), or it originated 100 or more home purchase loans (including refinancings of those loans) in the prior year.

The proposed rule for determining coverage of nondepository institutions is dramatically different and much broader than the current rule. Aside from having a home or branch office in an MSA, a nondepository institution would be covered if it originated 25 or more closed-end mortgage loans in the prior year, including closed-end reverse mortgages. Thus, regardless of the assets of the institution, or whether mortgage loan originations are a small fraction of its business, it would be covered by the proposed rule if it originated 25 or more closed-end mortgage loans in the prior year (and if it has its home or a branch office in an MSA). Equally important, the 25-loan test would include home equity loans and commercial loans that are secured by a dwelling, whether secured by the principal dwelling or a second home or investment property — as long as the dwelling is a residential structure. Thus, an entity located in an MSA that makes solely closed-end business/commercial loans would be covered if it originates at least 25 such loans and those loans are secured by a dwelling.

What Types of Loans are Covered?

Regulation C currently uses a "purpose" test to determine whether a transaction must be reported.

Institutions must report data on applications, originations and purchases of loans based on the purpose of the loan. Loans to purchase a home, improve a home or refinance a home loan are covered — and certain home improvement loans are covered even if not secured by a dwelling. The existing rule is not without its challenges. Because loans must be "classified" according to the purpose, lenders have to make judgments on the purpose when, for example, a loan is for both a covered and a noncovered purpose.

The proposed rule would eliminate the purpose test and cover nearly all dwelling-secured loans. While the proposed rule would exclude unsecured home improvement loans, it would cover significantly more types of loans. For example, currently, a home equity loan is covered only if the purpose is for a home improvement or other covered purpose. Under the proposal, all closed-end loans secured by a dwelling would be covered, unless an exemption applies. Thus, a second lien loan with the proceeds to be used for vacation, medical expenses or educational expenses would have to be reported under the new rule. In addition, a loan used for investment purposes, or even for business or commercial purposes, would be covered so long as the loan is secured by a dwelling. And, "dwelling" is defined broadly as a residential structure, which includes multifamily dwellings, rental properties and apartment buildings.

In addition, home equity lines, for which reporting is currently optional, would be fully covered. Thus, an open-end line secured by a dwelling would be covered regardless of the purpose of the line. Also, even if a home equity line is not for a consumer purpose (i.e., not for a personal, family or household purpose), it would be covered. Moreover, even if the loan is not made to a "consumer," it would be covered under the proposal. Thus, if a business entity obtains a home equity line of credit, it would be generally reportable under the proposal if it is secured by a residential structure.

Certain types of loans would continue to be excluded from HMDA reporting, including loans on unimproved land, agricultural loans and temporary financing.

What Data is Reported?

The proposed rule would significantly expand HMDA data reporting, adding not only 17 new data fields responsive to Dodd-Frank requirements, but also 20 more fields that the CFPB believes are necessary to "fill information and data gaps" in its monitoring of "access to credit," "how the Ability-to-Repay rule is impacting the market" and "developments in specific markets such as multifamily housing, affordable housing and manufactured housing."

Currently, the reported data includes a number of different fields, covering core information about loans and loan applications, including the following:

- Loan application information: application number, date of the application, type of loan, purpose of the loan and amount of the loan requested;
- Information about the action taken: the type of action taken (e.g., approved or denied) and the date of action taken, with optional reporting on reasons for denials of applications;
- Loan information: rate spread for certain higher-priced loans, lien status;
- Property information: property type, owner/occupancy status, property location by MSA, state, county, census tract; and
- Applicant information: ethnicity, race, sex, and annual income relied upon.

Dodd-Frank requires reporting of a number of additional data. Specifically, Dodd-Frank required the CFPB to promulgate rules for HMDA reporting of the following:

- total points and fees;
- rate spread for all loans;
- "riskier" loan features, such as prepayment penalties, teaser rates and nonamortizing features;
- unique identifiers for the loan officer and the loan to improving tracking of loans;
- application channel (i.e., whether the loan was originated in the retail channel, by a broker or otherwise);
- property value and more detailed property location information ("Parcel ID"); and
- the borrower's age and credit score.

The CFPB proposal maps those Dodd-Frank requirements to 17 proposed new HMDA data fields. The CFPB proposal goes far beyond the Dodd-Frank required information, adding 20 additional fields, covering the following:

- debt-to-income ratio;
- combined loan-to-value ratio;
- automated underwriting system used and the results;
- denial reasons, which under current rules are optional);
- qualified mortgage status;
- additional rate and points and fees information (interest rate, risk-adjusted, prediscounted interest rate, total origination charges, total discount points, etc.);
- additional property information (units financed and construction method replacing property type; affordable housing deed restriction information);
- manufactured housing data; and
- unique financial institution identification number (replaces RIN).

As discussed below, this additional required reporting raises a number of significant practical and strategic concerns.

When is the Data Reported?

The CFPB proposes another major change to the rule for "larger" HMDA reporters: quarterly reporting. Currently, all HMDA reporters report annually, by March 1 following the calendar year in which the data are compiled. The new rule would require that, within 60 calendar days of the end of each calendar quarter, a larger financial institution would have to report its HMDA data. (A larger financial institution would be defined as one that reported at least 75,000 covered loans, applications and purchased covered loans, combined, for the preceding calendar year.) The CFPB estimates that the rule would impact about 28 financial institutions, which, combined, report about 50 percent of all HMDA-reported transactions.

The CFPB notes that the purpose of this approach is to make data available to the public earlier than it is currently available, adding that the current "delay impairs the ability of the bureau and the appropriate agencies to use HMDA data to effectuate the purposes of the statute in a timely manner." Among other things, the CFPB "also believes that timelier identification of risks to local housing markets and troublesome trends by the bureau and the appropriate agencies would allow for more effective interventions or other actions by the agencies and other public officials." The CFPB expressly solicits comment on this proposal and whether it is appropriate, including any increase in costs resulting from the requirement. But, it notes at the outset that "[t]o the extent there are cost increases, the CFPB seeks to balance those costs with the benefits of quarterly reporting," adding that the proposal already "limits the imposition of any increased costs to those institutions with the largest transaction volumes."

If adopted, this timing provision would impose significant operational and other challenges for institutions. Many institutions perform extensive reviews and "audits" of HMDA data before reporting it to the appropriate federal agency. This ensures consistency and accuracy of data in order to satisfy the CFPB's data integrity requirements. This best practice would be all but impossible if data had to be reported within 60 days of the end of each quarter.

How is the Data Reported?

In February, the CFPB observed that many financial institutions are collecting the same or similar data for their own purposes, and that the bureau was considering "methods to align the HMDA data requirements with well-established data standards already in use by a significant portion of the mortgage market." The CFPB added that it is also consulting with other federal agencies about improvements to the HMDA data reporting and disclosure process, such as creating web-based HMDA data-entry software.

The proposed rule would align many of the HMDA data requirements with the widely used Mortgage Industry Standards Maintenance Organization ("MISMO") data standards, including the Uniform Loan Delivery Dataset ("ULDD") that is used in the delivery of loans to the government-sponsored enterprises. The CFPB notes that "[g]iven that a majority of mortgages originated in 2013 conformed to GSE guidelines — and that a large segment of the market sells at least some of their originated loans to the GSEs directly or indirectly — a significant portion of the market is already operating in accordance with the MISMO data standard." Some members of the Small Business Review Panel, however, noted that they do not use MISMO and that modifying their systems to comply with the proposed rule would require significant investment.

The CFPB also proposes a number of technical improvements, including geocoding improvements, web-based data submission (rather than the current software that must be reinstalled on local computers each year) and an improved process for editing HMDA submissions.

Takeaways

If adopted as proposed, the new rule will have significant impacts on any institution that reports HMDA data and could require the collection and reporting of data by a significant number of nondepository institutions that are currently not covered by HMDA. The costs to change systems, capture numerous additional data fields and integrate systems to comply with the new rule will be dramatic. For institutions meeting the 75,000-loan quarterly reporting threshold, the proposed rule would impose significant ongoing costs.

Collecting and reporting the detailed, newly proposed data could also have an impact on borrowers' privacy and on institutions' HMDA and fair lending compliance obligations. The CFPB did not state what, if any, of the new data proposed to be collected would or would not be made available to the public — the bureau is reviewing the matter. Clearly, release of much of this data, such as property address and credit scores, would raise significant privacy issues. Under the current rule, the following data is not made available to the public: (1) application or loan number, (2) the date the application was received and (3) the date action was taken. It remains to be seen how the CFPB will approach the release to the public of the proposed new data. The CFPB has stated that it “is mindful that privacy concerns may arise” and is seeking “comment on alternatives to addressing any potential risks to privacy interests.”

And, from financial institutions’ perspective, more data means more room for error, as judgments must always be made about specific data. While larger institutions may already be collecting much of the proposed new data (albeit not necessarily in the form the CFPB would now require), that data has never been required to meet the stringent accuracy requirements the bureau applies to HMDA data. As we’ve previously reported, the CFPB has made clear through recent enforcement actions and guidance that it believes HMDA data integrity is an integral part of fair lending compliance and enforcement — and that erroneous HMDA data is tantamount to an illegal action that “misleads the public.” The simultaneous use of public enforcement orders in reviewing HMDA compliance coupled with dramatically increased reporting obligations will no doubt heighten risks for HMDA reporters.

More broadly, collecting and publicly reporting all of this new data will inevitably lead to additional scrutiny and the obligation to monitor the data not only for technical compliance, but also for any potential fair lending issues. While HMDA data alone cannot be used to establish fair lending violations, significant new information will undoubtedly be used to raise even more fair lending issues. Institutions should be prepared to devote additional resources to evaluating potential fair lending matters, particularly if data is required to be reported on a quarterly basis.

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