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A new standard for "getting it right"

The Home Mortgage Disclosure Act (HMDA) evolves

The Home Mortgage Disclosure Act (HMDA) came into being more than 40 years ago to drive visibility in mortgage lending across the nation. Community leaders, industry stakeholders, and financial regulators rely on this home lending data to assess if housing credit needs are being addressed. As these stakeholders' needs evolve, HMDA keeps evolving as well. That has meant sweeping changes to the ways loan data is captured, collected, and reported.

For lenders, this presents a substantial compliance challenge, because "getting it right" doesn't just happen. The expanded reporting requirements necessitate new process implementations and rigorous, ongoing testing. But the new rule isn't all bad news: With a solid implementation plan, an institution can do more than achieve effective compliance. It can leverage the HMDA effort to enhance its own operations, eliminate redundancy, and proactively monitor its fair lending and data integrity risks.

The need is complex, but it becomes easier to approach if broken into discrete segments. By following a five-step approach, lending institutions can move more effectively toward compliance with the updated rules—and toward the benefits they can realize from standing up new systems and processes.

A brief history lesson

Enacted in 1975 to create transparency in the mortgage market,[1] HMDA was intended to provide the public with information to assess whether financial institutions were serving the housing needs of their communities. It was also designed to help public officials distribute public sector investments to improve the private investment environment.[2] Later amendments expanded the HMDA's objectives to include identifying potential discriminatory lending patterns and enforcing antidiscrimination statutes.[3]

Measuring impact

On October 15, 2015, the Consumer Financial Protection Bureau (CFPB) issued a final rule amending Regulation C, implementing amendments to HMDA required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[4] These amendments expand the reportable data fields and are intended to generate additional insight into financial institutions' lending patterns. The number of data fields that financial institutions must report has increased from 23 to 48, and large-volume lenders will now be required to report quarterly instead of annually. The changes affect the institutions and transactions that are subject to Regulation C, with a focus on dwelling-secured transactions. The CFPB has stated that it will use this information to further its mission of "protecting consumers from unfair, deceptive, or abusive practices" and taking action against financial institutions that break the law.

HMDA reportable fields – Three broad categories:

- "Outcome or Pricing Fields" (e.g., points and fees, interest rate, and rate spread)
- "Explanatory or Underwriting Fields" (e.g., FICO, loan to value, and debt to income)
- "Demographic or Application Fields" (e.g., age, race, and ethnicity)

Achieving ongoing compliance with the HMDA final rule will be no small feat. The CFPB estimates that after implementation, approximately 6,250 financial institutions will spend an estimated total of 6,851,000 hours[5] to report HMDA data for closed-end mortgage loans. In light of this mandate, all three lines of defense should consider deploying (and enhancing as appropriate) strong controls and control activities, including comprehensive testing, to assist their institutions in managing the risk of non-compliance and maintaining the integrity of their HMDA data.

[1] CFPB Final Rule, p. 9. Available at http://files.consumerfinance.gov/f/201510_cfpb_final-rule_home-mortgage-disclosure_regulation-c.pdf.
[2] CFPB Final Rule, p. 6.
[3] CFPB Final Rule, p. 7.
[4] The CPFB Final Rule applies to banks, savings associations and credit unions that meet the uniform loan-volume threshold and current in-scope Regulation C tests.
[5] CFPB Final Rule HMDA Regulation C (652-Rule only, p. 1).

Building a better home lending program: Making the HMDA final rule work for you

There's a silver lining to every large rule implementation. The changes that financial institutions must make under this new rule are also ones they can use to their own benefit. The likely benefits include streamlining internal systems and processes and increasing operational efficiencies. Institutions can also access the same information they're gathering for the CFPB and analyze that data to identify technology gaps, eliminate redundancies, and sharpen their understanding of lending patterns. The CFPB is a data-driven agency, and the new reporting requirements are likely to drive consistency across the industry and encourage the use of automated processes. Each institution can benefit from knowing how its unique HMDA data profile will help it prepare for examinations and identify needed changes.

A fair shake at fair lending

Collecting and reporting more types of data, such as underwriting, pricing, loan outcome, and loan demographics, should allow for a more robust internal fair lending review relative to the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA). They will also enhance institutions' abilities to self-monitor for fair lending risk exposure. Data elements such as FICO score, debt-to-income ratio, and loan-to-value ratio can be a powerful indicator in helping to establish that banks have treated borrowers in accordance with their established lending policies and pricing thresholds.

Institutions can also use this data to get ahead of the regulatory curve. By using data mining and analytics to execute fair lending risk and compliance assessments, an institution can perform its own analysis of fair lending impacts ahead of a regulatory exam and be prepared to answer examiners in a more informed way.

Enhanced detective controls and an enterprise view

To adhere to the new reporting requirements, institutions will need robust internal controls testing at various stages of the reporting process. They will also need to identify control breakdowns in a timely fashion, which will allow for remediation or process enhancements when necessary. For example: Are specific mortgage loan officers generating a high volume of loans with exceptions to policies? Are a large percentage of high-cost loans being issued in minority communities? Is there a lower concentration of loans to a particular minority group? Testing of HMDA data could help an institution identify these red flags and take corrective action.

All the systems and processes that standardize and streamline data collection for the sake of HMDA compliance can also benefit an institution by providing a more holistic internal view. For example, it may be easier to identify the unanticipated future needs that accompany an expansion into the secondary market. Investing time and resources into an effective compliance program with a holistic view can also give an institution greater confidence in the accuracy of its data. That can help prevent fines and potential losses from reputational damage.

Consistency in the industry, MISMO

HMDA is not the only force that's spurring the industry toward a more collaborative approach to reporting requirements. The Mortgage Industry Standard Maintenance Organization (MISMO) released an update, Reference Model Version 3.4, (October 2015), which supports the HMDA rule, the TILA-RESPA Integrated Disclosure rule (TRID), and the government-sponsored enterprise (GSE) Uniform Mortgage Data Program (UMDP).[6] The more consistent the data standards in place, the more benefit different institutions can derive from increased market efficiency, understanding, and oversight. Data quality can improve[7] and cost efficiencies can emerge.

With accurate HMDA data, an institution can better comply with both HMDA requirements and MISMO standards. In fact, the commonalities between the two make it possible to streamline the testing regimen for applicable data. A single team can perform one-time validation for multiple regulations and standards (notably MISMO, TRID, and HMDA) as long as appropriate attention is given to all reportable data. With this combination comes a need for caution, however. It will be necessary to compare where each field is defined across all regulations and standards and to identify any data elements that require unique permutations. For example, "application date" may not be defined consistently among MISMO, TRID, and HMDA.

[6] MISMO Updates Standards to Support TRID and Other Initiatives, October 6, 2015, http://www.mismo.org/files/PressReleases/PressReleaseOctober2015.pdf.
[7] Home Mortgage Disclosure (Regulation C), A Proposed Rule by the Consumer Financial Protection Bureau on 8/29/2014, https://www.federalregister.gov/articles/2014/08/29/2014-18353/home-mortgage-disclosure-regulation-c.

Implementing the final HMDA rule: A strategic approach

The breadth of the HMDA amendments is likely to challenge the resilience of institutions' change management processes. It will take strong lines of defense, adaptable compliance management and change management programs, and robust reporting infrastructures to make all phases of the implementation process effective.

As data requirements increase and reporting becomes more frequent, the accuracy, completeness, and consistency of data are paramount. Institutions may need to enhance their existing systems and processes, especially the procedures and technology infrastructure that support reporting.

To make that task manageable, institutions should consider following five key steps. Together they can provide an enterprise roadmap for the operationalization of the new requirements.

Step 1: Plan and scope
Dedicating significant time and thought to planning and scoping across all three lines of defense can provide for a smoother implementation process. Given the widespread effect of HMDA changes across a financial institution, management should consider:

- Assessing roles, responsibilities, and the current risk culture around HMDA
- Aligning project goals across business lines through training, communications, policies, and procedures

Starting with the planning and scoping phase, the independent risk oversight and internal audit functions—the second and third lines of defense—will have familiar roles. The second line can help by providing advice and technical support to new HMDA policy, procedures, and control development. The third line can assess and test aspects of the design of the new HMDA program. One or both lines will typically monitor the development timelines and progress, providing credible challenge as appropriate along the way.

Step 2: Perform a formal gap assessment
What processes, systems, and stakeholders will implementation of the HMDA final rule affect? To know the scope, management should identify and involve intake channels, data trails, and stakeholders from all three lines of defense. It should also consider which new or existing lines of business will be affected by the revised HMDA rule. An assessment of the current-state infrastructure for reporting, risks, and controls, weighed against applicable regulatory expectations and industry leading practices, can lead to identification of areas that require enhancement—such as weak controls for the reporting of new or modified HMDA data fields.

As part of this process, it's important to fully understand the provisions of the final rule, how the regulators will interpret it, and regulators' risk management expectations. Even as we write, the industry continues to dig deeper into the final rule and its provisions. New questions and issues are still emerging. The regulatory commentary published with the rule, in combination with the CFPB's Q&A email system, can help answer some of the questions. But the industry is also turning to industry groups to raise common issues that need interpretation.

Management can begin a gap analysis by identifying the new required fields and reporting requirements. Depending upon the size, complexity, and structure of the organization, this might be a centralized task or it may be appropriate to perform the gap analysis separately for each line of business or each system of record that will capture data under the new rule.

Where gaps are identified—such as additional training for application intake personnel to comply with expanded government monitoring requirements or the need to translate new data fields to HMDA reportable code—management can consider formally documenting the gaps for the benefit of stakeholders. That documentation, with proposed solutions including specific actions and dates, can help make controls over HMDA data more effective. For most institutions, the provisions around open-ended credit appear to present the largest gaps, including with respect to system impacts.

Step 3: Develop a comprehensive action plan
A comprehensive action plan that designates responsible parties and affected lines of business is essential to the function of a change management program for the HMDA final rule. Such a plan should include engagement from all three lines of defense to build consensus and drive proper regulatory coverage. In addition to detailing activities and milestones, the plan can incorporate the risk assessments, policy and procedure changes, training, testing, and reporting steps that will occur throughout the design, improvement, and implementation phases.

Step 4: Design and improve
The design and improve phase serves as a feedback loop. It allows time for trial and error so the institution can incorporate the lessons from pilot tests. This includes the reporting of both old and new HMDA data fields, which allows a financial institution to more effectively test the accuracy and completeness of implementation and identify areas it must enhance. In this phase, responsible parties develop specific implementation requirements to meet their assigned milestones. Then they begin full-scale execution. For example, the line of business would update policies, procedures, and training to detail

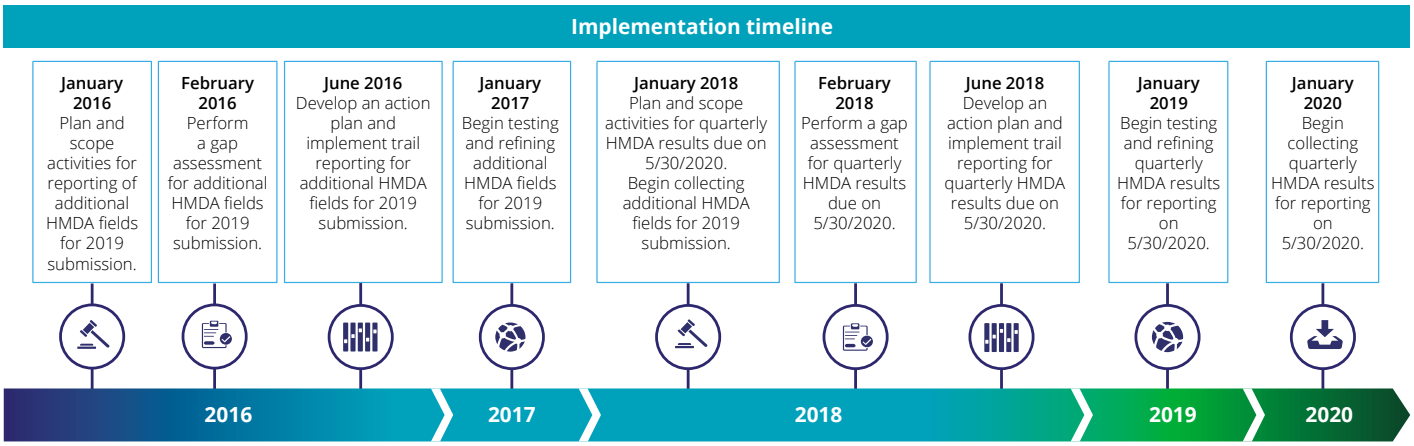
designated roles and responsibilities. Implementation planning, such as impact and readiness assessments across applicable lines of business, is also an important step to complete.

Step 5: Implementation and ongoing testing

Each line of defense in an institution will have its own mandates at the point of rollout.

- **First line of defense**. Even after full implementation of the final rule, HMDA compliance will require ongoing maintenance. Financial institutions may find it helpful to set up an implementation management office or similar group to centralize management of the implementation of the five steps discussed here. As management prepares for the go-live date, it should periodically communicate HMDA risks and resource needs to stakeholders and executives to maintain support for implementation.
- **Second line of defense.** Testing and validation of HMDA reporting does not stop after implementation. Frequent and ongoing testing and validation should be performed across all three lines of defense to identify any fields or lines of business that require remediation. The second line of defense should monitor the strategic action plan for the revised program build-out. This can help the institution address issues appropriately for timely implementation. The second line of defense also participates in the change control process to determine whether approved processes are being followed and necessary changes are being implemented.
- **Third line of defense.** Involvement of the third line of defense should include validating the sufficiency of first- and second-line monitoring and testing activities as well as the adequacy of the overall action plan. The need to amend compliance technology stems and other internal communication protocols is part of the scope of this mandate. Upon implementation, the third line monitors and tests, as appropriate, any high-risk populations that require remediation prior to filing of the HMDA Loan Application Register (LAR).

On an ongoing basis, financial institutions can monitor compliance with HMDA and related risks by executing risk assessments and using data analytics to mine HMDA data for potential fair lending risk exposure. Below is an illustrative implementation timeline.



How Deloitte Advisory can help

Change can be overwhelming. More so for organizations that take it on alone. The industry has no shortage of third-party allies that are positioned to support financial institutions through HMDA implementation. But few of these parties can bring substantial experience and a record of accomplishment to the table.

Deloitte Advisory's Regulatory and Compliance group includes industry veterans and former regulators who bring first-person experience with regards to consumer compliance regulations, including HMDA. We can assist with all phases of the assessment and implementation, including development of an action plan, change management, or HMDA-related testing. Deloitte Advisory also offers predictive analytics capabilities that can help assess HMDA data for fair lending risks.

HMDA has its roots in the fair treatment of borrowers, but the rule and the practices it inspires can benefit all parties in the home lending market. How many of those benefits arise, and how quickly, can depend on an institution's ability to break a multifaceted compliance challenge into discrete, understandable tasks.

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