



MBA Legal Issues In Mortgage Technology—Fair Lending and Fraud Considerations

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Joseph T. Lynyak III specializes in the regulatory representation of financial intermediaries. His practice includes providing financial companies advice in the areas of strategic planning, application and licensing, commercial and consumer lending, examination and enforcement and general corporate matters. Joe participated in the FDIC's Honors Program in Banking Law in Washington, DC. He is a frequent lecturer on legal topics involving the operation and regulation of financial service companies. He is a member of the American Bar Association's Banking Law Committee, and served as Chair of its Retail Subcommittee, the Subcommittee on FDIC Receiverships and Conservatorships and the Task Force on Derivatives. He also serves as a member of ABA's Consumer Financial Services Committee. Joe is a Fellow of the American College of Consumer Financial Services Lawyers.

Goals of Presentation

- To Look at Fair Lending Legal Issues
- To Look at Fraud Legal Concerns
- To Analyze Solutions From Technology Perspective
- To Provide Compliance Guidance and Recommendations

HMDA

- Enacted in 1975
- Implemented by Federal Reserve Board's Regulation C
- 2002 Amendments—
 - Lenders required to Reporting Pricing Data in the Form of Rate Spreads Above Certain Thresholds and HOEPA status
- Revised HMDA Data Now Available for Reporting Years 2004, 2005 and 2006

HMDA

- On an Annual Basis, Financial Institutions are Required to Report Specified Data on the Following for Residential Mortgage Loans:
 - Applications
 - Originations
 - Purchases
- This Data must be Filed in a Registered Format (the Loan Application Register or “LAR”)

HMDA

- LAR must be Filed Electronically for the Preceding Calendar Year's Data by March 1. Data must be Recorded within 30 days of the End of Each Calendar Quarter
- The Data is Available to the Public and is Used to Ensure that Financial Institutions are:
 - Complying with Fair Lending Laws and do not Engage in Discriminatory Lending Practices
 - Lending in Areas that They are Present (in Compliance with the Community Reinvestment Act)

Why Do We Care So Much About HMDA?

- **Home Mortgage Disclosure Act (HMDA) Data –Useful but not Enough—A Starting Point**
 - **Very Valuable for Screening Purposes by Regulators**
 - **Very Valuable for Basic Peer Comparisons**
 - **Very Valuable for Use in Internal Review by Lenders**
 - **HMDA is Key to Fair Lending Analysis because it is the ONLY Dataset that Allows Lenders to include Loan Level Information on Race and Ethnicity**
 - **Race/Ethnicity Changes since 2004:**
 - **Separation of race/ethnicity**
 - **Up to five race categories for applicant and co-applicant**
 - **HMDA also Includes Underwriting (Approval/Denial) and Pricing Information (Rate Spread, HOEPA)**

Screening

- The FRB Aggregates Lender Data
- Releases Data with Accompanying Statistical Analysis
- Performs Two-Step Screening to Identify “Outliers” from 8000 Reporting Entities
 - Use of Raw Data
 - Application of “HMDA Regression”
 - For 2005 Reporting Year—Approximately 270 Outliers
- Results Provided to Other Federal Agencies

Additional Scrutiny

- One Uniform Analytical Approach is not Followed by the Federal Agencies
 - FRB Uses 30/30/100 MSA Analysis
 - Other Banking Agencies Do Not Appear to Follow a Consistent Pattern
 - Opaque Rules and Process
- Defense of Investigation Requires Preparation of Credit Regression
 - All Lending Data Typically Reviewed
 - Reporting Difficulties
 - Draining on Internal Lender Resources
- Goal is to Avoid Being Targeted for Additional Scrutiny

Difficulties Experienced By Lenders

- Fuzzy Fair Lending Laws and Precedent
 - Questionable Applicability of Many Decisions Arising From Employment Law Context
 - Disparate Impact Theory Being Challenged
- Practical Proof Burden
 - An Obligation to Prove a Negative
 - “You Can’t Prove it” Does Not Work—at Least for Banks
- Extraordinary Expenses for Investigations and Litigation
- The Banking Agency Overhang
- Maintaining Privilege

Observations

- There is a Disconnect Between National HMDA Results and Consumer Claims
 - HMDA Data Supports Industry Perspective
 - Section 215 FACTA Act Report Supports Fairness of Mortgage Scoring
 - Mortgage Scores and Credit Reports are not Proxies for Race

Observations

- By Employing Fair Lending Claims—Consumer Groups Have Procedural Advantages
 - HUD Complaint Procedures
 - Necessity of Building Credit Model to Defend
 - Data Assembly and Verification Difficulties
 - Yearly Adjustments Required
 - Tactical Use of Fair Lending Claims May be More Successful When Employed Against FDIC-Insured Institutions and Affiliates

Observations

- Credit Modeling May De Facto Become Reality in Near Future
 - Large Institutions Currently Developing Models
 - Technology Tools Emphasize Real Time Analysis
 - Current HMDA Results Could Form Basis for Administrative Enforcement in Next Administration
- Will the Agencies Adopt a “Regression Lite” Approach?
- Subprime Meltdown Creates New Fair Lending Risk

Current Legal Concerns By Consumer Advocates

- Emerging Redlining Issues
- Reverse Redlining & Channel Pricing
- Tribal Communities
- Group Homes
- Foster Homes
- Adult Shared Living
- Row Houses
- Alaskan Rural Areas
- Puerto Rico and Territories
- Minimum Value & Pricing