The Federal Reserve Board

Remarks by Governor Edward M. Gramlich

To the National Association of Real Estate Editors, Washington, D.C.
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HMDA Data and Their Effect on Mortgage Markets

Thank you for the invitation to speak today. I am particularly pleased to accept an invitation to address the National Association of Real Estate Editors. Journalists are critical in helping the public understand the economics of the mortgage market, which has become more accessible, yet also more complex than ever. Your ability to demystify the mortgage market and identify trends greatly improves the public's understanding of the housing market--the market for one of the most important financial transactions an individual will ever undertake.

I also note that your readership includes real estate professionals--another group of individuals who play a crucial role in the efficient operation of the housing market. Homeowners often rely on recommendations from their realtors when looking for financing. Realtors must understand the role they play in making credit markets work, and in promoting sustainable homeownership opportunities for individuals.

In our society, homeownership is the most common step one can take toward accumulating wealth. Home equity, built over time, has also become an important source of cash for other investments, including educational expenses. Moreover, homeownership strengthens communities by turning residents into investors with an ownership interest in the places they live. Recently, homeownership rates have reached record levels, thanks, in large measure, to technological innovations that allow for risk-based pricing of loans, along with the rapid growth of the subprime mortgage market.

This brings me to the topic I want to discuss today: the recent release of pricing information collected under the Home Mortgage Disclosure Act (HMDA). As you are aware, HMDA requires that large mortgage lenders report their lending activities to the Federal Reserve Board and its sister agencies. The Board validates and ultimately compiles the data into a format that is made available to the public. The public can then use this information to evaluate whether lenders are serving their communities, enforcing laws prohibiting discrimination in lending, and providing private investors with information to guide investments in housing. Generally, for-profit lenders that have offices in metropolitan areas and that have more than $34 million in assets, or whose mortgage lending represents 10 percent of their lending originations, must report under HMDA.

In my remarks today, I will first review the history of HMDA as a backdrop for the new HMDA pricing data. The Federal Reserve is still editing these data, but I will also provide a preview of what they are likely to show.

HMDA History in Brief

The regulations implementing HMDA require that lenders disclose aspects of their home mortgage application and lending activities, including the applicant's or borrower's race, ethnicity, sex, and income. Also reported are characteristics of the loan, such as the amount and purpose, and the location of the property securing the loan. But it was not always this way.

When HMDA was originally enacted in the mid-1970s, the only information required to be reported was the number and dollar amount of loans, by census tract. Congress, concerned about the role that financial institutions' lending policies might play in the deterioration of our cities, designed HMDA to combat the practice known as "redlining," in which institutions took deposits but did not lend in their local communities. Initially, HMDA data simply helped the public and regulators track where an institution was lending and, more important, where it was not.

Not until the late 1980s did the data collection expand to include race, sex, and income levels for each loan application, along with whether the application was approved or denied. By then, the issue was whether minority borrowers were denied mortgage loans more frequently than white borrowers and whether those disparities reflected discrimination in mortgage underwriting.

Today, after significant changes in the mortgage market brought on by technological advances, deregulation, and financial innovation, the credit availability question is no longer limited to whether minority borrowers have access to credit but, rather, at what price that credit is available. Moreover, there are new questions about whether the price of credit always reflects the lender's risk or cost, or whether it is tied in any way to the race or sex of the borrower.

The technological changes have led to strong growth in the subprime mortgage market. In general, this growth appears to be a positive development. Homeownership is at record highs among low-income and minority borrowers, many of whom would not have qualified for mortgages several years ago, and most of whom have been able to make their mortgage payments. At the same time, the increase in mortgage lending among lower-income and minority borrowers has been accompanied by reports of abusive, unethical, and, in some cases, illegal lending practices. I am sure you are aware of the concern about whether consumers have the ability to shop for mortgages and to avoid unfair or deceptive lending arrangements.

Taking these concerns and public comments into consideration, the Federal Reserve determined that information on loan prices was critical to gaining insight into the functioning of the higher-cost mortgage market. In the Board's amendments to the regulation that implements HMDA, Regulation C, we attempted to expand the HMDA data to permit evaluation of this market. The same amendments also required recording of information about the lien status of the loan, whether it was for manufactured housing, and whether it was subject to the Home Ownership Equity Protection Act.

The new data were first reported for loans originated in 2004. Although the edited aggregate HMDA data will not be available until September 2005, lenders, as of March 31, are required to make their individual data available to anyone who submits a request. Some community organizations have already obtained and analyzed the data of some large lenders and have published reports indicating they believe that the data reveal discrimination in pricing. Simultaneously, the Federal Reserve, together with the other agencies that make up the Federal Financial Institutions Examination Council and the Department of Housing and Urban Development, has been explaining to financial institutions and to the public the uses and limitations of the pricing data and how these data will be used by bank examiners.

General Data Issues

The collection of HMDA data is premised on two distinct assumptions. The first is that the mortgage markets work more efficiently when information is publicly available. HMDA data have been used to identify credit demand that might otherwise have been overlooked. The analysis and conclusions drawn from the data have also encouraged the establishment of partnerships between lenders and community organizations to meet credit needs.

The other assumption is that data improve compliance with, and enforcement of, fair lending and consumer protection laws. The HMDA data are the first point of reference for fair lending examinations conducted by the Federal Reserve and the other banking regulators. Government agencies use HMDA data to assist in evaluating lender compliance with anti-discrimination laws--particularly the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA)--as well as other consumer protection laws. The data help examiners identify institutions, loan products, or geographic markets that show disparities in the disposition of loan applications by race, ethnicity, or other characteristics that require investigation under the fair lending laws. With the addition of price data for higher-priced loans, the agencies will be able to more easily identify price disparities that require investigation. If disparities are found to violate the ECOA or FHA, certain federal agencies are authorized to compel lenders to cease discriminatory practices and, among other remedies, obtain monetary relief for victims.

The public disclosure of price information under HMDA--in the form of spreads between the annual percentage rate (APR) on a loan and the rate on Treasury securities of comparable maturity--is designed to ensure that the data continue to be useful in improving market efficiency and legal compliance. The APR represents the cost of credit to the consumer and captures the contract-based interest rate on a loan as well as the points and fees that consumers pay up front, converted to a percentage rate. But since these fees have to be amortized over the term of the loan to calculate the APR, and since interest rates vary over time, even the APR can be difficult to use as a basis of comparison across loans.

Because of interest-rate fluctuations, the HMDA rules require lenders to report the difference between the APR and the rate on Treasury securities of comparable maturity for any loans with rate spreads that exceed prescribed thresholds. For first-and second-lien loans, the thresholds are 3 percentage points and 5 percentage points above the Treasury security of comparable maturity, respectively. These particular thresholds were chosen to exclude the reporting of the vast majority of prime-rate loans and include the vast majority of the subprime-rate loans, minimizing the burden of the data collection on lenders while providing information on that portion of the market where concern about consumer abuse is most prevalent.

Although the addition of the price data significantly increases the robustness of HMDA data, the data alone do not prove discrimination. Instead, the data will be used as a screen to identify any aspects of the higher-priced end of the mortgage market that warrant closer scrutiny. The new HMDA data are clearly limited: they do not include credit scores, loan-to-value ratio, or consumer debt-to-income ratio--all factors relevant to the cost of credit.

Because these important determinants of price are missing, one cannot draw definitive conclusions about whether particular lenders discriminate unlawfully or take unfair advantage of consumers based solely on a review of the HMDA data. The new data will be useful to examiners in identifying particular loan products or geographic areas with significant pricing disparities and establishing one or more focal points for a pricing analysis that would include a review of all the factors relevant to a particular institution's pricing decisions.

The Board did consider adding other data elements relevant to pricing to the HMDA collection. For each possible new data item, we weighed the potential benefits and costs. On the basis of that analysis and careful consideration of public comments, we decided not to add more factors. In addition to the cost to lenders of collecting additional data, more data being made publicly available would create very real privacy concerns. As it stands, many of the HMDA data fields are unique and can be matched with other information to determine the identity of individual borrowers. Given the costs and limitations of collecting additional data, we felt that the potential for further privacy losses outweighed the usefulness of the additional data.

It is always possible that banks could disclose additional information on their own, but even this is questionable from a legal standpoint. The recent Fair Credit Reporting Act limits financial institutions' ability to share consumer reports (such as credit scores) with third parties.

Regardless, the new data still offer the public and supervisory agencies charged with enforcement of the fair lending laws a better screening tool than was previously available. Until now, in determining whether a lender is discriminating in its pricing decisions, examiners have relied on several factors: the relationship between loan pricing and compensation of loan officers or brokers; lender policies giving loan officers broad pricing discretion; the use of empirically based and statistically sound risk-based pricing systems; disparities among prices quoted or charged to applicants who differ in their protected characteristics (such as race); and consumer complaints alleging price discrimination. These data will still be used, but the APRs will make the high-cost loan assessments much more precise.

Although discussions of the new HMDA pricing data have just begun, some outcomes should be anticipated. First, a debate will continue about what the HMDA data say about the lending practices of individual institutions. Some community groups have already publicized their analysis of the data provided by individual institutions, and those institutions have responded. The attorney general for New York is also reviewing the data of several institutions. I anticipate that these inquiries and the conclusions drawn from them will continue for several months.

Second, lenders can gain an increased awareness of the lending and pricing practices of their organizations, and of their competitors, through analysis of HMDA data. As a result, lenders may take opportunities to compete in areas where the data show concentrations of high-priced lending. Competitive pressures in such markets should increase efficiency in pricing, ensuring that prices for mortgages are commensurate with risk and do not just reflect an absence of competition.

Third, new and strengthened collaborations should emerge among lenders, community groups, realtors, and other participants in the real estate market. As lenders seek to enter new markets, or to better serve their existing markets, the groups that have an intimate knowledge of their communities will be viewed as valuable partners.

Finally, increased importance will be placed on the value of financial education to help consumers shop for and obtain the mortgage loan that represents the best price and terms for their financial situation and needs. The broad array of mortgage loan products makes choosing difficult, even for those with financial savvy. The choices are substantially more confusing for those with credit-impaired histories or those who are unfamiliar with the different types of financial service providers and products. Consumers are often bewildered by the mortgage credit process, and the consequences of poor choices or misunderstanding or misinformation can have lasting effects on their financial well-being.

An Early Look at the Data

As I said earlier, as of March 31, lenders have been required to make their individual HMDA data available. Many press reports have discussed these data and there is already a vigorous debate about what the data do, and will, show.

The Federal Reserve is now editing the data, and its reports will not be complete until September. Until then, we can only provide a broad preview of the overall picture. In 2004, some 8,800 lenders reported 37 million loan applications, compared with 8,100 lenders with 42 million loan applications in 2003. The drop in the number of loan applications reflects the slowing of the refinance market last year. The increase in the number of lenders is partly the result of the expanded coverage of the Board's amendments, but it could also suggest increasing competition in the home mortgage industry.

Regarding subprime lending, back in 1994 the subprime market, defined as high-cost mortgage loans, amounted to $35 billion, or 5 percent of total mortgage originations. By 2004, the subprime market had exploded to $530 billion, or 19 percent of total mortgage originations. The annual subprime market growth rate over this time was a whopping 27 percent.

The initial data also suggest that prevalence of higher-priced loans differs notably across racial and ethnic groups. As some press accounts have implied, the data indicate that blacks and Hispanics are more likely to take out higher-priced loans than non-Hispanic whites, and that Asians are the least likely to have higher-priced loans. These preliminary data also seem to indicate that the actual prices paid by those taking out higher-priced loans are about the same for different racial groups.

Until the editing process is complete, more details cannot be provided. Needless to say, everyone will have an opportunity to review the final data when they are released in September.

Conclusion

In closing, I cannot emphasize enough the importance of your role. By understanding the potential usefulness and limitations of the data, and conveying those messages clearly, we can promote a more efficient market and compliance with anti-discrimination laws without unfairly tarnishing the reputations of particular lenders. No one will be served if lenders are unwilling to enter, or remain in, certain higher-priced segments of the market. The most effective way to lower the cost of credit to higher-risk borrowers is to promote a competitive marketplace. And one of the most effective ways of ensuring competition is to make data available.

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