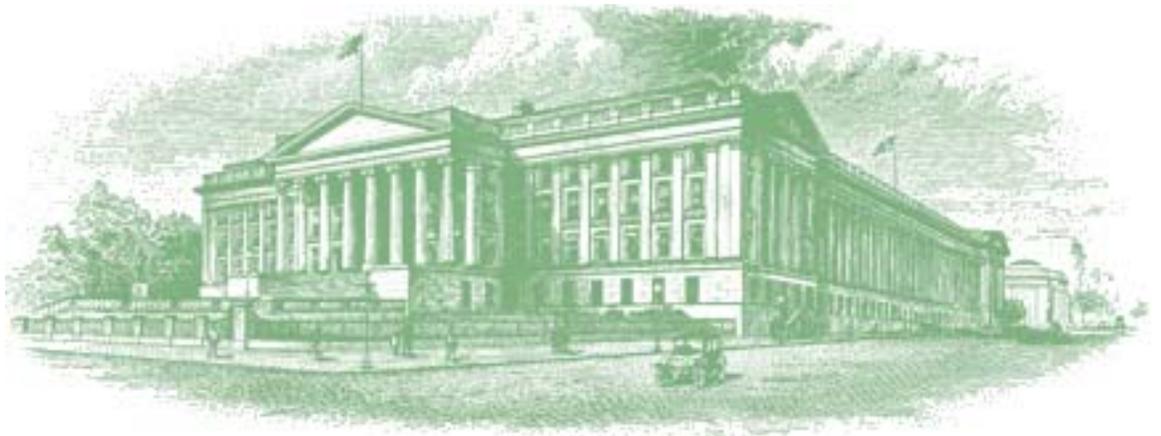




Audit Report



OIG-08-038

ACCESSIBILITY OF FINANCIAL SERVICES: OCC Is Appropriately Using HMDA Data in its Risk Assessment Process to Identify Possible Discriminatory Lending Practices

July 21, 2008

Office of
Inspector General

Department of the Treasury

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Abbreviations

FRB	Federal Reserve Board
HMDA	Home Mortgage Disclosure Act
HUD	Department of Housing and Urban Development
OCC	Office of the Comptroller of the Currency
OIG	Office of Inspector General
WSRC	Washington Supervisory Review Committee

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*The Department of the Treasury
Office of Inspector General*

July 21, 2008

John C. Dugan
Comptroller of the Currency

This report presents the results of an audit we conducted at the Office of the Comptroller of the Currency (OCC)¹ concerning the use of Home Mortgage Disclosure Act (HMDA)² data by OCC.

The objectives of this audit were to determine whether (1) OCC is making appropriate use of HMDA data in its risk assessment process to identify instances of possible discriminatory lending practices and (2) OCC is taking appropriate action to follow up on identified instances of possible discriminatory lending practices.

We conducted our audit from May 2007 through September 2007. We met with officials of the OCC and other federal banking regulators. We also reviewed relevant OCC documentation. As part of the audit, we did not assess the adequacy of the fair lending examination. Appendix 1 contains a more detailed description of our objectives, scope, and methodology.

¹ OCC charters, regulates, and supervises all national banks. It also supervises the federal branches and agencies of foreign banks.

² Pub. L. No. 94-200; 89 Stat. 1125 (Dec. 31, 1975), amended by Pub. L. No. 100-242; 101 Stat. 1945 (Feb. 5, 1988) and Pub. L. No. 101-73; 103 Stat. 525 (Aug. 9, 1989). Codified at 12 USC §. 2802.

In brief, based on our review, we found that OCC made appropriate use of HMDA data to identify instances of possible discriminatory lending practices and that OCC took appropriate action to follow up on these identified instances. We also found that although OCC has documented its internal operating procedures for the use of HMDA data, the document is in draft form only. We recommend that OCC finalize this document.

In a written response, the Comptroller of the Currency concurred with our findings and recommendation. Expressing concern that readers of our report may misunderstand the purpose and use of the document at issue, the Comptroller also discussed OCC's fair lending supervisory activities over the years. The response is included as appendix 2.

Background

OCC is responsible for fostering safety and soundness of the national banking system and for monitoring and enforcing national banks' compliance with laws and regulations. OCC considers HMDA data to determine whether additional review is needed as part of its examination process to determine banks' compliance with such statutes as the Community Reinvestment Act, the Equal Credit Opportunity Act, and the Fair Housing Act.

HMDA requires certain mortgage lenders to collect selected data on mortgage applications, originations, and purchases and to report these data to federal banking regulators each year. For the HMDA data collection and reporting requirement to apply, a bank, savings association, or credit union must have had assets on the preceding December 31 that exceeded a specified annually published amount; had a home or branch office in a Metropolitan Statistical Area on the preceding December 31; and originated at least one first-lien home purchase loan (or a refinancing of such a loan) on a one- to four-family dwelling in the preceding calendar year. In addition, for the requirement to apply, the institution must (1) be federally insured or regulated; or (2) have originated at least one first-lien home purchase loan or refinancing on a one- to four-family dwelling that was federally guaranteed, insured, or supplemented; or (3) have intended to sell the loan to Fannie Mae or Freddie Mac.

As an observation, HMDA data consist of certain borrower characteristics and certain loan characteristics. One of HMDA's purposes is to help regulators identify possible discriminatory lending patterns and enforce antidiscrimination statutes. HMDA data in past years have indicated disparities in mortgage lending by race and ethnicity, but HMDA data alone are generally considered insufficient to determine whether a lender is complying with fair lending laws because the data do not include potential key determinants of loan pricing, such as borrowers' credit scores, debt-to-income ratios, or loan-to-value ratios. Whether additional data, such as credit scores, should be added to HMDA reporting requirements has been the subject of ongoing debate in Congressional hearings. Consumer interest groups have advocated for the addition of such data because they believe that the additional information would allow federal banking regulators to increase Fair Lending enforcement and increase scrutiny of discriminatory practices. In the same hearings, federal banking regulators have questioned whether the cost of adding data would outweigh the benefits and whether it would yield a definite answer on the occurrence of discrimination.

Findings and Recommendation

Finding 1 **OCC Made Appropriate Use of HMDA Data**

Based on our review, we concluded that OCC used HMDA data as the law intended—to identify possible discriminatory lending patterns. OCC provided us with a draft copy of its internal policies and procedures related to HMDA data analysis. From this and other evidence we determined that OCC (1) runs HMDA data through several screens to identify outliers, (2) prepares a preliminary screening list that is reviewed by OCC's Deputy Comptrollers in charge of bank supervision,³ and (3) prepares a final screening list and schedules Fair Lending examinations for all institutions included on the final screening list.

³ OCC has eight Deputy Comptrollers who are responsible for its bank supervision activities—three for large bank supervision; one for mid-size and credit card bank supervision; and one for each OCC district (Central, Northeastern, Southern and Western).

OCC, as the regulator of national banks, receives HMDA data relating to these banks annually from the Federal Reserve Board (FRB) and an FRB Output Report, which identifies national banks that may represent high fair lending risk due to greater rate spread⁴ disparities.

After receiving HMDA data, OCC generates three risk-based screening lists of banks that are outliers in the areas of denial rate, terms and conditions, and rate spread. OCC also considers the results of public surveys and discrimination analyses prepared by others to identify outliers related to redlining and marketing.

OCC also compiles two screening lists that consist of randomly selected banks. The banks on these two lists are selected from all OCC-supervised banks that were not identified on the risk-based screening lists.

OCC compiles a preliminary screening list consisting of banks identified as outliers and the randomly selected banks. OCC's supervisory offices review this list and recommend banks to be added or deleted. Examiners must give a risk-based reason for deleting a bank from the list. After the supervisory offices have provided their input, OCC prepares a final screening list. Banks on the final list are scheduled for a Fair Lending examination during the next calendar year.

During its screening process, OCC filters out loan applications with certain characteristics. For example, loans in which the applicant listed multiple races and loans in which the applicant and coapplicant were of different races were screened out and not subjected to additional HMDA-related scrutiny during the screening process. The number of applications filtered out for these two reasons is less than 2 percent of the loan application population after other filters have been applied. OCC said that it decided to exclude these applications because it was unclear how to interpret the results applied to these groups and because this population was reasonably small. OCC informed us that it monitors

⁴ Rate spread is the difference between the annual percentage rate on a loan and the rate on Treasury securities of comparable maturity. Lenders must report the spread for loans with an annual percentage rate 3 percent higher than the comparable Treasury securities for first liens and 5 percent higher for junior liens.

demographic shifts and would change its screening process as needed.

All federal banking regulators receive HMDA data from FRB related to the institutions they regulate and use these data to screen for potential high-risk institutions that may warrant additional review. We interviewed personnel from FRB, the Office of Thrift Supervision, the National Credit Union Administration, and the Federal Deposit Insurance Corporation and found that they have HMDA data analysis processes in place that are generally similar to those used by OCC.

Finding 2 OCC Took Appropriate Follow-up Action

OCC provided us with documentary evidence to demonstrate its efforts to use HMDA data to address possible discriminatory lending practices. Based on this evidence, we found that OCC took appropriate action to follow up on HMDA data that indicates potential discrimination in lending. Specifically, we found that OCC schedules and conducts Fair Lending examinations for all banks on the final screening list.

All potential prohibited basis⁵ violations of the Fair Housing Act or Equal Credit Opportunity Act identified in Fair Lending examinations are brought to the attention of OCC's Washington Supervisory Review Committee (WSRC). WSRC recommends specific OCC enforcement action, as appropriate. WSRC makes recommendations to the appropriate Senior Deputy Comptroller for Bank Supervision on whether a referral to the Department of Justice or to the Department of Housing and Urban Development (HUD) should be made.

Cases where OCC has concluded that there is reason to believe discrimination has occurred are referred to the appropriate enforcement agency. Since April 1993, OCC has referred 38 national banks deemed to be in violation of fair lending laws to the Department of Justice and/or HUD. Most cases were returned to

⁵ "Prohibited basis" under the Equal Credit Opportunity Act refers to discrimination against otherwise creditworthy applicants on the basis of race, color, religion, national origin, sex, marital status, age or because an applicant receives income from a public assistance program. Under the Fair Housing Act, "prohibited basis" also refers to discrimination on the basis of familial status (presence of child under age of 18, and pregnant women) and handicap.

OCC to resolve administratively. Five cases were resolved through consent orders or settlement agreements entered into between DOJ and the bank and one case was resolved by HUD.

Finding 3 **OCC's Documentation of Its Internal Operating Procedures Is in Draft Form Only**

OCC began to develop internal written operating procedures for using HMDA data in January 2007. According to OCC managers, finalized internal written operating procedures were to have been in place by the end of summer 2007. To date, however, OCC has not finalized this document that describes its fair lending supervision process. The written description of such procedures represent an important internal control, defined in the Government Accountability Office's *Standards for Internal Control in the Federal Government* as the plans, methods, and procedures used to meet mission, goals, and objectives. Further, internal controls should be clearly documented and the documentation should be readily available for examination.⁶ Without a finalized, internal document reflecting internal operating procedures, lapses in the continued and consistent use of HMDA data could occur.

Recommendation

To help ensure that national banks and their operating subsidiaries comply with fair lending laws and regulations, we recommend that the Comptroller of the Currency finalize OCC's internal written operating procedures for the use of HMDA data. We also recommend that the written procedures address OCC's plans to monitor demographic shifts and to adjust the screening process as necessary.

Management Response

OCC agreed with the recommendation and plans to finalize the document reflecting its internal written operating procedures. The target implementation date for this action is September 30, 2008.

⁶ Government Accountability Office, *Standards for Internal Control in the Federal Government*, GAO/AMD-00-21.3.1 (November 1999).

OCC, however, expressed concern that readers of this report may misunderstand the purpose and use of the document at issue or conclude that without the document or absent its finalization, that OCC is not fully integrating HMDA data into its supervision of national banks. In its response, OCC states that it: (1) has been supervising national banks for compliance with fair lending laws for many years; (2) began to make use of HMDA data as soon as data regarding borrower characteristics became available; (3) issued bulletins and other publications to national banks providing both general, comprehensive guidance, including the use of HMDA data in supervision, for addressing fair lending concerns and specific guidance to address particular risk areas or emerging issues; (4) updated its latest set of comprehensive examination procedures, which are based on interagency procedures developed by the federal banking agencies and provide guidance to examiners and institutions in 2006; and (5) has employed an annual screening process to help identify institutions that may warrant closer examination scrutiny for possible lending discrimination since 2000.

OCC also stated that it began to commit its internal processes for handling the data, including the screens and filters, to writing as a “white paper” and intend it to be a living document for internal use only.

OIG Comment

We believe the planned corrective action is responsive to our recommendation. We recognize that: OCC has integrated HMDA data into its supervision of national banks for many years; and the internal written operating procedures for the use of HMDA data are intended for internal use only.

* * * * *

We appreciate the courtesies and cooperation provided to our staff during the audit. If you wish to discuss the report, you may contact me at (202) 927-5776 or Jeff Dye, Audit Manager, at (202) 927-0384. Major contributors to this report are listed in appendix 3.

Susan L. Barron
Director of Banking Audits

Our objectives were to determine whether (1) OCC is making appropriate use of HMDA data in its risk assessment process to identify instances of possible discriminatory lending practices and (2) OCC is taking appropriate action to follow up on identified instances of possible discriminatory lending practices. As part of the audit, we did not assess the adequacy of the fair lending examination.

To accomplish these objectives, we performed the following activities:

- Conducted interviews with OCC officials
- Conducted interviews with other federal banking regulators
- Reviewed OCC policies and procedures on its use of HMDA data
- Reviewed OCC documents related to past HMDA data analysis
- Reviewed laws and regulations relevant to discriminatory lending practices
- Reviewed OCC guidance on examinations
- Reviewed OCC testimony to the House Committee on Financial Services

We performed our audit from May 2007 through September 2007 in accordance with generally accepted government auditing standards.



MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Susan L. Barron, Director, Banking Audits

From: John C. Dugan, Comptroller of the Currency

Handwritten signature of John C. Dugan in black ink.

Date: July 2, 2008

Subject: Comments on Draft Audit Report

We have received and reviewed your draft report titled "Accessibility of Financial Services: OCC Is Appropriately Using HMDA Data in its Risk Assessment Process to Identify Possible Discriminatory Lending Practices." Your overall objectives were to determine whether the OCC is making appropriate use of HMDA data in its risk assessment process to identify instances of possible discriminatory lending practices and whether OCC is taking appropriate action to follow up on identified instances of possible discriminatory lending practices.

You concluded that the OCC is making appropriate use of HMDA data and taking appropriate follow-up action. We agree. We also agree that the document reflecting our internal written operating procedures is in draft form and we plan to finalize the document by September 30.

However, we have concerns that readers of your report may misunderstand the purpose and use of the document at issue or conclude that without the document or absent its finalization, we are not fully integrating HMDA data into our supervision of national banks. The OCC has been supervising national banks for compliance with fair lending laws for many, many years. We also began to make use of HMDA data in our fair lending supervision as soon as data regarding borrower characteristics became available in the early 1990s. Throughout the 1990s, we issued bulletins and other publications to national banks providing both general, comprehensive guidance for addressing fair lending concerns and specific guidance to address particular risk areas or emerging issues. These publications included information on use of HMDA data in supervision as well as for the institution's own self-analysis.

The OCC provided key leadership in developing the interagency Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,266 (1994). The Policy Statement provides guidance on fair lending principles and enforcement policy, including guidance on how HMDA data would be used in fair lending supervision. Our latest set of comprehensive examination procedures, which are based on interagency procedures developed by the federal banking agencies and provide guidance to examiners and institutions, were issued in 2000 and updated in 2006. Additionally, since 2000, we have employed an annual screening process to help us identify institutions that may warrant closer examination scrutiny for possible lending

Appendix 2
Management Response

discrimination. Our screening and filtering of the data have become more sophisticated over time, and we have modified our screens as needed to reflect developments such as additional sources of data.

For continuity purposes, we began to commit our internal processes for handling the data, including the screens and filters, to writing as a “white paper” last year. We intend it to be a living document for internal use only.

Thank you for the opportunity to review and comment on your draft report.

Appendix 3
Major Contributors To This Report

Susan Barron, Director, Banking Audits
Jeffrey Dye, Audit Manager
Gregory Quantz, Program Analyst
Amnoiphorn Samson, Program Analyst

Department of the Treasury

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