Regulation C: Home Mortgage Disclosure Act (HMDA) Public Hearing · September, 16, 2010 · Chicago, Illinois

REMARKS FOR HMDA HEARING
By J. Michael Collins, Assistant Professor University of Wisconsin-Madison and Faculty Director Center for Financial Security

Good morning. I am grateful for this opportunity to share my perspective with the Advisory Council of the Federal Reserve Board, Federal Reserve staff and Governor Duke**.** My name is J. Michael Collins and I am an academic researcher at the University of Wisconsin in Madison. I am also the faculty director of the Center for Financial Security at the University of Wisconsin. The Center conducts applied research on consumer financial decision making, including issues of financial literacy, capacity and stability. The Center is part of the Social Security Administration's Financial Literacy Research Consortium, a five year cooperative agreement to better understand how people manage savings and debt to ultimately achieve financial security. That said these comments are my own and do not reflect the opinions of the Center, the Social Security Administration of the University of Wisconsin. The goal of my research is to increase the understanding of consumer behavior and financial decision-making, specifically among vulnerable populations. Therefore, my perspective on HMDA is from that of a researcher and not from that of someone from the financial industry or a consumer advocate.

I recognize that the Home Mortgage Disclosure Act was created based on the premise that certain consumers in certain neighborhoods were not receiving access to credit relative to deposits drawn from these markets. Over time HMDA has evolved to provide information on credit demand, rationing, and institutional process. It has provided evidence of variations in application behavior by consumers and approval-denial behavior by firms. From the perspective of a researcher, HMDA data is very important. I certainly understand the scale of the data and the administrative burdens it creates. Nevertheless, the value of these data outweighs the costs.

Based on a simple search of Google Scholar more than 550 journal articles, books or book chapters or research reports have used HMDA data in the last 20 years. Many studies are carefully designed tests for discrimination and disparate treatment by race, income, residential location and other factors. Others are more simplistic contrasts of one group of loan applicants to another. But HMDA is used for more than just studying denial rates. HMDA is used to gauge the relative strength of housing markets at the Census tract level—virtually the only source of data at this micro level of detail. Beyond its community development and planning potential, HMDA is also useful for spotting trends in the market place in terms of loan sizes, the composition of applicants and borrowers, as well as market trends over time. An emerging and still underutilized use of HMDA is to examine consumer choices in mortgage markets. For example, I have used HMDA to examine the rate at which applicants withdraw applications, reject approved loan offers or submit incomplete documents as a proxy for financial sophistication or literacy. HMDA can also be used to explore intra and inter-state policy changes. For example, I have exploited state variations on disclosures for high cost loan applications to test the effects of regulatory policies. As more researchers have become interested in consumer and household finance, no doubt clever uses of HMDA will expand.

An important example of the usefulness of these data is in the context of the recent housing market expansion and recession. Researchers used HMDA data to inform policy makers and the industry on overall trends. As data from 2008 and 2009 is analyzed in more detail, hopefully evidence will be generated that informs strategies to better manage future challenges in the mortgage market.

Of course the main purpose of HMDA is to provide evidence of how people in neighborhoods fair in the mortgage application process. Prudent credit access has been and continues to be a key building block for financial security. The leveraged investment an amortized mortgage provides has historically been the primary vehicle for lower-income minority families to accumulate wealth. The expansion of housing values in the 2000s fueled the growth of home equity lending and cash out refinance, a phenomenon we observed to a large extent in HMDA as refinance applications and originations seemed to break new records annually. Concerns continue to be raised about credit being too easy in this period, and that rather than lenders rationing credit by denials, risk-based pricing facilitated expanded approvals but at more granulated interest rates. Thanks in part to late Federal Reserve Governor Ned Gramlich, HMDA included measures of APR spread during this period, allowing for these trends to be observed and studied. In the absence of these data researchers would have been forced to rely on incomplete proprietary datasets. Although the market moved faster than regulators could react, the behavior of consumers and firms was observable during this period in part due to the existence of HMDA data.

Beyond the utility of HMDA data, there is a strong basis in the fundamentals of information economics favoring making the activities of financial institutions more transparent through HMDA. HMDA makes data observable such that the market and researchers like myself can evaluate how financial institutions handled certain loans. This transparency promotes efficiency in markets.

We are all well aware of the standard objections to submitting loan application information under HMDA. Some financial institutions argue that lenders will incur additional costs if they are required to collect additional data. Others point out that if certain data is collected, there may be privacy concerns. Other experts may comment on the legality of these concerns, but in recent years more than 8,000 firms reported data on more than 25 million loans. The state of information technology has reduced the marginal costs of additional data reporting dramatically from the time when HMDA was first proposed. And actual breeches of privacy rarely are a concern.

Given the import of HMDA as a source of data on markets and consumers, I must advocate for the continuance of the availability of data under the Act. However, the Dodd-Frank Act presents an opportunity to revisit the fields collected under HMDA and to enhance its value for regulation, policy and research. I discuss here five major areas for the Federal Reserve to consider.

First, HMDA data is collected for the calendar year for most loan applications (excluding only small lenders based on asset size and loans outside of MSAs). The coverage of HMDA during the housing boom of the 2000s was improved but coverage remains a concern. Exclusions for a small number of lenders lending to a larger portion of the market need to be carefully examined. The broadest standard should be set as the benchmark such that most lenders report on most loan applications each year.

Second, the introduction of rate spreads in 2004 was a major step forward and recognizes that credit is priced as well as rationed. But analysis of the cost of credit without some measures of the risk observable to the lender proved to be problematic. Except for special datasets created by Federal Reserve researchers, the key issues of credit risk are not in the data. The inclusion of credit score in HMDA was discussed a decade ago and remains an important discussion today. Some indication of credit quality, likely using categorical indicators will be important (for example: no score, under 520, 521-580, 581-620, 621-650, 651-680, 681-720, 721+, and no score used). Likewise loan to value ratio or simply home value used in the application for approved loans is also an important measure. Again standard categories against industry benchmarks can be used for reporting (<60, 61-80, 81-90, 91-95, 95-97, 98+).

Third, origination channel has proven to be a key factor in the evaluation of what went wrong in the 2000s housing boom. Mortgage brokered loans exhibited classic principal-agent problems. An indication of a loan application being prepared internally or by a 3rd party broker would be a useful addition at a minimum.

Fourth, while I understand the desire for more detailed data, it is not clear expanding HMDA data collection on some fronts is warranted, nor that all existing data is proving to be useful. Parcel level data, for example, seems to be too difficult to collect while still providing consumers some sense of privacy. Census tracts remain relatively low levels of geography and are better than most other sources of data. Meanwhile existing fields, such as pre-approval, are rarely used in research. A universal loan identification loan number is an intriguing idea and one no doubt secondary markets might find attractive. This might allow for matching of loan application data to loan performance, although in practice regulators can perform these links within institutions today.

Finally, I would encourage the Federal Reserve to enhance the usefulness of HMDA for researchers. The current website at FFIEC has grown more robust each year, but researchers ideally would have access to machine formatted and labeled datasets ready for statistical software. There is little documentation on known issues with HMDA, and in general researchers rely on informal shared wisdom which is not always evenly spread or fully accurate. Other administrative datasets, even sensitive data such as government records on earnings, are made accessible to researchers under special request and authorization. The Federal Reserve could create a similar process to access data in a protected setting including fields not currently disclosed such as data of application or records linked to loan portfolios.

Thank you for the opportunity at this hearing to present the perspective of researchers and academics. HMDA is a tremendous resource with still as yet untapped potential.