



# Regulatory Practice Letter

ADVISORY

RPL Number 09-34

## Executive Summary

The General Accountability Office ("GAO") has released a report, GAO-09-704, with recommendations for strengthening the oversight of fair lending laws. The report, "*Fair Lending: Data Limitations and the Fragmented U.S. Financial Regulatory Structure Challenge Federal Oversight and Enforcement Efforts*," generally found:

- Certain data limitations limit regulators' ability to identify lenders most likely to be engaged in discriminatory practices; and
- Federal oversight of compliance with fair lending laws is limited with respect to consistency and effectiveness both among the federal depository institution regulators (Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration) and between the federal depository institution regulators and other federal enforcement authorities (Department of Housing and Urban Development ("HUD"), Federal

Trade Commission ("FTC"), Department of Justice ("DOJ")).

Based on these findings, the GAO recommends Congress consider:

- Options to expand the data collected under the *Home Mortgage Disclosure Act* ("HMDA"), especially for large lenders, to include certain underwriting criteria, as well as to collect personal characteristic data for nonmortgage loans; and
- Regulatory reform initiatives that overcome the "fragmented U.S. financial regulatory system" and enhance consistent and effective oversight of fair lending laws.

## Background

In April 2008, Barney Frank, Chairman of the House Committee on Financial Services, and fifteen members of his committee requested GAO conduct a comprehensive review of the current state of the federal enforcement of the *Equal Credit Opportunity Act* ("ECOA"), HMDA, the *Fair Housing Act* ("FHA"), and other related fair lending laws. The resulting report, GAO-09-704, was

## Subject:

**Report on the effect of data limitations with respect to Fair Lending enforcement and the effectiveness of oversight by federal regulatory and enforcement agencies.**

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released in July 2009. Chairman Frank subsequently issued a press statement on the report in August 2009 noting that it would be instructive to the committee’s efforts to reform the financial regulatory system, including H.R. 3126, which would create the Consumer Financial Protection Agency (“CFPA”).

As proposed by the Administration and subsequently written into H.R. 3126 (as introduced), the CFPA would be comprised of the consumer financial protection functions of the Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration and the Federal Trade Commission, which would be transferred to the CFPA along with the powers and duties vested in those agencies relating to consumer protection. (Please refer to RPL 09-24 for details.)

**Description**

Among other things, the objectives of the report were to assess:

- The strengths and limitations of data sources that enforcement agencies and depository institution regulators use to screen for lenders that have potentially heightened risk for fair lending law violations; and
- Federal oversight of lenders that may represent relatively high risks of fair lending violations as evidenced by analysis of HMDA data and other information.

*Data Limitations*

The GAO found that HMDA data is the primary source of information used by the depository institution regulators and

the enforcement agencies to identify lenders that have a heightened risk of violating fair lending laws. In general, they examine lenders that are identified as “outliers”.

The GAO concluded that certain restrictions on the collection of HMDA data limited its usefulness. The report suggested that the data collection could be enhanced by the addition of:

- Information that affects a borrower’s credit risk based on underwriting variables, such as: the borrower’s credit score; the borrower’s debt-to-income ratio; or, the loan-to-value ratio of the mortgages. This information is expected to help explain mortgage lending disparities among what otherwise appear to be similarly situated loan applicants and borrowers of different ethnicity, race, or gender.
- Additional underwriting data from lenders, such as detailed product information, mortgage-rate lock dates, overages, additional fees paid, and counteroffer information. This information is expected to help assess the basis for mortgage rate disparities identified through initial analysis of HMDA data.

GAO offered three options to reduce costs associated with the expanded data submissions:

- Require only the largest lenders to provide the expanded reporting information;
- Require all HMDA filers to routinely report the expanded information as part of their regulatory (nonpublic) reporting;
- Require only the largest lenders to routinely report the expanded

information as part of their regulatory (nonpublic) reporting.

The report acknowledges the pilot study being implemented by the Office of the Comptroller of the Currency, HMDA-plus, that requires certain large lenders to report additional underwriting data with their HMDA submissions.

GAO also noted certain other issues associated with using HMDA data to identify lenders that have a heightened risk of violating fair lending laws:

- Some agencies say reported HMDA data are geared toward assessing mortgage pricing disparities among subprime lenders rather than lenders that may offer prime, conventional mortgages or government-guaranteed (or – insured) mortgages.
- Without adequate data from the preapplication phase, such as through the use of testers, surveys, or alternative means, fair lending oversight and enforcement is incomplete because it includes only information on the borrowers that apply for credit and not the larger universe of potential borrowers who sought it.
- HMDA data is restricted to mortgage data and, as such, can not expose fair lending violations in nonmortgage lending.

As a final data limitation, the report noted that depository institution regulators generally do not have access to personal characteristic data (for example, race, ethnicity, and gender) for nonmortgage loans, such as automobile, credit card, and business lending, which are also subject to fair lending laws. In the absence of this data, the agencies tend to focus more

of their oversight activities on mortgage lending rather than on other consumer lending areas.

*Oversight Inconsistencies and Inefficiencies*

Eight federal agencies are responsible for oversight and enforcement of the fair lending laws. They are separated into insured depository institution regulators (Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration), which are responsible for federally insured banks, thrift, credit unions and certain of their subsidiaries, affiliates, and service providers, and other federal enforcement authorities (HUD, FTC and DOJ), which provide oversight for nondepository mortgage lenders including independent lenders. Pursuant to the ECOA, depository institution regulators must refer cases for which they believe there is a pattern or practice of discrimination to DOJ.

The GAO report found:

- The large number of agencies responsible for fair lending examination and enforcement leads to fragmented, inconsistent and inefficient oversight.
- Independent lenders are subject to less comprehensive oversight than federally insured depository institutions. The enforcement agencies do not initiate investigations of lenders unless they are found to be an outlier, and they do not investigate all outliers. In contrast, the depository institution regulators examine all lenders on a routine basis and examine all outliers.

- Independent lenders and nonbank subsidiaries of bank holding companies, which are outside the depository institution regulators' fair lending domain, may pose heightened fair lending risks compared to insured depository institutions.
- Despite joint interagency fair lending examination guidance and various coordination efforts, there are variations in screening techniques, the management of the outlier examination process, examination documentation standards, and the number of referrals and types of examination findings among the depository institution regulators.
- The ECOA's two-year statute of limitations, which requires civil cases to be brought within two years of the alleged violation, may inhibit the number of actions initiated by DOJ.

**KPMG Commentary**

In part because the financial crisis has focused attentions on subprime mortgage and credit card lending, insured depository institutions have, for some time, experienced fair lending examinations that have been increasingly rigorous. The regulatory agencies have been particularly demanding in the areas of

- Sound fair lending programs with strong fair lending governance;
- Enterprise-wide fair lending risk assessments;
- Ongoing and appropriate roles-based fair lending training; and
- Fair lending analytics and ongoing monitoring.

Although largely still focused on mortgage lending, the examinations

also include default management and loss mitigation, and non-mortgage lending, such as auto lending and overdrafts.

Chairman Frank and members of his committee believe the GAO's report highlights the need for the proposed CFPA, which they say would serve to close gaps in regulatory oversight and protect consumers from predatory loans. H.R. 3126 is now expected to be considered this month, having been postponed at the end of July amid significant opposition from the federal banking regulatory agencies and financial services industry participants. Amendments to the ECOA that would facilitate enhanced data collection for race and ethnicity and some loan information for small business loans are being considered for this bill.

Should Congress ultimately pass legislation requiring enhanced data collection (in addition to the current HMDA plus data), institutions subject to the requirements would likely have to address modifications associated with changes to information systems, training on new data collection and quality controls, as well as storage and security for sensitive consumer data.

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