

Client Alert

December 2015

Amendments to Regulation C Provide Additional Tools in Regulator's Fair Lending Arsenal

On October 15, 2015, the Consumer Financial Protection Bureau (the CFPB) issued the long-awaited Home Mortgage Disclosure Act (HMDA) final rule under Regulation C,¹ requiring financial institutions to now report 48 different data fields on each borrower. The final rule will undoubtedly result in significant reporting burdens and compliance snares as institutions work to implement these changes. Further, trade associations, such as the Mortgage Bankers Association, Independent Community Bankers Association and the American Bankers Association have already decried the data security and consumer privacy concerns due to the far-reaching information on consumers that the government will now be collecting.

The more troubling regulatory implications to institutions, however, are not so obvious. The data will certainly be used by regulators to conduct more robust analyses of potential fair lending risks, with additional requirements on collecting information about the applicant or borrower's ethnicity, race and sex, including "visual observations" by institutions. Indeed, the CFPB has applauded the final rule as "enhanc[ing] the ability to screen for possible fair lending problems, helping both institutions and regulators focus their attention on the riskiest areas where fair lending problems are most likely to exist."² Notably, by expanding the monitoring to include additional transactions, the CFPB has deftly increased its ability to monitor for products that regulators have historically viewed as potentially troublesome for consumers, particularly low-income and minority borrowers, including, reverse mortgages and open-end lines of credit.

And, importantly, the final rule will now provide data that the CFPB is likely to use to claim adverse trends in access to credit. This piggy-backs on the CFPB's May 2015 report entitled "Data Point: Credit Invisibles."³ In that report, the CFPB raised concerns about the reduced access to credit by "credit invisibles" (individuals without nationwide credit reporting agency credit reports) and consumers with unscored records. In that report, the CFPB concluded that "Blacks and Hispanics are more likely than Whites or Asians to be credit invisible or to have unscored credit records," thus signaling a new area of fair lending risk and potential disparate impact analysis. When combining the May 2015 report, recent Supreme Court precedent, and the expansive data now required by the final rule, the CFPB has created a tool for regulators to actively police institutions for potential disparate impact in access to credit.

As such, in considering the new HMDA changes, it is important to keep in mind these potential fair lending and compliance risks. These changes demand renewed focus and attention to, not only an

¹ The final rule may be found on the CFPB website at <http://www.consumerfinance.gov/regulatory-implementation/hmda>.

² See <http://www.consumerfinance.gov/newsroom/cfpb-finalizes-rule-to-improve-information-about-access-to-credit-in-the-mortgage-market/>.

³ Available at <http://www.consumerfinance.gov/reports/data-point-credit-invisibles/>

institution's data security and privacy procedures, but also the far-reaching fair lending implications for an institution's next compliance exam.

With this backdrop in mind, we now delve into the details of the HMDA changes:

What Institutions Are Now Subject to Regulation C?

Effective January 1, 2017, the final rule limits the scope of depository institutions subject to Regulation C. A bank, savings association or credit union will only be subject to the amended Regulation C if it meets the asset-size⁴, location⁵, federally related⁶ and loan activity⁷ tests under the current Regulation C and it originates at least 25 home purchase loans, including refinances of home purchase loans, secured by a first lien on a one-to-four family dwelling in both 2015 and 2016. Unfortunately, these thresholds are too low to exempt many community banking organizations.

Effective January 1, 2018, the final rule contains a uniform loan-volume threshold for all institutions. A depository institution will be subject to Regulation C if it originated at least 25 covered closed-end mortgage loans or at least 100 covered open-end lines of credit in each of the two preceding calendar years, and it meets current Regulation C's asset-size, location, federally related and loan activity tests. A non-depository institution will be subject to Regulation C if it originated at least 25 covered closed-end mortgage loans or at least 100 covered open-end lines of credit in each of the two preceding calendar years and it satisfies the current location test.

What Transactions Are Now Subject to Regulation C?

Effective January 1, 2018 covered loans under the final rule generally will include closed-end mortgage loans and open-end lines of credit secured by a dwelling. However, the final rule only requires covered institutions that originated at least 25 covered closed-end mortgage loans or 100 covered open-end lines of credit in each of the two preceding calendar years to collect, record and report information about such closed-end mortgage loans or open-end lines of credit.

The following are examples of transactions that are now covered by Regulation C:

- Closed-end consumer-purpose mortgage loans and open-end lines of credit secured by a dwelling.
- Dwelling-secured business-purpose loans and open-end lines of credit, but only if used for home purchase, home improvements or refinancing.
- Home improvement loans secured by a dwelling.

⁴ Banks, savings associations and credit unions with assets at or below \$44 million as of December 31, 2014, were exempt from collecting HMDA data in 2015.

⁵ On the preceding December 31, the institution had a home or branch office in a Metropolitan Statistical Area (MSA).

⁶ The institution is Federally insured or regulated; the mortgage loan was insured, guaranteed or supplemented by a Federal agency; or the mortgage loan referred was intended by the institution for sale to Fannie Mae or Freddie Mac.

⁷ In the preceding calendar year, the institution originated at least one home purchase loan (excluding temporary financing such as a construction loan) or refinancing of a home purchase loan, secured by a first lien on a one-to-four family dwelling.

The following transactions are specifically excluded from Regulation C coverage:

- Closed-end mortgage loans or open-end credit lines originated by an institution acting in a fiduciary capacity.
- Closed-end mortgage loans or open-end credit lines secured by a lien on unimproved land.
- Temporary financings.
- The purchase of an interest in a pool of closed-end mortgage loans or open-end credit lines.
- The purchase solely of the right to service closed-end mortgage loans or open-end credit lines.
- The purchase of closed-end mortgage loans or open-end credit lines as part of a merger or acquisition, or as part of the acquisition of all of the assets and liabilities of a branch office.
- Closed-end mortgage loans or open-end credit lines, or an application for a closed-end mortgage loan or open-end credit line, for which the total dollar amount is less than \$500.
- The purchase of a partial interest in a closed-end mortgage loan or open-end credit line.
- Closed-end mortgage loans or open-end credit lines used primarily for agricultural purposes.
- Closed-end mortgage loans or open-end credit lines that is or will be made primarily for a business or commercial purpose, unless the closed-end mortgage loan or open-end line of credit is a home improvement loan, a home purchase loan or a refinancing.

The final rule also changes the scope of covered preapproval requests. Currently, covered institutions may collect, record and report preapproval requests that are approved but not accepted. Effective January 1, 2018, however, covered institutions must collect, record and report information for approved but not accepted preapproval requests for home purchase loans. However, preapproval requests for open-end lines of credit, reverse mortgages and home purchase loans to be secured by multifamily dwellings will not be covered transactions under the final rule.

What New Data Must be Collected?

For HMDA data collected on or after January 1, 2018, covered institutions must collect, record and report additional information about originations of, purchases of and applications for covered loans. The final rule includes certain data points required by the Dodd-Frank Act as well as data points that the CFPB has determined will assist in carrying out HMDA's purposes. The final rule modifies the existing data points and adds new data points. The data points can be grouped into the following four categories:

- Information about applicants, borrowers and the underwriting process, such as age, credit score, debt-to-income ratio and automated underwriting system results.
- Information about the property securing the loan, such as construction method, property value and additional information about manufactured and multifamily housing.
- Information about the features of the loan, such as additional pricing information, loan term, interest rate, introductory rate period, non-amortizing features and the type of loan.

- Certain unique identifiers, such as a universal loan identifier, property address, loan originator identifier and a legal entity identifier for the financial institution.

Additionally, for HMDA data collected on or after January 1, 2018, the final rule adds a requirement to report how the institution collected the information about the applicant or borrower's ethnicity, race and sex. This information may either be collected through visual observation or surname. The final rule also requires covered institutions to allow applicants to self-identify their ethnicity and race using disaggregated ethnic and racial subcategories. However, the disaggregated subcategories cannot be used when identifying the applicant's ethnicity and race based on visual observation or surname.

What is the New Process for Reporting?

The CFPB is developing a new web-based tool for reporting HMDA data. Covered institutions must report data using the new web-based tool beginning in 2018. Appendix A, which currently provides instructions for completing and submitting the HMDA loan/application register (LAR), is amended effective January 1, 2018 to include new transition requirements for data collected in 2017 and reported in 2018. Appendix A will require that a covered institution electronically submit its LAR. In 2018, covered institutions will report 2017 data required under current Regulation C, but will use the new electronic submission tool and will submit data in accordance with amended Appendix A and procedures that will be available at <http://www.consumerfinance.gov/hmda>.

Effective January 1, 2019, the CFPB will remove Appendix A from Regulation C. At that time, covered institutions must report the new dataset required by the final rule, using the new electronic submission tool and revised procedures that will be available at <http://www.consumerfinance.gov/hmda>.

In 2020, the final rule will require quarterly reporting for covered institutions that are larger-volume, meaning any such institution has reported a combined total of at least 60,000 applications and covered loans in the preceding calendar year. When making its determination of whether it must report on a quarterly basis, an institution will not count covered loans that it purchased in the preceding calendar year. In addition to annual data submission requirements for larger-volume reporters, such reporters will submit HMDA data for the first three quarters of the year on a quarterly basis. May 30, 2020 is the due date for the first quarterly submission.

Effective January 1, 2018, covered institutions will provide a notice that its disclosure statement and modified LAR are available on the CFPB's website instead of providing a disclosure statement or a modified LAR to the public upon request. The final rule contains sample language that covered institutions can use for these purposes. These revised disclosure requirements will apply to data collected on or after January 1, 2017 and reported in or after 2018.

For data collected in or after 2018 and reported in or after 2019, the CFPB will use a balancing test to determine whether and, if so, how HMDA data should be modified prior to its disclosure in order to protect applicant and borrower privacy while also fulfilling HMDA's disclosure purposes. At a future date, the CFPB will provide a process for the public to provide feedback regarding the application of this balancing test to determine the HMDA data to be publicly disclosed.

Takeaways

In evaluating and ultimately implementing the new HMDA changes, covered institutions must be mindful of the regulatory implications, particularly in the fair lending and compliance context. Accordingly, covered institutions should:

- take a proactive approach now with regard to the volume of data that must be collected and reported even though most of the new requirements are not effective for over 2 years;

- be aware that compliance costs will likely increase as regulators look to expand their fair lending reviews through the enhanced data;
- make sure their data systems and staff can support the amount of additional data required to be collected and reported; and
- review lending-related policies and procedures to decrease the potential for fair-lending concerns.

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