

**BANKING****HMDA ... ARE YOU READY TO SUBMIT?**

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Many of us in banking were glad to see 2012 come to a close and hopeful for a better 2013. To the extent that better means fewer regulatory issues, now is the time to prepare your bank's Home Mortgage Disclosure Act ("HMDA") data for submission on March 1st.

It's not something new and it's definitely a process we attempt to improve each year. Unfortunately, managing HMDA data is not often a simple process. The risk of an inaccurate submission is becoming more critical as enforcement actions increase. In 2012, the FDIC imposed over \$400,000 in civil money penalties on 38 banks ranging from \$2,500 to \$60,000. HMDA data is equally critical as a component of a bank's Community Reinvestment Act performance evaluation and fair lending examination processes. Failing CRA can often threaten the continued existence of the bank itself.

Key considerations in managing HMDA data include training and education, policies and procedures, data management – collection, processing, geocode, and independent review. Training and education are required continually to ensure everyone involved in the lending process is aware of what is required by the regulation and what their responsibilities are with regard to ensuring the accurate and timely collection of data. Policies and procedures are important to clearly define any interpretations specific to a bank's business practices; i.e., system processes necessary to ensure the accurate identification of HMDA reportable applications. Data management is an on-going process, starting with data capture at the point of application, through the credit management process and ultimately submitted to the bank's primary federal regulator.

As you are preparing your 2012 HMDA data, please focus on the following common errors to improve the accuracy of your data:

**Omitted Data**

Ensuring the completeness of the HMDA Loan Application Register ("LAR") requires a comprehensive review of applications AND loans. Mortgage related lending is generally the focus of data capture and represents the majority of HMDA lending activity.

Remember - unsecured home improvement loans are reportable - if the loan is classified as home improvement. The challenge can be in determining what qualifies as "classified" ... Is the purpose captured as home improvement on the application system? Is the loan file "color coded" to identify home improvement loans? Is the purpose of the loan entered in the loan system?

Other common omissions include business, commercial and/or farm loans. Business loans secured by residential property may or may not be HMDA reportable, depending on whether the new

loan was made to pay off an existing lien secured by residential property. If a business loan secured by residential property is refinanced and an existing lien paid off, it is reportable. Farm loans can also create confusion because a new loan to finance a farm that includes a dwelling is excluded from HMDA reporting, but a refinance of a farm loan that includes a dwelling is not.

Testing for omitted data is most effectively managed through systemic data integrity testing. This involves reconciling HMDA data to application and loan system data using system classification codes and fields not commonly considered "HMDA" fields. For example, the call and collateral codes on a loan system can be used to identify residential secured and multifamily loans and a narrative field on an application system could be used to isolate "home improvement" purpose loans. Developing a systemic validation process provides a less manual and more effective process. In other words, use your system coding to help make sure you haven't omitted data that might not ordinarily be considered part of your residential lending program. This is more effective than going through loan files, and a whole lot more efficient.

**Government Monitoring Information**

GMI errors are most often the result of ineffective training programs. Common errors include:

- "Observed" GMI for telephone applications.
- "Corrected" GMI – the loan officer changed the codes even though the applicant had completed the GMI section of the application.
- Understated Income – application systems generating a HMDA LAR based on "standard" income fields, which did not reflect the actual income considered in the credit decision.

**Action Codes**

Most application outcomes are simple to identify, i.e., declined, approved not accepted and originated. However, many lenders struggle with actions that don't fit neatly into one of these categories. "Withdrawn" is only allowed if the lender has not made a credit decision and the borrower expressly withdraws the application. To avoid an error, be sure to note in writing in the file when the borrower requests that the application be withdrawn with details such as the date and the method of communication. A handwritten "withdrawn" on the application is unlikely to pass regulatory muster.

Incomplete applications are always problematic. For example, if an application has been reviewed by a credit officer and there is insufficient information to make a credit decision, the lender may send a letter requesting additional information or the loan officer may call or email the borrower. If a letter is sent stating that the application is incomplete, and the lender doesn't receive a response from the borrower, the application would be properly reported as

incomplete. However, the HMDA regulations allow for reporting incomplete applications as “denied for incomplete information”. The key here is consistency. Make sure your policies and procedures spell out when to report an application as incomplete and when to report an application as denied. Loan administration should test to make sure the rules are being followed.

## Geocoding

Geocoding is a critical component of HMDA data to ensure correct classification of the census tract for fair lending reviews and CRA lending test distribution analysis. Generally, lenders use automated geocoding systems or publicly available government sources. The challenge comes when there is a new census, which is what happened in 2012.

Many vendor programs including the FFIEC geocode program have been modified throughout the year to correct for errors and/or gaps in geocode data. These changes may result in geocode errors that are associated specifically with timing alone. If an address was geocoded in January of 2012 and changes were made to geocoding source data during the year, the geocode on a HMDA entry may be incorrect.

It’s important to include geocoding in any validation or scrub efforts performed prior to submitting your HMDA data. This can be accomplished through manual and automated processes, using in-house resources or outsourcing. Manual processes would include identifying significant changes in geographies within the lender’s market or assessment area and performing a review of applications located in those geographies. Automated processes could include geocoding all data to 2011 and comparing the results to 2012 geocoding to identify records for manual review.

The regulatory agencies have recently begun to question the independence of the method to test the accuracy of HMDA data. The examination procedures section on “Policies and Procedures” includes the following: *“Evaluate whether the institution’s informal procedures and internal controls are adequate to ensure compliance with HMDA and Regulation C. Consider the following: 15. Whether the Board of Directors has established an independent review of the policies, procedures, and HMDA data to ensure compliance and accuracy, and is advised each year of the accuracy and timeliness of the financial institution’s data submissions.”*

In other words, the same people who are charged with preparing your HMDA data should not be responsible for testing it. While the agencies have yet to clearly define “independence”, an abundance of errors may well call into question the overall effectiveness of your bank’s Compliance Management System. In many institutions, the compliance officer or department is responsible for data collection, review and submission. This does not necessarily meet the definition of “independence”.

As in so many instances, when it comes to HMDA, the devil is in the details. Attention to those details now, before the data is submitted, can save time and money in your next examination.

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