“Accountability and the Future of HMDA”

Testimony prepared for

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“REGULATION C: HOME MORTAGE DISCLOSURE ACT (HMDA) PUBLIC HEARING”

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FEDERAL RESERVE BOARD

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Distinguished presiders of the hearing:

Thank you for the invitation to testify at today's hearing on "Regulation C: Home Mortgage Disclosure Act." It is my honor to be here to discuss the future of the HMDA in the United States.

In my comments today I will address the principles behind the need for publicly provided information under HMDA as provided in the Dodd-Frank bill. I will be pleased to address the specifics of data gathering in questions and answers. I believe it is useful to point to the public purposes and potential gains to the Nation in mitigating future financial crises by the provision of the proposed information to public and private decision makers in their regulatory and lender, investor and borrower roles.

HMDA had its birth in the joint recognition by private and public sectors of the need for better informed credit decisions in urban America. In the face of the public policy challenge of urban disinvestment, concentrated inner city poverty, mortgage discrimination and redlining, HMDA helped achieve improved equity and efficiency outcomes. By bringing to the table bankers together with other community decision makers to consider community lending patterns as well as potential profitable lending opportunities, HMDA, along with the Community Reinvestment Act, helped turn around communities that were in a spiral of decline, that was neither efficient, equitable nor necessary. The legislation did so by providing information on geographical lending gaps and on disparities in lending based on borrower characteristics, such as race and ethnicity. These gaps, the literature has shown, may arise due to perceived but not actual neighborhood risk and due to the use of statistical discrimination based on borrower characteristics, which while, rational and profitable for individual lenders, violates societal norms of fairness. The strength of HMDA initially and going forward is the accountability provided by the public provision of data on lending patterns by neighborhood and borrower characteristics. Such data allowed communities and bankers to come together to identify profitable lending opportunities. The subsequent rise of community banking was part of a set of initiatives that have helped cities to overcome decades of disinvestment in the private and public spheres with enormous benefits to society, including improved life chances for low income households, who were concentrated in declining inner city neighborhoods.

The second public policy challenge came with the introduction of risk based pricing in mortgage lending, which could be used to price discriminate in the economic sense generating greater profits for individual lenders. Lenders could charge more in markets with population sectors who for various reasons would be willing to pay for subprime mortgage loans rates above the price for risk paid for by others. Subprime lending initially expanded disproportionately 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 on whether minority households, in particular, are provided equal opportunity in mortgage markets.

The Dodd-Frank bill currently under consideration allows for the collection of data elements under HMDA that would respond to the need for better information to determine whether lenders are providing the same price for same loan after taking into consideration borrower risk.

Importantly such geographically concentrated subprime lending will also lead to more volatility in the pricing of homes and in the availability of mortgage lending in disadvantaged neighborhoods.

While excessive price volatility increases 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 on the particular relevance of a potential expansion of HMDA under the proposed Dodd-Frank bill in response to the Nation's financial crisis. While taking different forms across the Nation's neighborhoods, regions, and states, the crisis is a national event.

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 investors' ability to verify the quality of underlying mortgages and relieved the originator's 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 rise in systemic risk is in part due to the difficulty of the real time monitoring of the pro-cyclical erosion of credit standards as well as to the lack of incentives to curtail unsustainable lending practices. The potential for future crises can be mitigated by the public provision of information on credit conditions as well as outcomes. More timely, more complete, and publicly available information on the quality of the Nation's mortgage loan portfolio and its pricing can provide a basis for better informed decisions by both public and private sectors actors, as regulators and investors or lenders.

Individual loan identifiers would allow better accountability to overcome misaligned incentives that arise when short term gains in fees drive the decision to make loans with little regard to tail risk and 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 enabled by this legislation.

In the absence of information on loan quality, pricing, and current defaults, until potential runs on banks and shadow banks made it imperative for unprecedented monetary and fiscal interventions, it was difficult for public or private sector action to respond in force to growing systemic risk. HMDA expansion as recommend in this legislation can help prevent a recurrence of the crisis, by providing such information.

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