THOUGHT LEADER

HMDA – It's Not Just About the Data

CrossCheckCompliance

Loretta Kirkwood
Managing Director,
Fair and Responsible Lending
lkirkwood@crosscheckcompliance.com

As lenders prepare for the new and expanded data requirements of the Home Mortgage Disclosure Act ("HMDA"), it can be easy to underestimate the impact of these changes on fair lending risk management. With regulatory focus continuing to evolve, it can be difficult to know how to react. Guidance has been updated, key fields have been identified, and a proposal has been issued regarding the public disclosure of data - all within weeks of the January 1, 2018 effective date.

Although uncertainties remain in data collection and reporting, it's important to ensure your fair lending compliance framework is ready for the change. Have you updated your fair lending compliance management system? Have you verified that preventive and detective controls have been modified to address new risks? Have you reviewed internal policies and procedures? Have lending personnel received training related to the expanded data requirements?

The new categories for applicant demographic information create additional fair lending risk – not only with regard to requesting the data from the consumer, but also the level of analysis needed to manage risk and to what extent there may be new types of discrimination claims. Regulators and the public will be able to perform not only comparative analysis between applicants at a single lender, but also selected groups of lenders and all reporting entities.

As the industry prepares for the new HMDA, lenders must review and update the fair lending compliance management system, to address the following key areas:

PROGRAM GOVERNANCE

Implementing regulatory changes that impact fair lending risk, such as HMDA, requires a strategic focus and comprehensive governance structure. The board and management must demonstrate responsible conduct in business decisions including compliance and audit oversight, sales efforts, application processing, and lender compensation. It is equally important that management define the level of risk that is acceptable based on the findings of internal or external monitoring, risk assessments, and audits. Differences in business models create the need for a more customized approach to defining a lender's risk appetite. For example, a lender that offers prequalification and preapproval programs will have a higher level of risk in consumer communication and will need to clearly define the differences in these options.

RISK ASSESSMENT

Fair lending risk assessments should address the changes to HMDA, focusing on qualitative and quantitative risk. Consideration must be given to identifying the expanded inherent risk, evaluating the effectiveness of existing or newly established internal controls, and determining the approach needed to manage residual risk.

- Developing methods for ensuring the accuracy and completeness of HMDA data, as well as any data used in analysis or provided to state and federal examiners is critical. Red flag testing exists today and new tests will emerge to identify potential errors and fair lending risk associated with discrimination, disparate impact, and redlining based on the new data.

- Assessing qualitative risk involves a review of all policies and procedures related to marketing, compliance, credit risk management, and cost of credit. Written and verbal communications must reflect the lender's commitment to compliance with consumer financial protection laws. Each employee must be held accountable to follow internal policies and governing laws and regulations.

- Performance or quantitative risk can be managed through a variety of options including basic disparity analysis or complex regression modeling. There is no one-size fits all approach – consider the products and services offered and their associated level of risk in determining the depth of analysis required. Especially with the expanded HMDA data, it is important to understand differences in levels of assistance, disparities in application outcomes, pricing variances, potential steering of applicants to particular products or sales channels, and potential geographic and demographic gaps in higher minority neighborhoods. Quantitative risk management should additionally include comparative file reviews - identifying similarly situated applications with different outcomes. This process is no longer about random samples or ensuring credit decisions and pricing is consistent with internal policies. Today, lenders utilize statistical models to compare control groups to target groups, using credit and pricing factors to ensure consistency with their internal guidelines.

PREVENTIVE CONTROLS

Developing and implementing effective preventive controls means ensuring adequate policies, procedures, process and system controls, and training exist to limit fair lending risk. Policies and procedures should be updated to reflect the technical requirements of the new HMDA rule, as well as detailed instructions on interpretation of the more complex data requirements. Process and system controls need to be modified and tested to ensure risks are identified and mitigated throughout the credit process.

Enhanced training efforts are warranted - not only to address the technical requirements of the new HMDA, but also the risk associated with consumer interaction. The industry is acutely aware of the new data requirements, but consumers are likely to be confused by and concerned with the level of information requested. Training should address the significant increase in risk associated with data accuracy and performance results. Do not overlook the need to provide loan officers and other business personnel with clear instructions on how to obtain the new fields of consumer information and the importance of their role in data integrity and mitigating fair lending risk and penalties.

"Ensuring the accuracy of the new HMDA data is critical, but equally important is updating and enhancing your fair lending compliance management system to address new and emerging risks."

DETECTIVE CONTROLS

Lenders must implement new levels of detective controls including enhanced transactional monitoring

and testing to facilitate accuracy of HMDA data capture. Performance analytics should ensure the results accurately reflect risk associated with the new data – specifically data that will be made publicly available.

Another key control is the complaint management process. Complaints may increase as lenders implement the new HMDA forms and processes. Complaints should be reviewed for fair lending issues and can provide valuable insight for process improvements or enhanced training. Tracking of complaints must now include root cause analysis, patterns of complaints, and corrective action plans to limit future risk.

Internal audit, the third line of defense, is responsible for evaluating the completeness and operational effectiveness of controls. Audit programs will need to be enhanced to address new policies, procedures, controls, and processes for managing fair lending risk.

LAST THOUGHTS

As lenders begin to manage risks associated with new HMDA data, it is important to remember – there is no simple road map to follow. Each lender has different systems, risks, and controls. Understanding the regulatory requirements, the lender's risk appetite, and the level of oversight required is the key to building an effective risk management structure. For information on CrossCheck's fair lending services, including representative engagements, visit: http://crosscheckcompliance.com/our-services/fair-lending/.