Bank Safety & Soundness Advisor

Executive intelligence on bank exams, enforcement and risk management.

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HMDA Data Repository Comes with Industry Risk, Experts Warn

With its proposal to expand collection of HMDA data, the CFPB would establish an unprecedented repository of personal financial data about borrowers and lenders operating in the world's largest consumer loan market.

So who gets to access it? What limits might regulators place on the information that is publicly disclosed? And how might this affect community banks?

The treasure trove of information would certainly help regulators achieve the stated purpose of the expansion – of making sure the huge and lucrative market operates efficiently and equitably. But it also represents an opportunity for people with less noble purposes – from neighbors interested in taking a peek at your credit score to hackers looking to make a buck from accessing and selling highly sensitive information.

Broad public disclosure of the information could also potentially alter the competitive landscape, says Andy Barksdale, managing director, TRUPOINT Partners, a Charlotte-based fair-lending consultant.

"Hypothetically speaking, imagine if you are a big bank

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CFPB's New HMDA Proposal Demands New Transparency, Intense Compliance Obligations

CFPB says its aggressive proposal to expand collection of HMDA data should help it protect consumers from abusive practices by lenders in the mortgage market. But it will also impose a daunting new regulatory burden on community banks and other financial institutions at a time when scrutiny of HMDA data and banks' fair-lending practices is already intense.

There's an important new exemption for the smallest lenders, but other community banks may find themselves having to report for the first time because of a proposal to expand the kinds of dwelling-related loans the bureau wants to monitor. Those new disclosures could end up becoming a tip sheet for plaintiffs' lawyers looking to litigate private discrimination claims.

And that does not even begin to address the privacy and security concerns raised by establishing a huge new government-controlled trove of sensitive personal financial data. The agency itself acknowledges it has not yet figured that out. Depending on who has access to the data it could end up becoming a competitive weapon against community banks.

Translation: Transparency, with a vengeance, is coming to the business of mortgage lending, and you had better get ready now.

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CFPB Struggles to Clarify RESPA/TILA Disclosure Rules before Deadline

The CFPB is in the process of introducing two new forms to streamline the disclosures lenders must make to mortgage applicants under RESPA/TILA. On the surface, it seems like a straightforward exercise.

Loan Estimate to applicant within three days of loan application submission? Check. Closing Disclosure delivered no later than three days before closing? Check.

Not so fast. Witness a recent Webinar held by CFPB and the score of questions it addressed that have already cropped up about the new rules, which go into effect next August.

The agency is trying to facilitate compliance by getting clarifying information to lenders ASAP. Besides Webinars, it has issued resource materials and guidebooks, and is soon planning to publish a "timing

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Publisher:

Aaron Steinberg
800-929-4824 ext 2471
asteinberg@banksoundness.com

Group Publisher:

Hugh Kennedy
800-929-4824 ext 2213
hkennedy@banksoundness.com

SUBSCRIPTIONS:

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ADDRESS:

Bank Safety & Soundness Advisor
Two Washingtonian Center
9737 Washingtonian Blvd., Ste. 200
Gaithersburg, MD 20878-7364

New HMDA Proposal

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The long-awaited and long-winded (573 pages) proposal would make sweeping changes in Regulation C, which implements HMDA, and dramatically expand financial institutions' HMDA reporting and compliance obligations.

The CFPB is proposing the addition of 37 new data fields including information about the age and credit score of applicants as well as new information about underwriting and pricing such as an applicant's debt-to-income ratio and the interest rate and discount points charged for a loan. The kinds of loans subject to the reporting requirement would also expand to include "all loans related to dwellings." That could capture reverse mortgages, open-ended lines of credit, and even some business lines.

"It is really a perfect storm from an enforcement or compliance perspective," says Angela Kleine, a lawyer with Morrison & Foerster in San Francisco. "When you have to interpret 37 different fields, all of which are new, with little regulatory guidance, combined with the threat of a crackdown on enforcement, it makes you worry."

Dodd-Frank directed the CFPB to expand HMDA data reporting to help regulators identify potential discriminatory lending practices and other market abuses. The proposal represents an even more robust reporting scheme than even Congress envisioned. Of the 37 proposed new data fields 17 were required by Dodd-Frank and 20 more fields were added by CFPB.

"It is critical that we shed more light on the mortgage market," CFPB Director Richard Cordray said in a prepared statement when the proposal was unveiled this summer. Cordray said the proposal would "help us understand better how to protect consumers' access to mortgage credit while simplifying the reporting requirements for financial institutions." The bureau said it is looking at way to "improve the electronic reporting process," including "new technological tools would make the data submission process more efficient, ease the data formatting requirements and help financial institutions prevent errors."

Regulators already provide a variety of tools to help financial institutions with the correct collection of HMDA data including help desks, FAQs, and a 119-page reporting guide. These tools are designed to help ensure the consistent and accurate collection of the 26 data fields that are currently required.

Whether there will be a smooth transition with new rules is far from clear. The new data fields will certainly bring additional complexity, recognizing the technical requirements associated with the additional reporting.

"There are regulator-provided tools that are designed to help provide clarity in a world that is imperfect and that already requires interpretation," says Andy Barksdale, managing director, TRUPOINT Partners, a Charlotte-based firm that provides fair-lending consulting services to community banks. "But what happens when you multiple that by a factor of two? There is going to have to be patience by all parties for this expanded data set to stand a chance."

Take the seemingly straightforward proposal to collect the age of borrowers. The question arises: at what point in the lending process?

"Is it the age at the time of the

application? At the time of decision? What if you have a birthday?" Kleine says. "Age is not transmutable. You could easily make a mistake." She notes that even banks committed to compliance can have problems when so many new variables are added to the HMDA reporting equation.

Large banks that can afford to systemically and broadly collect mortgage information may also find their current systems taxed or inadequate under the proposed new regime. CFPB argues that much of the data is already being collected according to Mortgage Bankers Association industry standards. But that data is often not being collected with an eye towards regulatory review.

"It is actually a big burden even for large institutions to clean up the data in a way that would satisfy the Bureau and avoid potential enforcement action," Kleine says. "Every HMDA submission needs to be cleaned up and vetted before it is reported. Even for larger institutions there is a significant burden there."

CFPB is proposing that banks with fewer than 25 mortgages a year be exempt from reporting. That would bring a measure of regulatory relief to as many as 1,600 institutions, the agency estimates.

But an untold number would also be added to the HMDA reporting rolls because of the proposal to require broader reporting of dwelling-related loans including even some business loans.

Kleine cites the case of a community banker who makes a second-lien loan to a small business owner that is secured by his or her home. "That is not something you would be currently reporting," Kleine says "but now you would be" under the proposal.

"If they expand the scope of what is reported," says Richard Andreano, partner in the Washington office of Ballard Spahr, "that cuts against the small entity exemption."

Institutions reporting for the first time could suddenly find themselves with a target on their backs. "If you are a small community bank, your fair lending analysis may have been falling under the radar," Kleine says. "Having more data available would make it easier for plaintiffs to assert private litigations on behalf of any number of different entities."

HMDA data has been used to support lawsuits under ECOA or the FHA, even though there is no private right of action under the law. Various cities and counties across the country have filed fair lending lawsuits against big banks on that basis.

But more expansive collection could also help some banks whose data under existing rules suggest a fair lending problem. The industry has long argued that current rules do not afford a complete picture of individual institutions' fair lending activities.

"By including these additional data fields (credit score, for example), one might successfully argue that the additional HMDA data provided will help organizations explain why there may be statistical disparities between prohibited basis groups," Barksdale says. "So there is an argument that this additional data will actually help organizations that are doing things correctly."

"If the data is good," Kleine adds, "it ought to reduce false positives."

A recent Morrison & Foerster analysis prepared by Kleine and colleagues made these additional points:

• The costs to change systems, capture numerous additional data fields, and integrate systems to comply with the new rules will be dramatic; and

• More data means more room for error, as judgments must always be made about specific data. CFPB has made clear 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."

"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 disparate impacts that the data reveal," the analysis concluded.

"I think most financial institutions really have not thought through the ramifications of what these additional fields may bring to the table," Barksdale says.

The largest institutions have been providing – and defending – expanded data to regulators for years in advance of regulatory exams. For smaller institutions in particular, who tend to have manual underwriting that would greatly impact the ability to collect the information, the rules could be a rude wake-up call.

In preparation for the expanded data set, regulators are placing a lot of emphasis on the existing 26 data fields. The agencies, Barksdale says, have been sending the banks this message: "You better focus on getting the current HMDA data right, because there are more data fields coming." ■

Clarify

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calendar" to illustrate when the integrated disclosures – and "re-disclosures" – have to be made.

"We, of course, understand that the timing and counting of days is not as simple as it may appear," CFPB lawyer Andy Arculin said at the Webinar. A follow-up Webinar to answer more questions has already been tentatively set for October 1.

To be sure, the new regime eliminates much of the discretion banks once had in gathering application information. At the heart of things is a standardized application that takes just six personally identifying and credit-related elements to be considered complete. There are also new rules limiting permissible charges. The interplay with existing rules and guidance is another area of potential confusion.

Here are CFPB's answers to some of the FAQs the agency has identified to date:

The Application

Q: The definition of application does not include loan term or product type. What if a consumer submits the six elements listed in the rule, but does not specify the type of product or term?

A: The creditor must provide the Loan Estimate within three days of receiving the six elements that constitute an application under the new rules even if the consumer has not specified the loan product or term.

At the same time, lenders should be able to obtain the loan product or term information from the applicant before the six elements are received and the Loan Estimate must be provided. Arculin noted that the rules provide flexibility for lenders to strategically collect the six elements and maintain a degree of control over when they have to provide the Loan Estimate. Lenders would also have flexibility in choosing the products upon which they base the Loan Estimate where the consumer has not specified a product in advance of submitting the application.

"The creditor would have discretion regarding what product or term or other feature it uses to make the Loan Estimate, so long as the disclosures are made in good faith and consistent with the best information reasonably available," Arculin said. "The creditor would not be required under our rule to produce multiple loan estimates that cover different product types."

"We, of course, understand that the timing and counting of days is not as simple as it may appear."

"The question has been raised whether the creditor would have to produce estimates for everything. The answer is 'no.' However, it could provide different options if it so chooses," Arculin said. "The question has been raised to us whether there is any expectation or requirement that creditors operate with specified default products such as 30 year fixed. Again, the answer is no."

Q: What if the consumer starts filling out an online application and saves it with the six pieces of information entered, but has not yet submitted it to the creditor?

A: The application must be submitted to the creditor for the three-day Loan Estimate disclosure clock to start ticking.

"If a consumer starts filling out a mortgage application online and enters the six pieces and then saves the mortgage application form to complete at a later time, the consumer has not submitted" the application, Arculin said. "In other words, so long as the consumer has not submitted the application to the creditor for purposes of obtaining an extension of credit we do not view the creditor is under any obligation to produce a Loan Estimate at that time."

Q: What if the loan is a refinance and the creditor already has this particular information on file?

A: "In our view, a creditor having information on file from a previous or existing loan or a loan application does not mean a new application has been submitted. This would hold true if a consumer contacts the creditor and expresses interest in applying for refinancing or a new loan and six pieces of information exist on the credit system or on file," Arculin said. "Application is only triggered only upon submission of that information for the purpose of obtaining credit and information is not deemed re-submitted just because it exists on file."

Q: May an online application system reject applications submitted by a consumer that contain the six elements of an application because other preferred information is not included?

A: No. Submission of the six elements, whether online or through a dialogue with a loan officer or other means, triggers the Loan Estimate requirement.

"There is a degree of consumer

empowerment," Arculin said.

"The rule contemplates the use of online application systems but does not provide special treatment (for creditors) in this regard.

Scope

Q: Do the new disclosure requirements apply to assumptions?

A: "The short answer is 'yes,' assuming that when we are saying assumption we mean a post-consummation event that is deemed a new closed-end credit transaction secured by real estate" as defined by existing federal rules (as opposed to colloquial, common law or industry meanings of the term).

Variations/Tolerances

Q: Is owner's title insurance not required by the creditor subject to the 10% cumulative tolerance?

A: No. Owner's title insurance is not a charge that is assigned to a particular tolerance category. So the answer depends on whether the creditor requires the insurance, and if so, whether the consumer may shop for a provider. Where not required by the creditor and disclosed as an optional service, OTI is not subject to any percentage tolerance limitation, even if paid to creditor affiliate.

Arculin acknowledged that the preamble to the final rule includes language that implies that the bureau intended to subject OTI to the 10% cumulative tolerance even where it is not creditor required. "There may be a slight inconsistency between the preamble and the rule text. But the rule text is clear and that is what you should follow and that's what controls," Arculin said.

Disclosure/Redisclosure Timing

Q: Does the 7-day waiting period before consummation that applies to Loan Estimates apply to revised disclosures?

A: No. "The 7-day waiting period is a TILA statutory waiting period that applies today to the initial TILA disclosure, or after August of next year, to the Loan Estimate provided after application," Arculin said. "It does not apply to revised disclosures."

A revised Loan Estimate must be received by a consumer no later than four business days before consummation. Arculin noted that a creditor will need to put the revised disclosure in the mail no later than the 7th business day before consummation to be received in a timely fashion based on the so-called mail box rule under which consumers are deemed to receive disclosures three days after they are mailed.

Arculin said a compliance guide it previously published for small entities may have led to confusion over the issue, and that the guide has been amended and will be re-published soon.

Q: Are creditors required to provide revised Loan Estimates on the same business day that a consumer or loan officer requests a rate lock?

A: "Not necessarily," Arculin says.

The rule provides that the revised Loan Estimate must be provided on the same business day on which the rate "locked." Bureau commentary indicates that means the same business day on which the rate lock agreement is "entered into" – not necessarily the day a rate lock is requested. The bureau has taken the position in the preamble to the rule that creditors do not need that much time in situations where the interest rate is locked because the creditor controls when it executed the rate lock agreement.

The bureau is nonetheless considering amendment regarding the re-disclosure and rate lock. "Numerous stakeholders have identified potential operational challenges as well as potential and consumer disadvantage that could result from this approach," Arculin said. "This is an issue we are closely considering in response to extensive feedback we have received to-date."

Q: May a Closing Disclosure be provided early and revised Closing Disclosures used in place of revised Loan Estimates for redisclosing estimates that changed due to changed circumstances?

A: Arculin noted that the rule provision that controls timing for the delivery of the Closing Disclosure allows creditors to provide the disclosures earlier than required. To wit: it only requires that the consumer receive the Closing Disclosure no later than three days prior to consummation.

Of whether the Closing Disclosure could be provided early and then used to re-disclose: "The short answer … is going to be, 'No,'" he said.

Q: Is an additional 3-business-day waiting period required if the APR decreases by more than 1/4 or 1/8 percentage points?

A: Creditors may continue to use existing CFPB and Federal Reserve guidance on this subject: An APR that was over-disclosed due to over-disclosed finance charges is not considered inaccurate and does not require a new waiting period. Arculin added: "This only applies in situations where the APR was over-disclosed due to finance charges, and it would not apply in situations where the over-disclosure resulted from something else. However, it is unclear how that would occur." ■

Data Repository

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in New York with sophisticated data analysis capabilities," Barksdale says. "The new HMDA data may include credit scores and pricing data that will provide that bank the ability to analyze market rates around the country. The HMDA expanded data, if made public, will allow banks to see that in rural Louisiana they may be charging slightly more for mortgage loans. The additional HMDA data could provide large banks the ability cherry pick or attack that community bank like never before."

Even if the agency restricts public access to the personally identifying information as it has done in the past there is a question about how secure the information will really be in an era of ubiquitous data breaches.

"We have regularly seen very large sophisticated companies getting hacked. What makes the bureau think it is not susceptible to the same forces?" says Richard Andreano, partner with Ballard Spahr in Washington. "To me it is a question that needs to be addressed and probably at the congressional level. Congress is the reason for the proposal to collect this expanded data. What comes with that, I think, is some oversight."

Such privacy and data security issues present perhaps the biggest stumbling block as the CFPB moves forward with the long-awaited proposal, which was ordered up by Congress as part of Dodd-Frank in the wake of the mortgage crisis. The comprehensive overhaul – including a doubling of data fields being collected and an expanded definition of the loans that are subject to reporting – is aimed at giving regulators insight into the market and how it functions. The idea: head off troubles that led to the crisis as well as give regulators a more definitive view of banks' fair-lending practices and possible discrimination.

"We have regularly seen very large sophisticated companies getting hacked. What makes the bureau think it is not susceptible to the same forces?"

CFPB acknowledges it does not have all the answers, and in seeking comment on the proposal is reaching out to industry and others for help.

"The Bureau … is looking at ways to improve how the public can securely use HMDA data modified to protect applicant and borrower privacy," the agency said in a statement when it released the proposal this summer. The agency has been heretofore promoting access to the data, releasing an online tool in February that helps the public better use available mortgage loan data. An enhanced repository of data could also be of even more value to academics and researchers for whom HMDA data is already the preeminent source of loan origination information about mortgage market trends.

Banks now must make HMDA data available to the public upon request but with some redactions to protect applicant and borrower privacy. Personally identifying information such as name, address, date of birth, or Social Security number is excluded from public view. Among other information, the proposed expansion would require banks to report the age and credit score of consumers.

The CFPB has said it is investigating strategies and techniques to protect consumer privacy while maximizing the data's utility.

Among those options:

- The use of various statistical disclosure limitation techniques, such as techniques aimed at masking the precise value of data points, use restrictions, and a restricted access program;
- Proposing that banks and other covered institutions continue to report loan amount and income rounded to the nearest thousand and continue to delete fields that are deleted before HMDA reports are made public;

Proposing that institutions delete or modify additional data points from public disclosure that raise privacy concerns, including credit score and age.

"The data security and consumer privacy issues intersect in a very negative way," says Angela Kleine, a lawyer for Morrison & Foerster in San Francisco. "CFPB has really put the onus on industry to suggest how it ought to handle privacy issues." ■