Home Mortgage Disclosure Act Public Hearing, July 15, 2010
Panel Two: Susan Wachter

Sandra Braunstein:
Susan.

Susan Wachter:
Good morning, I am Susan Wachter. I am a professor of real estate and finance at the Wharton School at the University of Pennsylvania. Thank you for the invitation to testify at today's hearings. It's my honor to be here to discuss the future of HMDA.

In my comments, I will address the principles behind the principles behind the need for publicly provided information under HMDA, particularly has provided as proposed in the Dodd-Frank Bill.

HMDA had its birth in the recognition of the need for better informed credit decisions in America Particularly in the face of the public policy challenge of urban disinvestment concentrated inner city poverty, mortgage discrimination redlining, HMDA helped achieve improved equity and efficiency outcomes. HMDA, by bringing to the table common information, enables bankers, together with other community decision makers, to consider community lending patterns as well as potential profitable lending opportunities. The strength of HMDA, initially, in going forward, is the accountability provided by the public provision of data on lending patterns by neighborhood and borrower characteristics.

A second public policy challenge has risen with the introduction of risk-based pricing in mortgage lending. Risk-based pricing can be used to price discriminate in the economic sense generating greater profits for individual lenders. It is possible and profitable for lenders to charge more in markets with population sectors who, for various reasons, might be willing to pay more for the same loan. Subprime lending initially expanded disproportionally in minority and immigrant neighborhoods. While these lending patterns are not evidence of discriminatory behavior in the legal sense, several studies, using HMDA data, point to questions such patterns raised.

The Dodd-Frank Bill, currently under consideration, allows for the collection of additional data elements under HMDA that would respond to the need for better information to determine whether lenders are providing the same price for the same loan after taking into consideration borrower risk. I am in favor of these provisions for all mortgage providers. Importantly, geographical concentrated subprime lending leads to volatility in the pricing homes and the availability of mortgage lending in disadvantaged neighborhoods. While excessive price volatility increases neighborhood foreclosure rates as is currently evident, I will focus the remainder of my time on the impact of such volatility on the broader economy and the relevance of the expansion of HMDA under the proposed, and the proposals in the Dodd-Frank Bill in response to the nation's recent financial crisis.

With the transformation of bankers from portfolio lenders to securitizers has come a distancing of loan origination from risk. Private label securitization has both restricted investor's ability to verify the quality of underlying mortgages and relieved the originators responsibility to underwrite loan quality. Importantly, in the legislation under discussion, there will be the option to construct a unique loan identifier for individual loans which will enable the monitoring of performance through mortgage repayment or if the loan fails to foreclosure.

The information that loans were failing at heightened rates, if made fully public in 2006 when this was first occurring, would not have prevented the crisis but would have prevented the deepening of the disaster due to the expansion of unsustainable lending in 2007 and even 2008. This legislation has the potential to identify spikes in the failure of loans by cohort and by product type which, together with additional information, could help alert regulators, investors, and lenders to the heightened risk of system wide failure.

Inadequate response to the rising systemic risk is, in part, due to the difficulty of reapplying monitoring of the procyclical erosion of credit standards as well as to lack incentives to curtail unsustainable lending practices. Individual loan identifiers would allow for better accountability to overcome misaligned compensation incentives that arise when short term gains and fees drive the decision to make loans with little regard to tail risks and the potential for heightened long term losses. Risk management techniques to secure accountability more generally would be far more easily implemented with a cradle-to-grave loan-tracking system linking individual loans and their performance to their originators as potentially enabled by this legislation. Thank you.