TO: Board of Governors

FROM: Division of Research and Statistics
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SUBJECT: Regulatory Analysis of Proposed Revisions to Regulation C

DATE: November 22, 2000

SUMMARY

Staff is proposing that the Board publish for public comment possible amendments to Regulation C, which implements the Home Mortgage Disclosure Act of 1975 (HMDA). The proposal follows analysis of comments received under an Advance Notice of Proposed Rulemaking (ANPR) issued in March 1998, reports to the Congress on mortgage-related issues by the Federal Reserve and other federal agencies in the recent past,[1] and hearings on related aspects of the Home Ownership and Equity Protection Act (HOEPA) held by the Board this summer in four cities.

The major changes proposed for the regulation involve bringing more institutions and transactions under requirements for data collecting and reporting and requiring more data on each covered transaction. Among the proposed revisions, those increasing the transactions covered and the data that are required to be reported are the most significant in terms of potential benefits and in increasing regulatory burden. The proposal would affect all institutions currently within the scope of the regulation, including covered small institutions.[2] The number of institutions that would newly be brought under the regulation is probably fairly limited. None of the

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[1]See Board of Governors of the Federal Reserve System and Department of Housing and Urban Development, Joint Report to the Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act, 1998; Department of Housing and Urban Development and Department of the Treasury, Curbing Predatory Home Mortgage Lending, 2000.

[2]The Home Mortgage Disclosure Act and Regulation C exempt institutions that do not have a home office or branch in a metropolitan area (or, in the case of non depository institutions, that do not make more than five loans in a metropolitan area); most of these institutions are relatively small. Further, depository institutions with offices in metropolitan areas but which are below an asset size that adjusts yearly (currently $30 million) are not required to comply.

newly covered institutions would be small mortgage lenders; they would be institutions that originated $50 million or more of home-purchase loans (including refinancings of such loans) in the prior calendar year and they may have significant other lending activities as well.

The draft proposal does not arise from a need to implement specific legislative changes. Rather, it is a consequence of Board policy to review its regulations periodically and a desire to update the regulation to reflect mortgage markets better, enhance consumer protection, and comply with new guidance from the Office of Management and Budget concerning collection of data on race and ethnicity by federal agencies.

It is difficult to quantify the benefits and costs associated with the proposed changes to the regulation. The expanded coverage will provide data to help identify possible discriminatory lending patterns and assist regulators in conducting examinations under the Community Reinvestment Act and other laws. The data will also help inform the public about developments in the mortgage market by revealing the distribution of annual percentage rates on home loans and by ensuring that information is available about a significant and growing segment of the home-loan market, home equity lines of credit.

Although the proposed changes may offer a number of benefits they also will impose significant costs on lenders by requiring changes to their current procedures and systems for collecting and reporting required data. The regulatory agencies will take steps to mitigate these costs, but start-up costs for financial institutions to revise current computer and compliance systems are likely to be significant. The regulatory agencies themselves will also incur costs to revise computer software used to edit the HMDA data prior to its release to the public and to prepare required reports for both the regulated institutions and the public.

DISCUSSION

Regulation C currently requires that covered institutions record and send to supervisory federal agencies required information on certain applications and loans in a specified format known as the loan/application register (HMDA-LAR). Required data are collected on home-

purchase and home-improvement applications and loans originated, purchased or refinanced. The Federal Financial Institutions Examination Council (FFIEC) and the Department of Housing and Urban Development (HUD) aggregate the collected information from individual institutions and make the data available to the public in a variety of formats and reports. The revised regulation would make changes in institutional coverage, transaction coverage, and required data.

1) Institutional coverage. Currently, Regulation C requires reporting by depository institutions with assets greater than $30 million as of December 31 of the previous year (adjusted annually to reflect changes in the Consumer Price Index), with a home office or branch in a metropolitan area (MSA), and which made first-lien home-purchase loans on 1-4 family dwellings or refinanced such loans in the past year. The regulation also requires reporting by other for-profit lending institutions that had an office or loan activity in a MSA and that either (1) had assets of more than $10 million (based on combined assets of the institution and any parent corporation), or (2) originated or refinanced 100 or more home-purchase loans in the past year, subject to the exception that for-profit, non depository lenders need not comply if their home-purchase loans and refinancing of such loans amounted to less than 10 percent of total lending volume in dollars in that year.

The proposed revisions to Regulation C would not change coverage for depository institutions. However, for non depository institutions the revised regulation would employ a new test that would add to covered entities any institution with prior-year originations of home-purchase loans (including refinancing of home-purchase loans) that equaled or exceeded $50 million (assuming the other coverage tests are met). In effect, this would eliminate the 10 percent exemption test for some non depository lenders.

In 1999 there were 7602 reporting institutions that originated or refinanced home-purchase or home-improvement loans: 6284 depository institutions, 263 affiliates of depository institutions, and 1055 independent mortgage companies.[3] Among reporting institutions of *all* types, 6070

(80 percent) originated or purchased less than $50 million in home-purchase loans or refinanced home-purchase loans in 1999; although, because of their relatively small size, their market share of such loans reported was much smaller than the proportion of small institutions among all covered lenders.[4]

It is not possible to tell with available information how many additional institutions the revised regulation would newly cover, although staff does not believe that many additional institutions would be required to report data. The intent is to include within the scope of the regulation any non depository lending institutions that, while extending many home-purchase and refinancing loans, are not currently reporting, presumably because their originations of covered loans do not rise to 10 percent of their overall lending due to the size of other credit activities (including unsecured lending, such as credit-card credit).

2) Transaction coverage. At present, the regulation requires that covered institutions record and report certain data from applications, originations, and purchases of home-purchase and secured or unsecured home-improvement loans, including refinanced loans of both kinds. The draft proposal would increase the number of covered transactions at covered lenders through a number of separate revisions to the regulation.

A. Definition of refinancing. The regulation currently permits some discretion for the covered institution in determining which refinanced loans are to be reported; it may be the case that many second-lien and other loans are not reported. The staff proposal would remove this discretion in favor of a more precise definition of refinanced loans as credits satisfying and replacing an existing obligation by the same borrower where both the existing loan and the new loan are secured by a

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[3]An additional 230 institutions were required to report in 1999 because they qualified as reporters as of December 31, 1998, the date for determining 1999 reporters, but they did not make any covered loans in 1999. These institutions are excluded from the totals.

[4]Among non depository institutions 47 percent originated less than $50 million in home-purchase loans or refinanced home-purchase loans in 1999.

lien on a dwelling.[5] Staff believes that changes in this area would produce greater consistency of data collection across lenders.

It is not possible to determine how many lenders or loans would be affected by the proposed changes in transaction coverage, although it seems likely that many of the loans that would be reported under the revised definition are already reported under current rules. The most significant effect may be to increase consistency across reporting institutions.

An alternative approach the staff recommends be offered for public comment would increase coverage, perhaps substantially, by eliminating the refinancing category altogether in favor of requiring the reporting of all non-purchase loans at covered lenders secured by a dwelling. In addition to refinanced loans covered now and refinanced debts that would be covered in the draft proposed approach, the alternative approach would also cover any new junior-lien loans at these regulated lenders (and some additional first-lien loans) that are not currently reported. These newly covered loans would include loans that do not refinance home-purchase or home-improvement-related debt. Newly covered loans would include, for example, loans for education or other consumer purposes secured by a home.

Consumer surveys in 1997 indicated that about 5 percent of homeowners had (closed-end) second mortgage loans outstanding, or about 3.3 million households. Most junior loans likely are with covered lenders or lenders who would be covered under the revised regulation. All *new* such loans at the covered lenders would be subject to reporting under the alternative approach. Some additional first-lien loans may also be newly covered on account of this part of the proposal.[6]

Information from the consumer survey of home-equity borrowers in 1997 indicates that approximately two fifths of closed-end second-lien home loans were originated in the year before the interview. Estimates of loans outstanding

[5]The proposal also would ask for comment on whether lenders should be required to report refinancings of originally unsecured home improvement loans.

[6]Glenn B. Canner, Thomas A. Durkin and Charles A. Luckett, "Recent Developments in Home Equity Lending," Federal Reserve Bulletin, vol. 84 (April, 1998), pp. 241-51.

and new lending drawn from the consumer surveys, suggests that new reporting under the alternative approach could exceed one million loans per year, *assuming* that most of the loans of this type are not currently reported. HMDA data from 1999 show that about half of the applications for covered loans result in an origination. Thus, there could be another million reported applications arising from this revision to the regulation.

In fact, we do not know how many closed-end junior-lien loans and applications for such loans are currently reported. However, survey data indicate that almost 40 percent of closed-end home equity loan borrowers do not report using the funds for home-improvement purposes. These loans and associated applications likely are not currently reported.

B. Definition of home-improvement loans. The current regulation permits covered institutions to report loans as home improvement credits based upon the purpose of the loan being home improvement and the classification of loans as such by the covered institution’s definitions and classification systems. Consequently, if an institution chose not to classify loans made by borrowing purpose (if, for example, it classified all installment loans simply as installment loans, and not by purpose), then it would not be required to report loans as home-improvement loans. The draft proposal would change this treatment. Henceforth, any loan for home improvement purpose would be reported regardless of classification.

The revised definition of home-improvement loans for reporting purposes raises questions whether lending institutions are able to identify consumers’ uses of loan funds with any degree of accuracy and whether lenders will be able to comply in a meaningful way. In any case, this change will likely mean an increase in coverage of the regulation, although the extent of additional reporting is not known. It also would require some lenders to make changes in systems and procedures to identify loans properly for purposes of reporting and examination.

C. Preapprovals. The draft proposed revision would extend coverage of the regulation to another new area, preliminary approvals not comprising full underwriting that evaluates a particular property (sometimes called

“preapprovals”), but which provide a written commitment up to a designated amount for a certain period of time.

There is only limited information on the number of covered institutions offering preapproval programs that would be newly subject to reporting requirements under the proposed extension of the regulation, but the number could be relatively large. In recent years, many depository and non depository institutions have put in place preapproval programs that qualify potential customers before they choose a property. These programs would become newly subject to requirements for data reporting, although since the category of preapprovals is narrowly drawn, not all preapprovals would be subject to reporting.

Mandatory collection of data on preapprovals would require some institutions to establish or modify systems to capture and record data. Some commentators on the ANPR indicated that the effect of this possible revision could be a diminution of the willingness to offer any pre-qualification product. This seems unlikely, however, because preapproval programs appear to be a popular product and the category is narrowly drawn. Rather, the likely impact of this proposed change in coverage of the regulation will be on the underlying regulatory costs associated with the mortgage process. Staff believes that the change will provide an opportunity to evaluate more fully lenders compliance with the fair lending laws. Currently, preapprovals are not covered by the Home Mortgage Disclosure Act, except in the case where a preapproval ultimately leads to an extension of credit, and no information on these activities is captured in recorded data.

D. Home equity lines of credit. The draft proposal would also require reporting of data on home equity lines of credit, which the current regulation permits but does not require. Consumer surveys indicate that most home-equity lines are used, at least in part, for home-improvement purposes, however, some institutions include home-equity credit lines in their reported home-improvement loan data while others do not. At present, although data are not available, staff believes most home equity lines of credit are not reported. Consequently, staff has recommended that all home equity credit lines be reported, separately from closed-end loans.

Consumer survey information in 1997 indicated that about 8 percent of homeowners, or about 6 million accounts, had home equity lines of credit. About two thirds (69 percent) of respondents reported that they had used the account at least in part for home improvement. The surveys in 1997 show that about one third of these credit lines were new in the previous year, approximately matching the number of accounts closed due to refinancing, moving, or other reasons for account lapses.[7] If the relationship of new accounts at approximately one third of outstanding accounts has remained the same since this survey and most home equity lines have not been reported under Regulation C, as many as 2 million accounts yearly might be reported due to this part of the revised proposal. Since not all applications for home equity lines of credit are approved, the total number of reported transactions could exceed the 2 million estimate.

3) Required data. The current regulation requires collection of thirteen items of information on covered mortgage applications and loans in three categories (an institution at its option may also report the reasons it denied the granting of a loan):[8]

A) Data on applications and loans:
1) Loan or application number;
2) Date application received;
3) Type of loan;
4) Purpose of loan;
5) Amount of loan or application;
6) Action taken on application;
7) Date of action taken; and
8) Type of institution purchasing loans sold within the same year as origination or purchase.

B) Data on applicants or borrowers:
9) Race or national origin of applicant or borrower;
10) Sex of applicant or borrower; and

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[7]The consumer surveys did not specifically ask about account closings, but the proportion of homeowners with accounts open did not change between the 1993-4 surveys and the 1997 surveys, indicating that closings approximately equaled openings over the period.

[8]Institutions supervised by the Office of the Comptroller of the Currency and the Office of Thrift Supervision currently are required to report the reasons for denial.

11) Gross annual income of applicant or borrower relied upon in processing the application.

C) Data on the property:

12) Owner-occupancy status of related property; and

13) Location (MSA, state, county, and census tract) of loans for which the institution has a home or branch office in the MSA.

The revised regulation would add to the current information collected on each covered transaction. In addition to the above pieces of information, it would require collection of new or revised information in the following areas:

A) Data on applications and loans:

1) The annual percentage rate (APR) on a loan;

2) Whether a loan is subject to the Home Ownership and Equity Protection Act (HOEPA);

B) Data on applicants or borrowers:

3) Revised categories and more options for race or national origin conforming to new guidelines of the Office of Management and Budget.

C) Data on the property:

4) Whether the loan or application involves a manufactured home.

Staff is proposing to expand data collection for several reasons. Much of the new information is intended to enhance enforcement of HOEPA and the fair lending laws. Each of the new data items would also be helpful in monitoring and understanding mortgage market developments and the subprime market in particular.

Information on HOEPA status will allow the regulatory agencies to readily identify lenders active in this portion of the mortgage market and specific loans that may warrant particular scrutiny. Information on the APR of a loan would enhance fair lending enforcement principally by helping examiners evaluate the pricing activities of lending institutions. At the present time examiners do not have readily available information that they can use to help determine which institutions or loan products warrant special attention or more detailed review during consumer

compliance examinations. The APR would also be useful in distinguishing prime and subprime loans. Distinguishing between prime and subprime loans is important for interpreting trends observed in the HMDA data with regard to both denial rate patterns and changes in lending to various subpopulations.

Like the APR, data on manufactured home loan status would be used to enhance fair lending enforcement and to provide information about mortgage market activity. Manufactured home loans are underwritten differently than other home loans, and, consequently need to be accounted for separately in fair lending reviews. Manufactured home lending activity also has a great influence on denial rates observed in the HMDA data and identifying such loans and applications would improve interpretation of changes in denial rate patterns observed in HMDA data.

At a minimum, these changes in data collection would require system alterations for every covered institution and would affect every covered application and loan. Also, there likely would be costs associated with personnel training and for management and legal supervision. Available research on the costs associated with implementing disclosure regulations suggests that there are economies of scale associated with compliance costs.[9] Thus, while all covered financial institutions will incur costs as a result of implementing the proposed changes to the regulation, institutions with large numbers of transactions likely will have a cost advantage per account. There also will be budget implications for the supervisory agencies that conduct compliance examinations and process the HMDA information and for the FFIEC, which prepares the public reports.

CONCLUSION

The staff draft of proposed revisions to Regulation C will likely cover only a few more institutions but will include many more loans and applications. The volume of data collected on each application and loan will also rise, and for the first time there will be limited data collection on applications under preapproval programs. Virtually every covered institution will have to make

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[9] See Gregory E. Elliehausen, The Cost of Banking Regulation: A Review of the Evidence, Federal Reserve Staff Study 171, April 1998.

substantial changes in data-capture procedures and systems. Staff believes that the proposed changes to HMDA will enhance regulatory efforts to enforce the fair lending laws and enhance efforts to ensure compliance with the Community Reinvestment Act. The revised HMDA information will also improve the regulators' and the public's knowledge about the mortgage market and more closely reflect changes in these markets over time.