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THE HOME MORTGAGE DISCLOSURE ACT: AN OVERVIEW OF RECENT DEVELOPMENTS AND A GUIDE TO LIMITING RISK

New Data on Home Mortgages, First Made Public Last Year, Have Spawned Waves of Investigation by Regulators and Class Actions Alleging Discrimination in Pricing on the Basis of Race, Gender, or Ethnicity. The Authors Review the Developments and Suggest a Four-Point Program for Lenders to Reduce Risk.

By Andrew L. Sandler, Anand S. Raman, Joseph L. Barloon & Darren M. Welch*

In these pages last year,[1] our colleagues predicted that mortgage lenders would soon be facing a wave of regulatory examinations, enforcement inquiries, and class action litigation relating to their data reported under the Home Mortgage Disclosure Act ("HMDA").[2] That wave has now begun — and has quickly turned into an onslaught. In numbers that appear to be unprecedented in recent history, lenders throughout the nation are being scrutinized regarding their loan pricing practices and policies, and being asked to demonstrate that such practices and policies do not result in discrimination based on race or ethnicity.

This scrutiny is coming from many directions: federal banking regulators; the Department of Housing and Urban Development ("HUD"); the Department of Justice; and state attorneys general and other state enforcement agencies. Close behind this governmental scrutiny will likely come significant class action litigation — some of which has already begun. Such inquiries and litigation pose significant risks to financial institutions.

These risks, including reputational risks, are magnified by the media's recent interest in the issue of loan pricing disparities — as reflected in numerous press articles on the subject since the release of 2004 HMDA data. And finally, community groups and other advocacy organizations likely will continue to publish studies identifying both lenders and specific geographic areas with significant potential disparities in loan pricing — thus intensifying the reputational risks, and making it more likely that significant litigation and regulatory

1. New Home Mortgage Disclosure Act Pricing Data: The Next Enforcement and Litigation Frontier for Lenders, The Review of Banking & Financial Services, Vol. 21 No. 6, at 3 (June 2005).
2. 12 U.S.C. §§ 2801-2810.

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enforcement action in this area will continue for the foreseeable future.

The driving force behind these recent developments is the implementation of regulations amending HMDA. In the spring of 2005, lenders were required, for the first time, to report to the federal government prior-year pricing data with respect to certain higher-cost loans. The Federal Reserve Board released this data to the public in the late summer. At the same time, the Board conducted an extensive analysis of the data and published a lengthy bulletin detailing its results (the "Fed Report").[3] The Fed Report — along with detailed institution-level analyses that the Fed provided to regulatory and enforcement agencies, but did not release publicly — in turn fueled many of the inquiries by these agencies, most of which were commenced in the Fall of 2005.

As lenders work on their responses to information requests and other inquiries from regulators and enforcement agencies about their 2004 HMDA data, and start preparing their 2005 data for release, many are asking fundamental questions: What do the data show on a national level? What particular issues are regulatory and enforcement agencies focusing on? Can state agencies conduct inquiries of federally regulated institutions? What shape is class action litigation likely to take? And, perhaps most importantly, what steps can proactive lenders take to mitigate their risks in the future?

This article addresses these questions. Part I provides a brief overview of HMDA and its new pricing disclosure requirements. Part II discusses the conclusions and implications of the Fed Report and its findings regarding the 2004 HMDA data on a national level. Part III discusses recent enforcement and regulatory agency inquiries arising out of the Fed Report, and analyses undertaken by other governmental agencies, including the New York attorney general. Part IV discusses the potential for class action litigation arising out of the HMDA data. And Part V discusses concrete actions that lenders can take — both through statistical analysis and revisions to their policies and procedures — to limit their risk.

OVERVIEW OF HMDA AND THE NEW PRICING DATA REQUIREMENTS

Original Purposes of HMDA

HMDA was first enacted in 1975 and was originally designed as a tool to detect so-called "redlining," the practice of avoiding lending in particular geographic areas.[4] Accordingly, HMDA's implementing regulations — known as Regulation C[5] — required lenders to report on their home mortgage lending volume, in particular, Metropolitan Statistical Areas ("MSAs"), but did not require the gathering or reporting of information on declined loan applications or information on applicants' race or ethnicity.

3. Richard B. Avery et al., *New Information Reported under HMDA and its Application in Fair Lending Enforcement,* 2005 Federal Reserve Bulletin 344.

4. Home Mortgage Disclosure Act of 1975, Pub. L. No. 94-200, §§ 301-310, 89 Stat. 1125-28 (1975).

5. 12 C.F.R. pt. 203.

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In 1989, HMDA was amended to expand the types of institutions that must comply with the Act[6], and to expand the scope of data to be reported. In particular, the 1989 amendments required financial institutions to begin reporting information on all applications, not just those loans they originated or purchased.[7] The amendments also required financial institutions to report each applicant's race, sex, and income, as well as other information about each mortgage loan application, such as the loan amount.[8]

Following the 1989 HMDA amendments, the Boston office of the Federal Reserve Board published a path-breaking study based on HMDA data that concluded that there were significant disparities between the rates at which loan applications from minorities and white applicants were being declined.[9] Driven in part by the public interest in the Boston Fed Study and the ready availability of HMDA data, enforcement and regulatory agencies, including the U.S. Department of Justice's Civil Rights Division ("DOJ"), began to actively investigate and bring cases under the Equal Credit Opportunity Act ("ECOA") and Fair Housing Act. Many of these cases culminated in settlement agreements in which the DOJ alleged that lenders had acted in a discriminatory manner in underwriting applications for credit.[10] In addition to several cases brought by the DOJ, inquiries involving similar allegations were initiated by HUD and the federal bank regulatory agencies — the Federal Reserve Board, Office of Thrift Supervision ("OTS"), Office of Comptroller of the Currency, Federal Deposit Insurance Corporation ("FDIC"), and the National Credit Union Administration.

Increased Concern With Respect to Pricing

Although a few of these cases involved pricing issues,[11] the predominant focus of the enforcement and regulatory agencies following the enactment of HMDA and its 1989 amendments were redlining and underwriting. In the late 1980s and early 1990s, the practice of "risk-based pricing" — adjusting loan prices on a loan-by-loan basis based on the customer's credit score, loan-to-value ("LTV") ratio and other credit criteria — was not yet firmly entrenched in the mortgage industry, and many lenders did not significantly vary the interest rates or fees charged to customers with respect to a particular product.

Throughout the 1990s, however, as lenders developed increasingly sophisticated risk models, they became able to, and in fact did, begin to offer their products with different terms and conditions, depending on risk. This development naturally led to greater variation among borrowers obtaining a similar product — such as a 30-year fixed mortgage. At the same time, the home mortgage market experienced tremendous growth in the "subprime" segment, which involves lending to borrowers with less than perfect credit.[12] As a result, credit increasingly became available to customers who might previously have been declined for an application. But such credit came at a higher price, as measured by the annual percentage rates ("APRs") paid by subprime borrowers compared with prime borrowers.

Although the higher APRs charged to subprime borrowers could, to a significant degree, be justified based on the increased risk and higher costs of originating such loans, this rapid growth in the subprime market raised two

6. As originally enacted, HMDA required only "depository institutions" to comply with the reporting requirements. In 1989, HMDA was amended to include within its scope "other lending institutions," defined as "any person engaged for profit in the business of mortgage lending." Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, § 1211(d) (1989).
7. Home Mortgage Disclosure, 54 Fed. Reg. 51,356 (Dec. 15, 1989) (codified at 12 C.F.R. pt. 203).
8. *Id.*
9. Alicia H. Munnell et al., *Mortgage Lending in Boston: Interpreting HMDA Data* 1-4 (Federal Reserve Bank of Boston, Working Paper No. 92-7, 1992) (the "Boston Fed Study").
10. *See*, e.g., *United States v. Deposit Guaranty National Bank*, No. 3:99-CV-670 (S.D. Miss., complaint and settlement filed Sept. 29, 1999); *United States v. Shawmut Mortgage Co.*, No. 3:93-CV-2453 (AVC) (D. Conn., complaint and settlement filed Dec. 13, 1993).
11. One early pricing case was *United States v. Long Beach Mortgage Co.*, No. CV-96-6159 (C.D. Cal., complaint and settlement filed Sept. 5, 1996). In *Long Beach*, the government alleged that between January 1991 and June 1994, the lender charged higher loan prices to African-American, Hispanic, female, or older borrowers in the "B/C" credit market than it charged younger, white, male borrowers by applying discretionary premiums that were not related to credit risk. The lender agreed to pay $3 million into a fund to compensate 1,200 borrowers, to contribute $1 million to consumer education programs, and to take certain internal measures to improve its pricing and compliance practices.
12. One study cited by the Federal Reserve estimated that during the period 1994–2004, the annual subprime home loan market increased from about $35 billion to more than $530 billion. *See* Richard B. Avery et al., *New Information Reported under HMDA and Its Application in Fair Lending Enforcement,* 2005 Fed. Res. Bull. 344, 349.

significant concerns on the part of community groups, and enforcement and regulatory agencies. First, there was concern that some of these subprime loans might be "predatory" loans that were obtained through fraudulent, deceitful, or unfair practices. And second, some were concerned that members of protected classes might be receiving such loans in disproportionate numbers relative to their credit risk, in potential violation of the federal fair lending laws.

As noted above, the HMDA data provided little insight into these issues, because lenders were not required to report which of their loans were subprime, or to publicly disclose the APRs that were charged to customers. HUD and other agencies attempted to classify lenders into "subprime" and "prime" categories, but such classifications were necessarily imprecise, since they were based on incomplete data, and many lenders were operating in both segments of the market.

In order to gain an understanding of the growing subprime segment, to determine which lenders were originating subprime loans, and to determine whether members of protected classes were obtaining such loans in disproportionate numbers, the Federal Reserve amended Regulation C in 2002 to require the reporting of certain loan pricing information.[13] As Federal Reserve Governor Mark W. Olsen explained in a speech in late 2005:

> The change in reporting requirements was also the result of a fundamental reassessment of the nature of mortgage lending abuses. Previously, it was presumed that a potential result of inconsistent mortgage loan administration was denial of credit on the basis of race, sex, or other impermissible factors. More recently, the pricing of loans — not just the availability of loans — has been a potential source of discriminatory lending practices.... Given these concerns, and after considering public comments, the Federal Reserve determined that information on loan prices was critical to gaining insight into the functioning of the higher-cost mortgage market.[14]

13. *Id.* at 345.
14. Remarks by Mark W. Olson, Federal Reserve Board Governor, *A Look at Fair Lending through the Lens of the New HMDA Data,* before the Consumer Bankers Association 2005 Fair Lending Conference, Arlington, Virginia, November 7, 2005.

The 2002 HMDA Amendments

The 2002 amendments to Regulation C required lenders to disclose information about loans they originated that exceeded certain pricing thresholds. In particular, lenders were required to identify and disclose the "rate spread" for first-lien loans with an APR that exceeded the interest rate on Treasury securities of comparable maturity by at least three percentage points.[15] Lenders also were required to identify and disclose the rate spread for subordinate-lien loans that exceeded the interest rate on comparable Treasury securities by at least five percentage points.[16] These thresholds were designed so that virtually all subprime loans would be reported and almost no prime loans would be reported — though, as discussed below, the initial results suggest that the HMDA amendments were not entirely successful in this regard.[17]

THE 2004 HMDA DATA AND THE FED REPORT

By March 31, 2005, a total of 8,853 lenders had submitted their 2004 HMDA data to the Federal Financial Institutions Examination Council ("FFIEC"), which in turn transmitted the data to the Federal Reserve Board for analysis, prior to its public release. Smaller lenders do not have to report under HMDA, but the data from these 8,853 lenders constituted an estimated 80% of industry lending volume.

In August 2005, the Fed published its report based on the 2004 data. This report contained both good and bad news for the lending industry. The approximately 200 lenders that were flagged for further review represented only 2% of HMDA-reporting lenders; but they accounted for 48% of owner-occupied loans reported in the 2004 data. Of the 200 institutions, approximately half are regulated by the bank regulatory agencies and half are unregulated mortgage lenders. According to Mr. Canner, who

15. Home Mortgage Disclosure, 67 Fed. Reg. 7222 (Feb. 15, 2002) (codified at 12 C.F.R. pt. 203).
16. *Id.*
17. In addition, the 2002 amendments required lenders to identify any loans that are secured by a manufactured home and to identify any loans that are subject to the protections of the Home Ownership and Equity Protection Act of 1994 ("HOEPA"). 12 C.F.R. § 203.4(a)(13); 12 C.F.R. pt. 203, Appx. A, § I(A)(4). Also, lenders were required, for the first time, to permit applicants to separately designate their race (*e.g.*, Black, White, Asian) and ethnicity (Hispanic or non-Hispanic). Previously, Hispanic applicants could not specify a race category.

was one of the Fed Report's co-authors, most of the 200 lenders make both prime and subprime loans.

Findings Regarding Pricing Disparities

The initial data showed that 32 percent of black borrowers, 20 percent of Hispanic borrowers, and nine percent of white borrowers received price-reportable loans in 2004. On the other hand, only about six percent of Asian borrowers received reportable loans. Much of this disparity can be accounted for due to differences in credit, LTV, and other factors.[18] The report found that the magnitude of the rate spread above the trigger was relatively small, generally within one or two percent of the trigger rate.[19] The report noted that minority borrowers were much more likely to get credit from institutions that report a higher incidence of higher-priced loans, which could result from either a benign segmenting of the market based on credit characteristics of borrowers, or perhaps from steering minority borrowers to certain lending institutions.[20]

Matching Methodology

The Fed did not have available data on credit and LTV, as such information is not reported under HMDA. However, other loan-level information, such as borrower income and loan amount, is available. Although these data paint only a partial picture, the Fed was nonetheless able to control these variables in order to create a rough approximation of a true regression analysis. This analysis showed that the rates at which borrowers received higher-cost loans, on matched basis, were 16 percent African-American, 12 percent Hispanic, and nine percent white — significantly lower disparities than in the unmatched data.

As noted above, the Fed transmitted its specific findings to the regulatory or enforcement agencies with oversight responsibility for each lender.

INQUIRIES AND EXAMINATIONS BASED ON 2004 HMDA DATA

Just as there was a significant increase in enforcement and regulatory activity following the publication of the Boston Fed Study, enforcement and regulatory agencies have responded to the release of 2004 HMDA pricing data by initiating a number of informal inquiries, and devoting significant resources and energy to addressing pricing issues in the context of regularly scheduled compliance examinations.

All of the federal bank regulatory agencies have initiated either informal or formal inquiries of a number of the entities that they regulate. At least initially, the greatest number of inquiries appear to have been initiated by the OTS and the FDIC. Each of the regulatory agencies can take action against individual lenders, such as cease-and-desist orders. In addition, the agencies are required to refer any detected pattern or practice of discrimination to the Department of Justice.

In addition, the DOJ has also sought information relating to pricing from at least three unregulated lenders that report HMDA data. Likewise, HUD has initiated informal inquiries to determine whether to classify certain lenders as "subprime lenders" on the basis of HMDA pricing data.

Finally, the New York attorney general, Eliot Spitzer, initiated an inquiry of a number of lenders, based on their 2004 HMDA data. This inquiry, however, brought to the surface an issue which had been lurking for some time: the authority (or lack thereof) of state governments to regulate federally supervised financial institutions. In *Office of the Comptroller of the Currency v. Spitzer,*[21] the court held that state governments did not have such authority and enjoined the New York Attorney General from enforcing fair lending regulations against national banks.

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18. *See* Richard B. Avery et al., *New Information Reported under HMDA and Its Application in Fair Lending Enforcement,* 2005 Fed. Res. Bull. 344, 385-86. The Fed Report cites a study by the Credit Research Center at Georgetown University that controlled for credit-related factors such as FICO score and LTV ratio. That study concluded that by controlling these credit-related factors, the disparity between black and Hispanic borrowers as compared to non-Hispanic white borrowers for the incidence of higher-priced loans on conventional first-lien home purchases, was reduced by about one-third. *Id.* at 385-86. The Fed Report also found that "More than two-thirds of the aggregate difference in the incidence of higher-priced lending between black and non-Hispanic white borrowers can be explained by differences in the groups' distributions of income, loan amounts, other borrower-related characteristics included in the HMDA data, and the choice of lender." *Id.* at 393.
19. *Id.* at 371 ("Except for loans backed by manufactured homes, the vast majority of higher-priced loans have prices within 1 or 2 percentage points of the pricing threshold.").
20. *Id.* at 394.
21. 396 F. Supp. 2d 383 (S.D.N.Y. 2005).

As this article goes to press, the Spitzer litigation is being appealed. In addition, many of the regulatory and enforcement inquiries discussed above are in progress, and it is too early to predict whether they will lead to significant actions.

POTENTIAL FOR CLASS ACTIONS

Although much of the initial focus relating to loan-pricing and the 2004 HMDA data has revolved around state and federal enforcement and regulatory scrutiny, lenders also face the potential for significant class action litigation as well. Important lessons can be drawn from a series of cases alleging discrimination in automobile financing that were filed against major auto lenders over the past several years.

In these cases — many of which were filed in the U.S. District Court for the Middle District of Tennessee — plaintiffs alleged that a number of banks and auto finance companies had violated ECOA by permitting dealers to "mark up" automobile finance contracts in a discretionary manner, which led to higher interest rates for minority customers.[22] The plaintiffs alleged that this "disparate impact" on minorities violated ECOA. The cases were vigorously defended by the auto finance companies and banks, which disputed whether the disparate impact theory could be used under ECOA, argued that the discretionary component of the interest rate was set by independent dealers, over which they had no direct control, and disputed that there were, in fact, disparities in loan pricing.

Most of the legal arguments advanced by the defendants were rejected by the trial courts handling these cases, and most of the cases resulted in settlements, with millions of dollars of class-wide relief but no admissions of liability on the part of the defendants. As a consequence of the settlements, none of the cases were appealed, and many of the legal issues that arose are therefore still not firmly settled.[23]

22. *See, e.g., Coleman v. General Motors Acceptance Corporation,* No. 3:98-CV-211 (M.D. Tenn. filed Mar. 9, 1998, final judgment approving settlement Mar. 29, 2005); *Lee v. WFS Financial, Inc.,* No. 3:02-CV-570 (M.D. Tenn. filed June 17, 2002, final judgment approving settlement Nov. 15, 2004).
23. In one case that was tried before a federal judge, the court found the auto finance company legally responsible for the disparities. *Borlay v. Primus Automotive Financial,* No. 02-CV-382 (M.D. Tenn., found liable Mar. 16, 2005). As of the publication of this article, the parties had been referred to mediation and the court had not yet ruled on damages.

The legal theories relied upon in these cases can be applied to residential-secured lending as well. For example, just as auto finance companies accept assignment of auto finance contracts from independent dealers, wholesale lenders originate or purchase loans from independent brokers or correspondents. And of course, lenders who deal directly with customers on a retail basis have equal or greater exposure.

STEPS LENDERS CAN TAKE TO LIMIT HMDA PRICING RISKS

In view of all of these risks, what is a prudent lender to do? Although no lender can guarantee that it will not be subject to adverse regulatory or enforcement activity, or that disparities will not arise in its loan pricing, all lenders can take steps — such as those discussed in this section — to reduce these risks. It must be stressed, however, that there is no "one-size-fits-all" approach to managing these risks. In developing an effective risk-mitigation program, each lender should weigh the recommendations discussed below against its own, institution-specific risks and priorities.

Establish and Maintain a Comprehensive and Effective Fair Lending Program

First and foremost, lenders should establish and maintain a strong and effective fair lending program. Such a program should impress upon employees the importance that the institution places on treating all applicants and borrowers equally regardless of race, ethnicity, or any other prohibited basis. The program should be documented in writing and distributed to every employee. In addition, the program — or at least its main points — should be made public, through a lender's web site or other means.

In particular, the program should emphasize the importance of treating similarly situated borrowers equally in all aspects of a credit transaction, including loan pricing. The program should also cover non-pricing aspects of lending, including loan marketing, underwriting, and processing. Frequent training of all employees, particularly those in customer contact positions, should be a central part of the program.

Conduct Privileged Statistical Analyses

Despite an institution's strong fair lending program, it is possible for pricing disparities to arise. In order to evaluate and respond to this risk, it is important that lenders

analyze their own data before others do so. In addition, regulators are more likely to view an institution in a favorable light if it has identified and addressed problems *before* any inquiry began.

The principal focus of any such analyses should be on whether there are disparities in loan pricing between minority and white non-Hispanic borrowers, since this is, for most lenders, the most significant area of risk.[24] Such analyses should be designed to address at least three distinct issues: (i) do minority customers obtain "triggered" loans more frequently than non-minority customers (an "incidence" analysis); (ii) does the size of the reported rate spreads for minority customers exceed the size of the reported rate spreads for non-minority customers (a "magnitude" analysis); and (iii) does the average APR for minority customers for all loans — regardless of whether they are triggered loans — exceed the average APR paid by non-minority customers (an "overall pricing consistency" analysis).[25]

In conducting these analyses, the institution should control for credit score, loan-to-value ratio and other factors that affect loan pricing, in order to determine whether similarly situated customers receive similar loan pricing. In addition, it is strongly preferable to conduct such analyses under the direction of counsel and pursuant to the attorney-client privilege. Analyses that are not conducted under the supervision of counsel are not subject to a claim of privilege, and are therefore discoverable in civil litigation and regulatory contexts regardless of whether the findings are positive or negative.[26]

24. Although our focus here is on pricing consistency, pricing analyses may also alert lenders to risks unrelated to pricing disparities. For example, a lender who is perceived as a "prime" lender by its regulators and the public may find, due to interest rates or other conditions, that it has an unexpectedly large number of triggered loans. By conducting an early self-evaluation, a lender potentially can take corrective action, such as limiting the types of loans that are most likely to trigger and also can take steps to manage regulatory expectations.
25. The overall pricing consistency analysis is particularly important, inasmuch as the HMDA reporting triggers are designed as a tool to direct further inquiry and are therefore arbitrary in nature. It is possible for a lender to have disparities in trigger frequency yet have overall pricing consistency (and vice-versa).
26. Although there is a limited self-examination privilege under ECOA, this protection is generally regarded by regulatory agencies as applying only to special tests, such as "mystery shopping," in which new information is created, rather than to analyses of pre-existing information. 15 U.S.C. § 1691c-1.

Determine the Causes of Any Disparities and Take Action to Address Them

In electing to conduct a pricing analysis, a lender should also be prepared to investigate the root causes of any identified disparities and to take action to correct them. Such causes are often related to the exercise of discretion in pricing — and thus the identification of the situations in which such discretion is permitted, and the restriction of such discretion is often one of the first places a lender should turn in seeking to limit such disparities.

In the case of *retail* lending, pricing discretion is often permitted in the form of pricing "overages" or "underages," which reflect loan prices other than those generated by a rate sheet, pricing matrix, or loan pricing software. Frequently, overages are shared by the loan officer and lender. To the extent an institution permits such discretionary pricing adjustments, it should test them directly in order to determine whether they are applied in a consistent manner.

Where there are disparities, a lender should examine the caps on overages and underages commonly applied by other lenders in its segment in order to determine whether the extent of pricing discretion may be viewed as excessive. In addition, where disparities in such discretionary adjustments are persistent, a lender should consider a program of more frequent testing (*e.g.*, quarterly or semi-annually). Such testing may include reports at the loan officer or loan production office level, which may identify individuals or offices that have persistently high disparities. Corrective action, including enhanced training and discipline, should be taken where unexplained disparities continue.

Finally, lenders should require loan officers to document the reason for any overages, underages, or other pricing exceptions, such as adjustments made due to an offer from a competing lender or an applicant's longstanding deposit relationship. By requiring that such reasons be contemporaneously documented, a lender can track them more effectively and control them in any statistical analyses.

Wholesale lenders must manage pricing risk somewhat differently, inasmuch as brokers or correspondents — and not their own employees — are typically the parties who have the largest degree of pricing discretion. Even though a third party is dealing with the customer, however, whole-

sale lenders may themselves be held accountable for pricing differentials, and thus should take action to minimize them.

Among the most effective steps a lender can take is imposing a cap on points and fees earned by brokers. While *bona fide* discount points may be excluded from such a cap, it is advisable to include both fees paid directly by the borrower (*e.g.*, a broker's "origination fee") as well as fees paid by the lender to the broker (*e.g.*, yield spread premiums or rebates). Just as in the retail context, wholesale lenders are well advised to survey their market segment in determining an appropriate cap. In so doing, lenders should recognize that regulators and enforcement agencies may themselves conduct such a survey in order to determine which lenders to target for further scrutiny.

In addition, just as in the retail context, wholesale lenders that have unexplained pricing disparities should conduct additional analyses to determine which brokers are contributing the most to such disparities. Frequently, a small number of brokers may account for a significant proportion of a lender's pricing disparities. If certain brokers have a pattern of unexplained pricing disparities, lenders should cease doing business with them.

Minimize the Number of Reportable Loans

One final approach to reducing the likelihood of regulatory or enforcement agency scrutiny based on HMDA pricing data is to reduce the number of reportable loans. Although such action will not necessarily eliminate overall APR disparities, it can have two positive benefits: first, if the number of reported triggered loans is extremely low (or zero) there will be very little basis for any further scrutiny; and second, if a lender has a very small number of triggered loans, it reduces the likelihood that it will be perceived as lending to the subprime segment of the market — which is often seen as presenting a higher degree of risk than prime lending.

The simplest approach to reducing the number of triggered loans is, of course, to impose a system-wide prohibition on them. If that is not practical, an institution can still limit the number of reported loans by setting a pricing cap at even five or six points above the comparable Treasury rate. Not only will such a cap likely reduce the number of reported loans, but it will also have the effect of preventing extreme pricing outliers. Such outliers often contribute heavily to an institution's pricing disparities.

Another step a lender should consider is to reduce the prevalence of loans that are most likely to be reportable — such as short-term loans with balloon payments. With respect to such loans, the comparable Treasury rate is determined by the term of the loan, not the amortization schedule. In 2004, for example, the yield for a five-year Treasury security ranged between 2.74% and 3.1%. Thus, such loans were reportable with APRs as low as 5.75%. If an institution makes a significant number of such loans, it may draw undesirable scrutiny merely because its rate of HMDA price-reportable loans is so high.

CONCLUSION

As a result of the 2002 HMDA amendments, a wealth of new pricing information is available with respect to home mortgage loans. With this new data comes significant risks. However, prudent lenders can manage these risks by analyzing their pricing data and taking corrective action where warranted. ■