High-cost Mortgages from the Home Mortgage Disclosure Act Data

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Disclaimer

- The opinions expressed in this presentation are my own and are not necessarily the official positions of the Federal Reserve System.

Selected HMDA Timeline

- 1975 – Introduction of HMDA
- 1989 – Race, gender, and income characteristics now required
- 1992 – Boston Fed regression analysis shows that race plays a role in mortgage lending
- 1994 – The Federal Reserve adopts regression analysis as a tool for identifying discrimination
- 2002 – Loan pricing information now required, starting in the 2004 reporting year

Motivation for the Boston Fed Study

- Early HMDA data showed that minorities were up to three times more likely to be rejected than whites.
- Bankers argued that if minorities were being rejected at a higher rate, then they must have weaker average credit quality.

Boston Fed Findings

- Boston Fed economists collected a variety of credit quality variables to see if race continued to play a statistically significant role in Boston-area rejection rates.
- They found that race plays a smaller role than it does in the raw HMDA data, but it is still statistically significant.

Critiques of the Study

- The dataset consisted of many different loan products, each with different underwriting standards.
- The data came from many different banks in the Boston area, also with different underwriting standards

Fed Response

- In 1994, the Fed formally adopted regression analysis, but the analysis would be limited to one bank at a time and would account for differences between loan products, geographic areas, and time periods.

Loan Pricing Analysis

- Starting with the 2004 reporting year, banks are required to identify “high-cost” loans:
  - A first-lien loan is “high-cost” if its APR is more than 3 percentage points above a comparable-maturity Treasury security.
  - A junior-lien loan is “high-cost” if its APR is more than 5 percentage points above a comparable-maturity Treasury security.

Three-Step Process

1. Preliminary screens using HMDA data
2. Follow-up regression analysis using enhanced data
3. Matched-pair analysis using enhanced data

Step 1

- Preliminary Screens Using HMDA Data
  - Look at both the proportion of high-rate loans and the average spread for high-rate loans
  - Look for disparate treatment using various definitions of minority
  - Look at overall data and various splits (MSA, product type, etc.)
  - Focus on lenders with:
    - Significant rate spreads
    - Sufficient sample size

Step 2

- Enhanced Data Analysis
  - If possible, get enhanced data for all loans, not just a subset of products or MSAs
  - Dependent variable depends on lender’s business model and available data:
    - Annual Percentage Rate (APR)
    - Overage
    - Yield Spread Premium (YSP)
  - Independent variables depend on lender’s pricing policies and rate sheets, where applicable

Step 3

- Matched Pair Analysis
  - If significant disparities remain after accounting for enhanced data, compare files directly to determine whether legitimate factors that did not enter the regression were the cause of pricing differences
  - Give the bank opportunity to explain any disparities

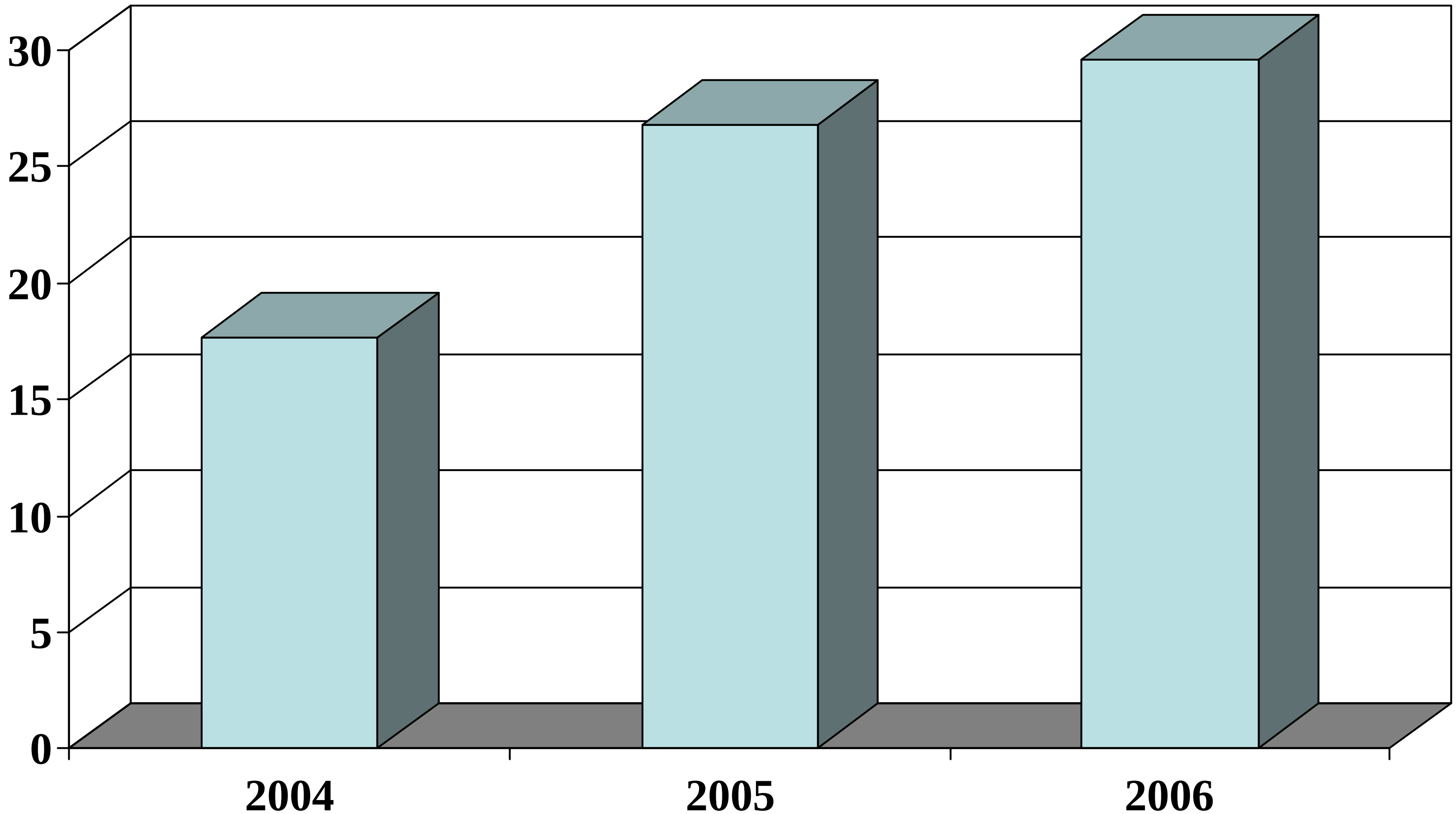
HMDA Requirements

- Why not require more detailed HMDA data submissions?
  - Idiosyncratic nature of variables
  - Privacy concerns for borrowers
  - Regulatory burden

Risk-Based Exam Scoping

- The following slides contain graphs of HMDA data from the St. Louis Metropolitan Statistical Area (MSA)
- How would we go about scoping this exam if all of these loans came from a single lending institution?

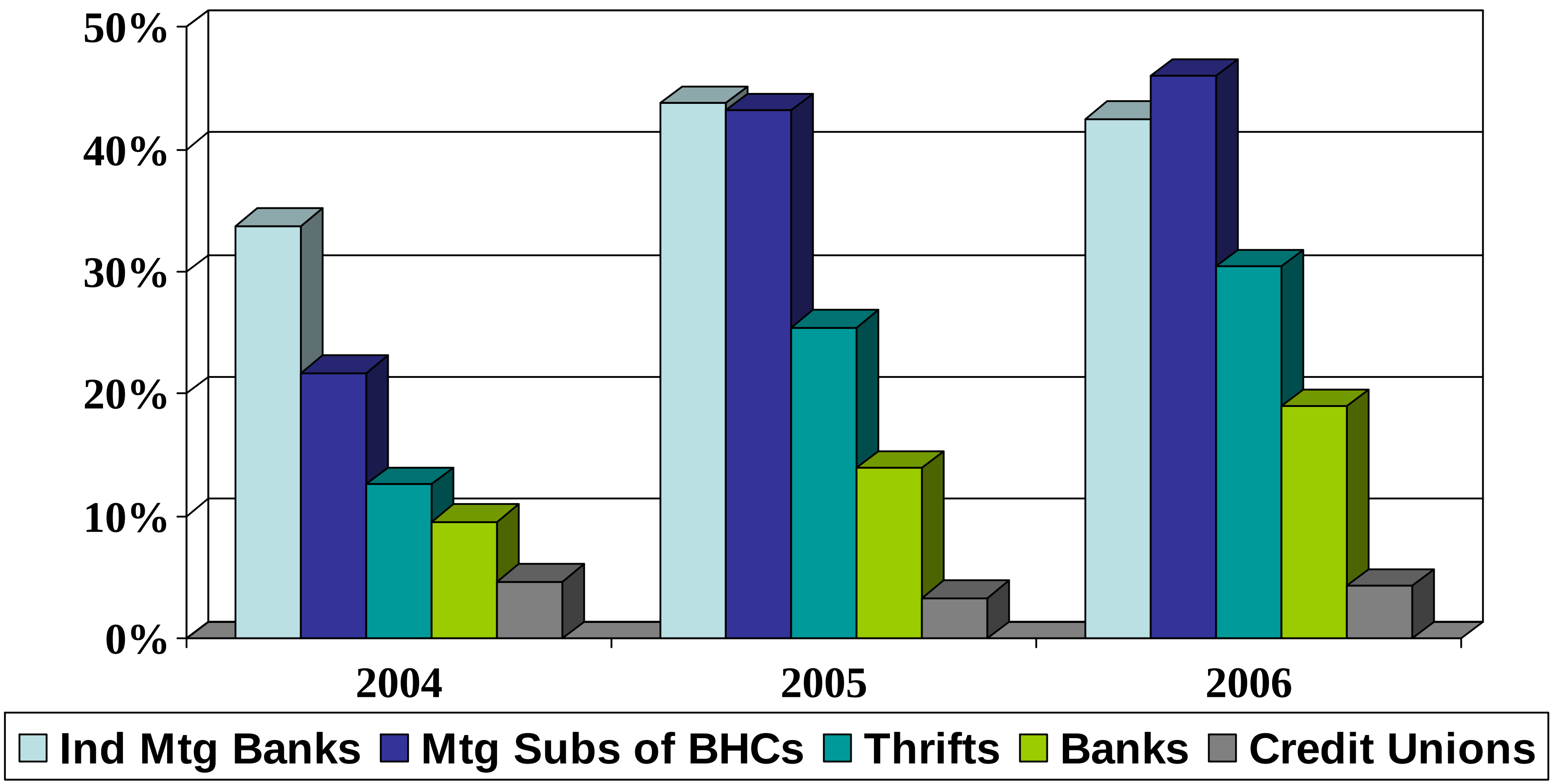
St. Louis High-Cost Mortgages



The proportion of “high cost” loans has risen steadily over last three reporting years

Source: HMDA.

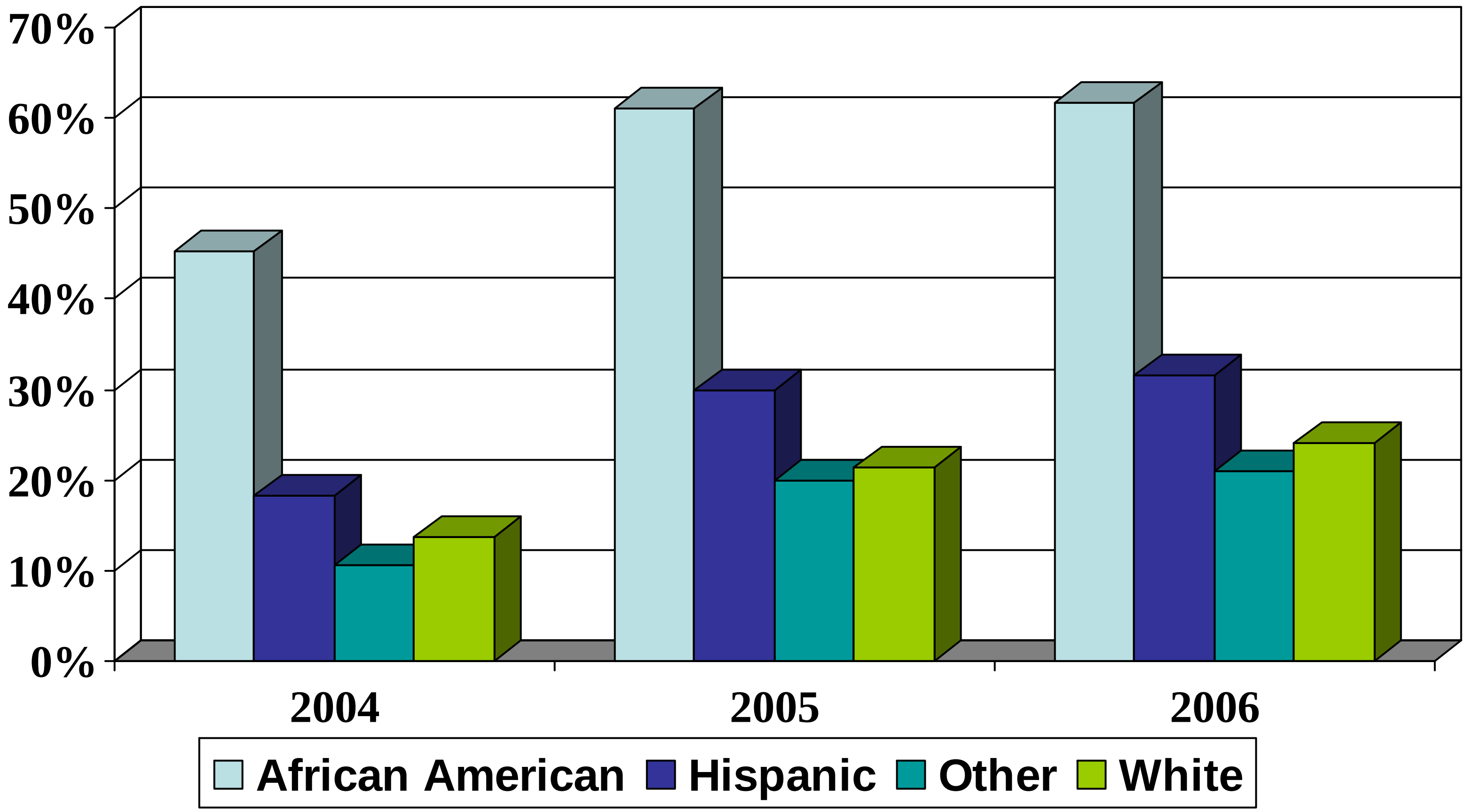
St. Louis High-Cost Mortgages



Independent mortgage banks and mortgage subsidiaries are costlier than the others

Source: HMDA.

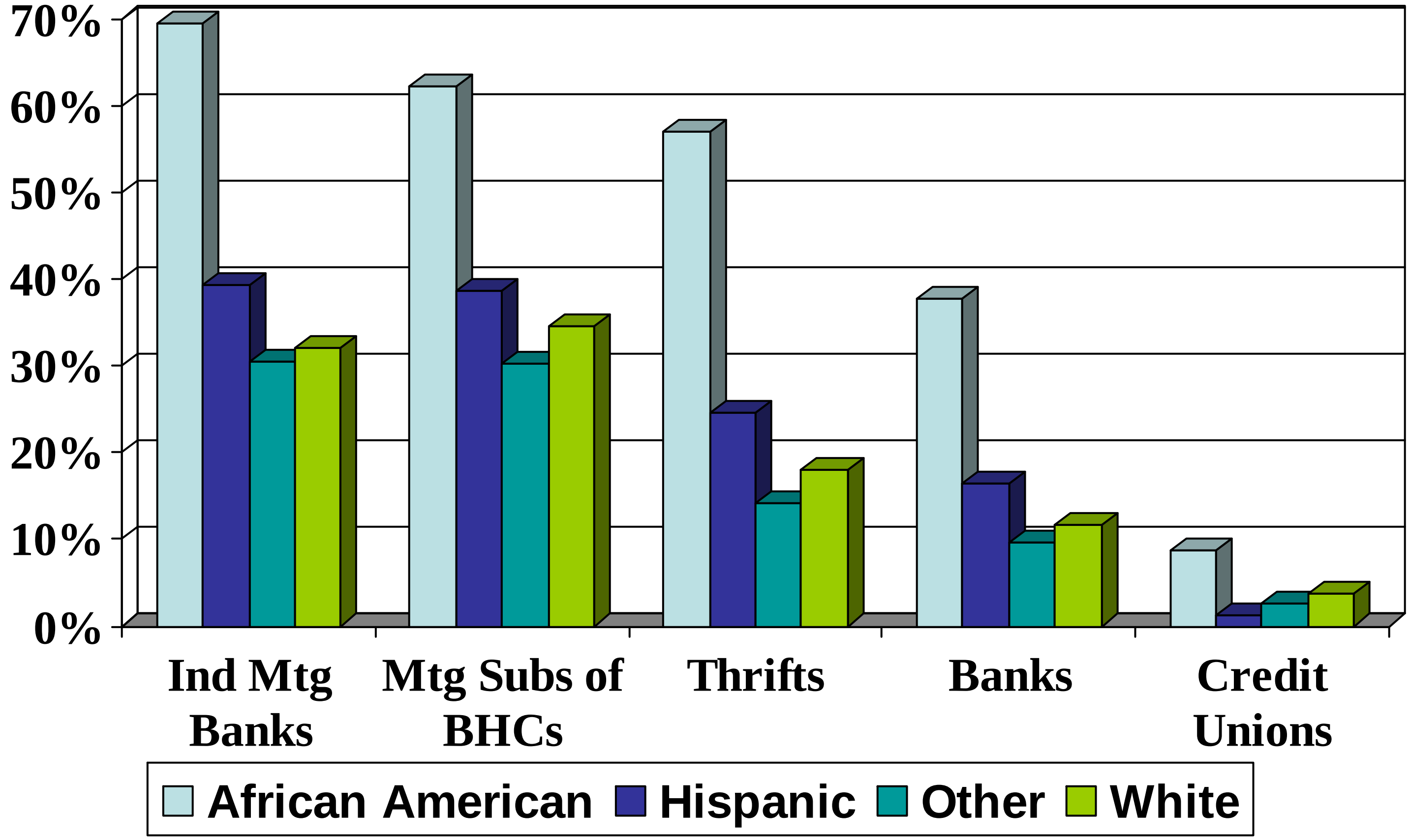
St. Louis High-Cost Mortgages



There are potential fair-lending implications for minority borrowers

Source: HMDA.

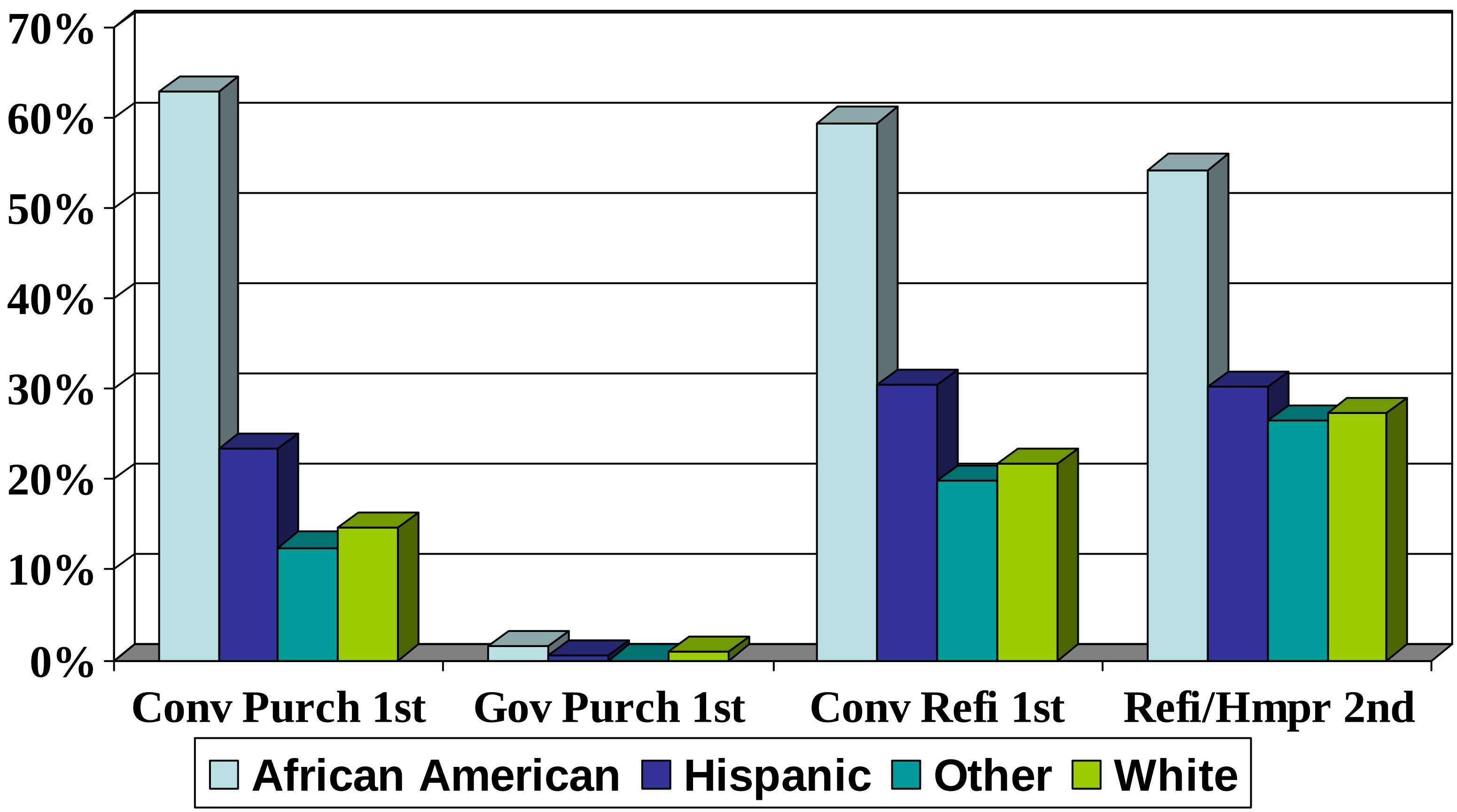
St. Louis High-Cost Mortgages 2006



Steering (or self-selection) into high-priced lenders cannot explain the disparities

Source: HMDA.

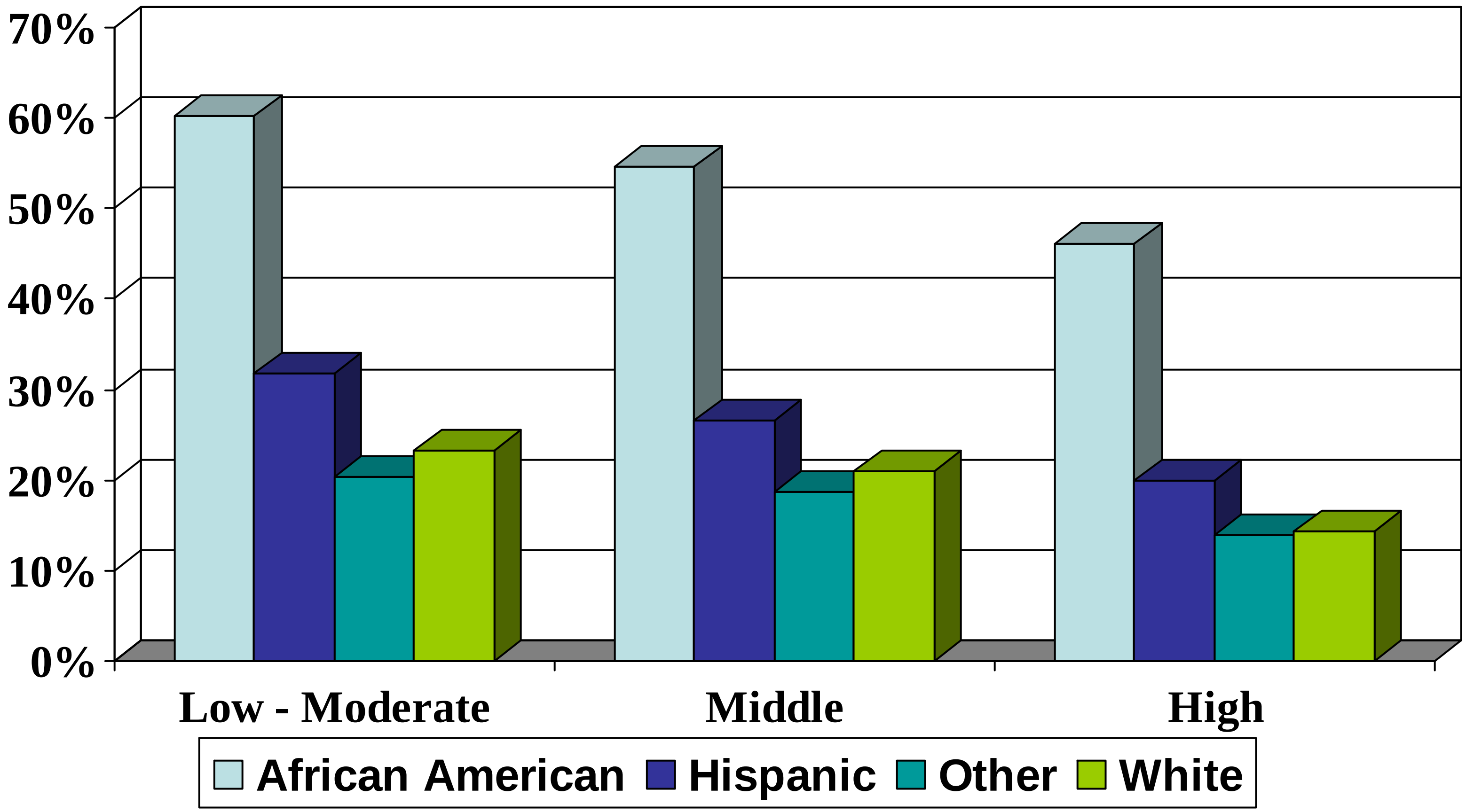
St. Louis High-Cost Mortgages 2006



The disparity is not isolated in only one or two loan products.

Source: HMDA.

St. Louis High-Cost Mortgages 2006



Income alone does not explain the disparities

Source: HMDA.