February 11, 2001

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-10001

Dear Ms. Johnson:

I am writing on behalf of the Woodstock Institute to respond to the request for comments by the Board of Governors of the Federal Reserve System on proposed changes to Regulation C: Home Mortgage Disclosure Act (HMDA) data regulations.

Since the HMDA data became available in the late 1970s, The Woodstock Institute was among the earliest and most prolific users of the data and authored some of the earliest anti-redlining studies. We have followed the evolution of HMDA from loan origination data for banks and thrifts only, to the expansion to mortgage companies, and then to the addition of application data including race and gender. HMDA has been a key tool in the effort to improve access to credit. In fact, the availability of and improvements to HMDA data over the years have clearly raised public consciousness around access to credit issues. In fact, the 1989 changes to HMDA were clearly responsible for a number of key research reports documenting lending discrimination (led by the Federal Reserve Bank of Boston's study) and a number of improvements in marketing and service by lenders to minority communities. It is no coincidence that the largest gains in home buying among minorities occurred within the four years after the 1989 changes became public.

We are pleased with many of the proposals put forth by the Federal Reserve, including some of the reclassifications of data, the removal of the 90 percent composition reporting rule, and the addition of some fields. At the same time, in order to inform some of the key changes in the lending marketplace and to address concern that the Federal Reserve itself has expressed, the proposal must be significantly expanded and modified. Moreover, the argument given against collecting additional data – that the costs are too great – are not substantiated and are clearly misguided.

The mortgage lending market has changed dramatically since the Act was passed in 1975 and even since the FIREA changes were enacted in 1989. High-risk, high-cost lending has grown phenomenally since the early 1990s. There is ample evidence of high-cost loans being marketed disproportionately to minorities and the elderly. Risk-based pricing will be increasingly commonplace, even in parts of the prime market. The lack of pricing and credit data in HMDA is making the data functionally obsolete. Concerns over access to credit have been replaced by concerns over affordable credit. Also, concerns of discrimination in approvals of loans have been superseded by concerns over differential marketing, steering, and pricing. As shown in our 1999 study, Two Steps Back, and in HUD's Unequal Burden reports from last year, African American neighborhoods are dominated by subprime lenders, particularly in the refinance market.

No doubt the Board will receive many comments from the lending industry complaining about the costs and burdens any new data fields will cause. The Institute has seen the "regulatory burden" argument raised again and again over the years as it and other organizations have called for increased reporting and disclosure of critical lending data. When the 1989 FIREA changes to HMDA were enacted (changes much more significant than any contemplated in recent Regulation C discussions), many lenders cried regulatory burden. When small business lending data was initiated in 1996, they made the same complaints. We have yet to see any evidence that shows that any of these changes required a lender to go out of business or to increase the price of credit significantly. These costs, which are modest and primarily fixed, are easily spread over literally millions of loans and over many years.

What the Board's decision comes down to is a cost-benefit calculation and an evaluation of the distribution of those costs and benefits. Some very modest, short-term conversion costs will be necessary to collect key data that enable a much better understanding of credit access issues and allow regulators to target lenders for fair lending and consumer compliance investigations much more efficiently. These data will also be of great utility during Community Reinvestment Act performance evaluations. The costs of the new data collection, as the industry will no doubt tell you, will be passed on to borrowers of all kinds. It is impossible to imagine that adding a few fields of data will result in any noticeable change in mortgage pricing. And yet, the benefit from such an investment will be the provision of a key tool that can help prevent vulnerable borrowers from losing their homes, moderate-income neighborhoods from being destabilized by foreclosures, and working families from losing hard-earned home equity.

If the Board is serious about its interest in bringing more light to the problem of predatory lending and fair lending, then it must go further than the current proposal. Governor Gramlich has articulated the reasons for such action:

"Other steps may need to be taken, and may be taken, to deal with predatory lending. But we should be able to agree that more information is an important prerequisite to sensible policies in this area. Increased HMDA data collection is the first step in gaining broader understanding of the business practices of subprime lenders and in helping us distinguish appropriate from inappropriate lending practices."

-Governor Edward M. Gramlich
From a speech at the Federal Reserve Bank of Philadelphia
December 6, 2000

I will now address many of the proposed revisions to HMDA, as well as related concerns:

I. Modernizing the Data Fields in HMDA (Definitions 2i, Additional Items 4(a)(9))

In order to inform regulators and others as to the appropriateness of a loan, as well as to provide the tools needed to enforce consumer compliance, fair lending, and Community Reinvestment Act laws, it is critical to update the fields in the HMDA loan application register to match today's lending environment.

We welcome the Board's proposal to require the Annual Percentage Rate, HOEPA status, and manufactured home status. APR is critically important to the understanding of higher-cost lending and the potential for problems of race-based steering, poor access to affordable products, etc. Unfortunately, these three fields are not at all adequate for making HMDA data the much more powerful tool that it could be in identifying potential predatory lending practices or discrimination, or in determining the CRA performance of depositories.

There are a number fields that are readily accessible to lenders that could easily be incorporated into this regulatory change. Given that lenders will have to change their reporting systems, the addition of more new variables will not affect the conversion costs substantially. And adding sufficient fields now will prevent the Board from having to go back to lenders in the near future with additional changes.

We recommend the following fields be required in addition to the three proposed variables. The Board has requested comments on some of these but not others.

<u>Points and Fees</u>

We strongly urge the Board to include a field for points and fees on the loan. The bulk of what we know about predatory lending indicates that the primary motivation for lending abuses and the resulting high defaults and foreclosures stem from the excessive points and fees charged to many subprime borrowers. Excessive up-front charges are the key to predatory lending. APR does not give significant information on fees in a loan. Responsible subprime lending will rely primarily on the interest rate to recover revenues, so that lenders have a greater interest in loan repayment.

As an example of why APR alone severely obfuscates actual costs to the borrower, consider two 30 year fixed-rate loans, one at 10 percent interest and no points and fees and the other at 9.7 percent interest and 8 percent points and fees. Many subprime loans prepay in two years or less. Over such a period, the first loan costs the borrower 30 basis points more per year in interest, or 60 basis points, while the second costs the borrower 8 percent more in fees – or 13 times more in costs than the first loan. Because the fees are amortized over 30 years, however, the APR on the second loan would only be 10.6 percent, only slightly higher than the 10 percent for the first loan. Thus, not collecting points and fees data gives lenders a perverse incentive to allocate their revenue to fees rather than interest rate, precisely the opposite of responsible lending practice.

The Board should require the reporting of HOEPA points and fees, since it is this calculation that triggers consumer protections under HOEPA. Moreover, since lenders should be calculating HOEPA points and fees to determine whether a loan meets the high-cost threshold, the data are available to all lenders. Only a very small fraction of high-cost loans meet the APR trigger under HOEPA. By subtracting HOEPA points and fees from principal (loan amount), one would be able to determine how close the fees were to the HOEPA trigger. This field could be substituted for HOEPA status, since the combination of it and the APR field would indicate HOEPA status.

<u>Age of Applicant</u>

Since age is a protected class and predatory lending has been found to disproportionately impact the elderly, it is critical that the Board add age as a field under HMDA. The data is easily reported in the same manner as race and gender, which are currently reported under Regulation C.

<u>Credit History</u>

The Board should require a credit score to be reported for each loan applicant whenever a score is available or used in the application process. Notwithstanding their limitations, FICO scores are the most widely used and available and would be the most frequently reported. The variety of sources for credit scores, however, makes obtaining consistent scores an issue. One alternative would be to require a lender to indicate both score and vendor.

Another alternative that might allow somewhat less resolution in credit information is to require four fields that would describe the credit history of the applicant across a number of key credit history experiences. The chart below illustrates how four credit history fields might be developed to characterize an applicant's credit history. Each field would be measured independently, so that there is no suggested correspondence between columns in the table and conventional credit grades (e.g., A, B, C, D). The categories for each field might be modified or refined by the Board to reflect empirical evidence on the distributions of each characteristic. The intent here is not to aggregate the four credit experiences into one variable that is categorized (such as the A-D grading system) but to merely give categorical data on each of these four distinct criteria. Analysts could then use simple multivariate analysis to determine relationships between these credit criteria and pricing.

<u>Categories for Each Field: 1,2, 3, 4, 5</u>

Credit Field

Late Mortgage Payments*
<2, 30 days and 0, 60 days: Category 1
2, 30 days and 0, 60 days: Category 2
3, 30 days and 0, 60 days: Category 3
4, 30 days and 1, 60 days: Category 4
More: Category 5

Late Consumer Loan Payments*
<2, 30 days and0, 60 days: Category 1
2, 30 days and 1, 60 days: Category 2
2, 30/60 days and 1, 90 days: Category 3
3, 30/60 days and 2, 90 days: Category 4
>3, 30/60 days and >1, 90 days: Category 5

Judgements, charge-offs or repossessions
None: Category 1
>5 years old: Category 2
2-5 years old: Cateogry 3
1in last 2 years: Category 4
More than 1 in last 2 years: Category 5

Bankruptcy
None: Category 1
>5 years old: Category 2
4-5 years old: Category 3
2-3 years old: Category 4
< 2 years old: Category 5

*Delinquency measures are taken over the most recent year.
Note: There should be a sixth category for each field for borrowers with no credit history.

Total Monthly Debt Payments of Family

This figure is critical to examining whether lenders are lending beyond conventional back-end debt-to-income ratios. Since family income is already reported, this field would allow the calculation of this ratio.

Loan-to-Value Ratio

The Board specifically asks for comments on requiring appraised value versus loan-to-value ratio. We recommend reporting the latter. The cumulative loan to value ratio is readily available on disclosure forms and is a better measure than might be available through simply reporting appraised value, since total property debt is not otherwise available.

Identity of Parent Company

This is critical information. Financial modernization makes it increasingly important. Ideally it should be made available in a manner consistent with the Board's NIC database.

Other Fields

The Institute urges the Board to consider adding fields that describe the terms of the loan, including term (in months), amortization (in months), prepayment penalties (as percent of principal or months of interest), and the presence of lump-sum credit life, disability or unemployment insurance.

II. Reclassification of Loan Purpose (Definitions 2f, 2g, 2h, 2k)

The Institute generally agrees with the proposals to redefine loan purpose/type classifications, with some suggested modifications. The addition of a separate open-ended home equity line of credit category is very important. It is important to distinguish these from closed-end loans. The proposal to standardize home improvement loan reporting is also long overdue. The new rules should include only secured, closed-end loans as home-improvement loans. The Institute also strongly agrees with the revamping of the refinancing definition so that it is consistent across institutions and picks up all refinancings, not just those of home purchase loans.

At the same time, the Institute strongly recommends the reporting of any refinancing of debt, and not just the refinancing of dwelling-secured debt. Since a great deal of refinancing is used to pay off unsecured consumer debt, this is a critical addition.

The Board offers an alternative that aims to cover more loans but reduces information on the use of the loan. We appreciate the Board's goal of trying to include all types of dwelling-secured loans.

We suggest a slightly different approach that borrows from both alternatives. It would offer complete coverage and yet not lose any key information on loan purpose. Lenders would classify loans based on two variables (in addition to conventional/government type):

Structure: First-lien Closed-End, Junior-lien Closed-End, Home Equity Line of Credit (open-end), Unsecured Home Improvement

Purpose: Home Purchase; Refinance Dwelling-Secured debt, Refinance Other Debt, Home Improvement; Other

Loan purpose would be determined as follows:

1) if the applicant is purchasing a home, regardless of improvements, classify it as a home purchase loan;
2) if the loan is refinancing debt, determine whether the majority of the debt is secured or unsecured and classify accordingly
3) if the loan is not classified as 1) or 2) and part of the proceeds are for home improvement, classify accordingly
4) if not classified as 1) through 3), then classify the purpose as "other"

Such a scheme more logically breaks out the use or purpose of the loan from the structure of the loan. The exception is the unsecured home improvement loan, which is the only unsecured loan that would be reported (due to statutory issues). This scheme would yield a great more information. For example, one could determine for what purpose home equity lines of credit were being used versus junior-lien closed-end loans.

III. Coverage of Reporters (Definition of Financial Institution 2e)

The Institute welcomes the Board's recommendation to eliminate the exemption of a nondepository institution from reporting if its home purchase loan originations and refinances of home purchase loans were less than 10 percent of all originations by the institution, based on the notion that they were "not in the business of mortgage lending."

Of course, consolidation and convergence in the financial services sector has rendered the composition test relatively meaningless as a gauge of whether an institution is a significant mortgage lender. One institution may make all sorts of loans. Even if home purchase loans are a small part of its own total lending portfolio, a lender may be a significant mortgage lender. Thus, it is important to look primarily at the volume of residential lending by the institution, and not at that volume with respect to other activities by the firm.

However, a few serious problems with the Board's proposal in this area remain. First, counting only home purchase and the refinance of home purchase loans in determining the threshold is inappropriate, especially given the dynamics of residential lending markets. Home equity loans, home improvement loans, and refinances of non-home-purchase loans are of great concern in the current environment. In fact, one of the greatest concerns in the predatory lending debate is the phenomenon of flipping, where a borrower is refinanced repeatedly over a short period of time. There is as much concern about refinancings of refinance loans as about refinancings of home purchase loans.

Any threshold, therefore, should be based on the total number of HMDA-reportable originations under the new regulations. That is, all dwelling-secured loans should be considered in determining the threshold, including home-improvement loans, home purchase loans, refinances of all types, other closed-end second mortgages, and home equity lines of credit.

Second, the threshold should be set substantially lower than the proposed $50 million. The Board's rationale for this threshold is "that approximately half (of 1999 reporters) reported originations of $50 million or less." This rationale makes little sense. The threshold should be based on whether omitting lenders below a certain size risks losing important information in local lending markets. Because a lender making 400 loans could be a major actor in a local market – especially in a rural area or small town – this level is much too high. A level of $10 million, or 100 loans, is more appropriate. The 100 loan figure is also consistent with the existing lending volume threshold in Regulation C. If a dollar volume is used, the $10 million level is especially relevant for lenders who specialize in home improvement loans or home equity lines of credit, where loan amounts are smaller.

Third, the threshold also raises concerns in that it is proposed to run only to the lending volume of the reporting lending institution. Highly fragmented firms may inadvertently benefit from such a test. Some financial firms may own a number of separately reporting institutions. It is also conceivable that some institutions wishing to avoid reporting may "split" their operation into separate institutions to avoid reporting. Thus, it is important to apply any threshold to the lending volume of all affiliates combined. If the sum of lending by all affiliated lenders meets the threshold, then each affiliate should be required to report.

Finally, there should be no exemptions for reporting based on metropolitan vs. nonmetropolitan location. All lenders should report as long as they meet the national thresholds recommended here.

IV. The Board Should Require All Lenders to Report Race And Gender (and Age) Data For All Loan Applications

Increasingly, lenders – especially of refinance and home improvement loans -- are not fully reporting the race of applicant data requested under HMDA. In the case of refinancing, 19 percent of loans had no race data. Whether this is due to increasing telephone or Internet applications or not, lenders should be required to obtain these data. We have heard anecdotes of lenders or brokers encouraging borrowers not to supply these data on their applications, suggesting that technological reasons are not solely responsible for the lack of race reporting. In many cases, specific lenders (including many subprime firms) report race data for less than one-half of their applications. Some report little to no race data.

V. Reporting of Preapprovals

The Institute supports the reporting of preapprovals (not prequalifications) as long as a field is added to indicate that the loan is a preapproval. Otherwise it will be difficult to distinguish regular applications from preapprovals.

The Institute welcomes this opportunity to comment on Regulation C. It is vitally important that HMDA data be modernized to maintain its relevance in a changing financial environment and see it as the Board's mandate to do so. Without modernizing these data, the intent of the Act would be effectively thwarted through inaction of the implementing agency.

We would be happy to discuss further details on any of the items addressed in this letter. Thank you for your consideration of our recommendations.

Sincerely,
Dan Immergluck
Senior Vice President

cc: Malcolm Bush, President, Woodstock Institute