Lessons From the Recent Washington Federal Bank HMDA Settlement

The recent settlement between Washington Federal Bank (WFB) and the Consumer Finance Protection Bureau (CFPB) of reporting violations under the Home Mortgage Disclosure Act (HMDA) demonstrates that mortgage lenders should maintain a high level of focus on their compliance management system (CMS). The CFPB found that WFB had multiple systemic failures and lacked sufficient resources in maintaining a robust CMS to support its HMDA submission processes. The value of maintaining an effective HMDA CMS is a critical overall lesson that compliance professionals can take away from this HMDA settlement.

The limited information disclosed in the **consent order**, however, masks other important lessons that may be learned from this enforcement action. For example,

- Which specific data fields were problematic?
- What was the nature of the errors (e.g., inaccurate numeric values, miscoded categorical values, etc.)?
- Were there red flags that could have alerted WFB to these issues before regulatory scrutiny began?

The 2017 public HMDA data allow us to dig a little deeper into these questions and understand the issues that led to the consent order. Starting with the 2017 reporting year, the CFPB provided regular updates of resubmitted Loan Application Registers (LAR). These updates enable us to compare earlier HMDA LAR submissions with an institution's most recent resubmission.

In the remainder of this article, we share what we learned from our analysis of WFB's earliest 2017 LAR (retrieved on May 7, 2018) and most recent LAR (retrieved on November 15, 2020) for 2017. We refer to them throughout the article as the Initial 2017 and Current 2017 LAR submission files, respectively. In addition, we provide insights on how we assist clients in identifying and correcting these issues before the consequences become irreversible.

The likely sources of HMDA reporting errors

As described in the **consent order**, the CFPB found that multiple fields in the Initial 2017 submission file contained reporting errors. However, no detail is provided regarding the specific fields and issues identified by the CFPB. To gain this level of insight, we compared the Initial and Current 2017 submission files. We describe key observations from our analysis below.

Nearly half of HMDA records were changed

The CFPB found a high overall error rate – the percent of total records with at least one reporting error – in the samples it reviewed for 2016 (40 percent) and 2017 (32 percent). Our analysis of the Initial 2017 and Current 2017 files was consistent with the CFPB's finding, though we estimated the overall percentage of records with the value in at least one field having to be corrected was somewhat higher

(45 percent) than identified through sampling. The consistency in our overall findings and those from the CFPB's sampling also validates our other findings.

Non-reportable records

The Current 2017 submission file includes 2.4 percent fewer records than the Initial 2017 submission file. This implies that at least 200 records were either duplicative or non-HMDA reportable transactions and subsequently excluded from the 2017 submission.

Action taken

The field that required the most changes between the Initial 2017 and Current 2017 submission files was in the Action Taken field. Overall, 14 percent of records included a change in this field. After investigating the records we could match between the two submission files, we found that:

- 5.7 percent of records were changed from approved, not accepted (ANA) to denied;
- 4.6 percent of records were changed from ANA to withdrawn by the applicant;
- 2.8 percent of records were changed from withdrawn to closed for incompleteness (CFI), or vice versa; and
- 1.3 percent of records were changed from withdrawn or CFI to denied.

The changes among ANA, withdrawn and CFI applications reflect lender challenges we often encounter when performing HMDA audits for our clients.

The high frequency of ANA-to-denied changes is particularly notable. Nearly all (97.4 percent), upon resubmission, had a denial reason indicating an incomplete credit application, or Denial Code 7. A possible explanation is that these records represented conditional approvals that did not reach the point of a final credit decision and were not formally withdrawn by applicants. If these records were in the system incorrectly as approvals, it is likely that WFB did not send a Notice of Incompleteness (NOI) to these applicants, which would have allowed the bank to report these as CFIs instead of denials. Whatever the explanation, the high frequency of changes signals that fundamental weaknesses in the bank's CMS.

Geocode results

11 percent of geocodes – the numeric codes assigned to each state, county, and census tract – in the Initial 2017 submission file were changed in the Current 2017 file. These changes were driven most often by the over nine percent of Initial 2017 records submitted with a value of "NA" in all three geocode fields (i.e., the state, county, and census tract codes). These NA values were updated to numeric geocode values in the Current 2017 file.

Demographic information changes

Four percent of the records in the Current 2017 submission file reflected changes to ethnicity, race, or sex for the applicant and/or co-applicants. We concluded these issues were driven primarily by two issues.

- Changes from codes indicating the information was not provided to codes indicating it was not applicable. One plausible explanation is that the applicant was a corporation rather than an individual, though other explanations are also plausible.

- Revisions to reflect no co-applicant, even though the Initial 2017 submission pointed to both an applicant and a co-applicant is another reporting error that ADI encounters frequently when conducting HMDA reviews. These errors often result from changes in the decision to include or exclude a co-applicant to maximize an applicant's likelihood of approval and reduce the loan price. Thus, these revisions may be an indicator of not properly updating system data with new information.

Income and loan amounts

A comparison of the distribution of records by reported income and loan amounts pointed to a high frequency of changes to these numeric fields. Changes in reported income occurred in nine percent of the records in the Current 2017 submission file. Despite the frequency of changes for this field, we did not identify issues that typically drive changes in income values, such as misreporting income as "NA" (i.e., not applicable) and vice versa or using dummy values – such as "0", "1" or "999999" – that are not updated based on new information, or otherwise corrected. Instead, the changes are present throughout the distribution of values. Potential causes for these types of changes are data entry errors, mistakes in rounding income values to the HMDA-appropriate format (i.e., annual income reported in thousands) or failures to update data in the Loan Origination System (LOS) with new, verified information.

Changes to loan amounts affected two percent of records in the Current 2017 submission file. In contrast to the income field revisions, these changes followed a clear pattern: the changed records were initially reported with a value of "1", indicating a loan amount of $1,000. There was no discernible pattern in the revised loan amount values. Such an abnormal concentration of one value and the randomness of the subsequent changes raises the possibility of the use of dummy values that were not corrected in the LOS.

Property type

The final data field in which we found a material frequency of changes was Property Type. Two percent of the records included changes in this field, most of which included recoding multifamily properties (i.e., code "3") to one-to-four-unit properties (i.e., code "1"). Though the implied field error rate was below the five percent HMDA resubmission threshold for the field, it contributed to the resulting error rate that exceeded the 10 percent threshold and triggered the resubmission of the entire LAR. Moreover, this additional field would have provided the CFBP an additional data field supporting its allegation of systemic HMDA compliance failures.

HMDA monitoring components to manage compliance risk

Our analysis of WFB's Initial 2017 and Current 2017 HMDA submission files identified several data fields that were potential sources of the issues identified in the CFPB's enforcement action. Our findings are consistent with the CFPB's overriding allegation of systemic reporting failures and a lack of a strong CMS. What could have been done to identify and address these issues before the CFPB's scrutiny? Following on the next page are some key HMDA monitoring components of an effective CMS that ADI recommends lenders have in place to ensure HMDA compliance.

Traditional HMDA compliance components

Training

The foundation of any HMDA CMS is an effective training program. Proper training addresses many reporting issues on the front-end by guiding employees through their roles and responsibilities in implementing the lender's HMDA reporting policies and procedures, in accordance with regulatory requirements. For WFB, a quality HMDA training program may have enabled employees to identify some of the needed revisions that ADI identified, such as whether a particular transaction is HMDA reportable and when it is appropriate to use "NA" in geocode fields.

HMDA audits

A key HMDA CMS component is a thorough auditing program. Conducting both quarterly and annual reviews of application-level samples for 2016 and 2017 activity could have uncovered WFB's reporting issues before the CFPB found them. Furthermore, enlisting a third party that specializes in auditing HMDA data offers an important layer of independent quality control to a lender's HMDA compliance program. Results from external audits can also identify training opportunities for staff members responsible for HMDA compliance.

Reportability checks

As noted above, one of our findings was the net decrease in HMDA records reported in the Current 2017 submission file. This decrease potentially suggests that records initially reported were deemed not to have been HMDA-reportable. A focus on the HMDA-reportability of individual transactions is an important part of an external HMDA audit that should be conducted prior to LAR submission. The pre-submission review includes validating that each record on the LAR meets the **definition of a reportable application.**

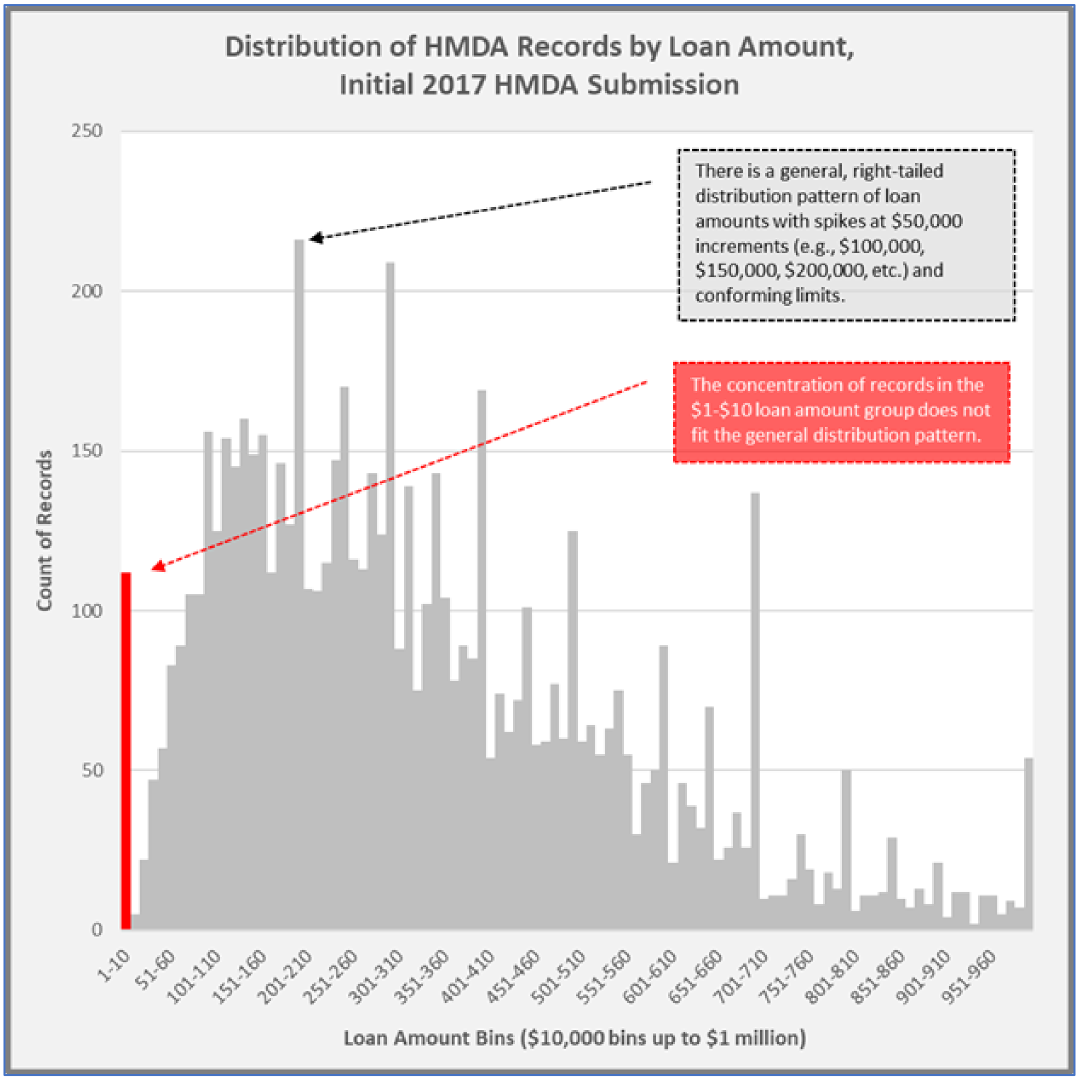
Analytic HMDA compliance components

Numeric distribution analysis

For numeric fields such as loan amount and income, evaluating the distribution of values can provide a simple, yet effective way of identifying potential reporting anomalies. From WFB's 2017 HMDA data, we observed a concentration of loan amounts with the value of "1", indicating a loan amount of $1,000. A simple histogram of the distribution of loan amounts would have been an effective method of exploring this data field for potential reporting issues.

As shown in Figure 1, on the following page, the concentration of records in the $1,000 to $10,000 group did not fit the general distribution pattern of loan amount values. Such a finding could have prompted an investigation of these files to determine if the loan amount values were accurately reported or if there were systemic reporting issues. With the significant expansion of numeric data fields required under the 2015 HMDA Rule – including property value, credit score, debt-to-income ratio, and interest rate – this type of analysis has become increasingly important for lenders to quickly identify potential reporting anomalies for these fields.

Figure 1. Distribution of Numeric Values, Loan Amount

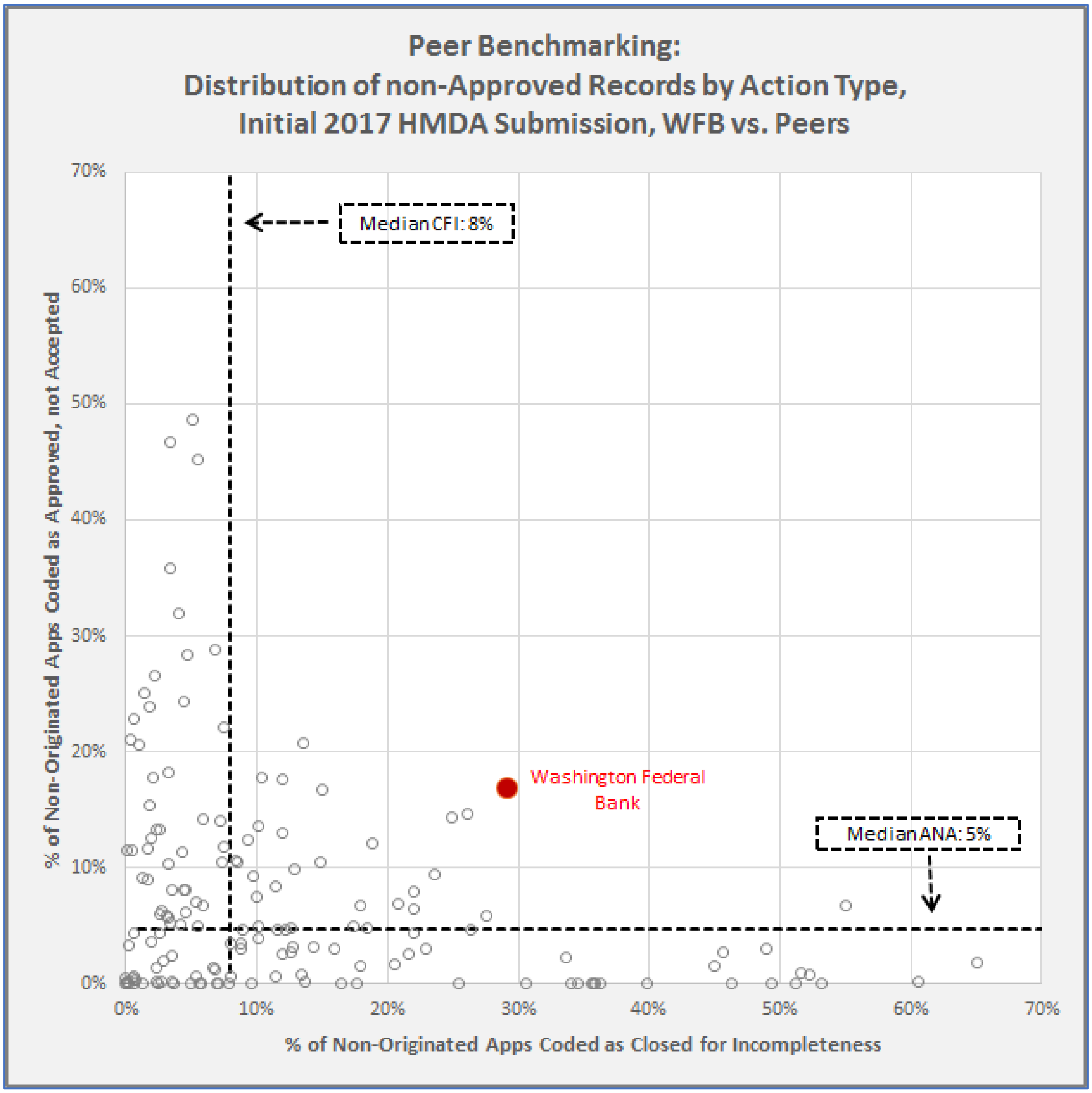


Peer benchmarking

Another effective tool for evaluating a HMDA LAR for potential reporting errors is benchmarking reporting patterns against peer lenders. Benchmarking data fields that are at risk for reporting errors by current processes – such as Action Taken and demographic information – and specific scenarios (e.g., reporting "NA" for income, geocodes, etc.) can uncover reporting patterns that are substantially different from peers.

Figure 2 on Page 6 provides an example of this approach. It plots the percentage of non-reported applications coded as either ANA or CFI among HMDA reporters with between 50 percent and 200 percent of WFB's count of records for initially reported 2017 activity. This plot highlights how WFB was an outlier in reporting ANAs and CFIs relative to other reporters with comparable activity. Such patterns of reporting outliers are red flags of potential reporting issues. When we find a similar pattern for our clients, we recommend reviewing samples of these records to validate the accuracy of the reported values. If WFB performed this analysis it may have been able to identify potential errors. If through review, the errors were confirmed, the Bank could have addressed these issues prior to LAR submission.

Figure 2. Distribution of Action Type Frequencies, WFB and Peers



Is your institution sufficiently monitoring its HMDA reporting for potential violations?

A robust monitoring of the accuracy of a developing LAR is an important tool for every lender. The HMDA monitoring components discussed above are representative of what ADI recommends for our clients to minimize compliance risk.

The systemic nature of WFB's reporting issues might make it a rare case among HMDA reporters. However, as shown in Figure 2, the reporting patterns of many other HMDA reporters also indicate they are outliers. WFB is by no means the only reporter with potential reporting issues. Moreover, these patterns often reflect system errors that have strong potential to multiply as the increased complexity of modern HMDA reporting evolves and regulatory scrutiny increases in the coming years. For these reasons, ADI recommends that HMDA reporters conduct the types of analyses that can effectively identify issues before they incur reputation and monetary costs. We also recommend maintaining strong training programs to prevent such errors from recurring.

Figure 3. Summary of HMDA Revisions and Recommended HMDA Monitoring Components

HMDA Reported Data Element with Revisions Detected by ADI in Washington Federal Bank's 2017 HMDA Submission	Frequency of Revisions ↑	HMDA Monitoring Components to Proactively Address Reporting Issues				
		Traditional Components			Analytic Components	
		Training	*Audits*	*Reportability Checks*	*Numeric Distribution Analysis*	*Peer Benchmarking*
Action Type	14%	✔	✔			✔
State, County & Tract	11%	✔	✔			✔
Income	9%	✔	✔		✔	
Demographic Info	4%	✔	✔			✔
Property Type	2%	✔	✔			
Loan Amount	2%	✔	✔		✔	
Non-Reportable Records	2%	✔	✔	✔		

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ADI helps banks, mortgage lenders, and other clients address compliance needs related to Fair Lending, HMDA, BSA/AML, CRA, and other critical issues. We are driven by data and hard information on regulatory requirements, business processes and, where appropriate, our clients' customers. We are also careful to recognize the value of history and current perceptions that are important to our work. Finally, we strive to communicate effectively with our clients at the board, senior management, compliance officer and frontline employee level.