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April 6, 2004

VIA ELECTRONIC MAIL

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Mailstop 1-5
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Washington, D.C. 20219

Jennifer J. Johnson
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Office of Thrift Supervision
Regulation Comments
Chief Counsel's Office
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Re: Proposed Revisions to CRA Rule
OCC Docket No. 04-06
FRB Docket No. R-1181
FDIC RIN 3064-AC50
OTS Docket No. 2004-04

Ladies and Gentlemen:

Land of Lincoln Legal Assistance Foundation, Inc. is a federally funded legal services provider, serving low income individuals, families, and community groups in 65 counties in southern and central Illinois. I have worked in the East St. Louis office since 1994, primarily representing homeowners threatened with foreclosure. For five years, I also served as corporate counsel for the largest nonprofit provider of affordable homeownership opportunities in East St. Louis. I currently serve as a member of the Consumer Advisory Council of the Board of Governors of the Federal Reserve System.

Introduction

I am writing to comment on the proposed revisions to the CRA rules that would provide that abusive, though legal, lending might reduce a CRA rating. According to the joint notice of proposed rulemaking, you seek comment on what abusive practices, other than asset based lending, are subject to definition. I believe that there is a list of practices, subject to ready definition, about which there is widespread agreement of their predatory nature.

I applaud the agencies for working to ensure that CRA will serve the purpose it was intended to serve, that of promoting reinvestment in communities that leads to sustained growth. As you note in your notice, predatory practices are "inconsistent with the purposes of the CRA."[1] I believe the specific identification of asset-based lending as a practice that will receive adverse CRA consideration is an important first step.

CRA Treatment of Illegal and Abusive Practices

The specific steps taken by the agencies, under the proposed rule, to clarify that all illegal practices will subject the lending institutions to adverse action under the CRA, to consider evidence of a pattern or practice of asset-based lending in consumer loans, and to consider abusive lending by affiliates within the assessment area where an institution designates any loans by an affiliate for CRA treatment, are important first steps. The agencies should not pull back from those specific steps. I urge the agencies to consider a broader list of abusive practices so that lenders receive the proper incentives for making good loans and are not perversely rewarded for detrimental loans.

The proposed rule indicates that there will not be an automatic demerit for any particular illegal or abusive practice but that indicators of illegal and abusive practices will be considered in context in arriving at an appropriate CRA rating. Given this approach by the regulators, I believe it is possible to identify a wide list of potentially abusive practices that can be relatively narrowly defined. Any given practice will not result in an automatic demerit, but should subject the institution to greater scrutiny in the CRA exam process. This contextual approach permits examiners to respond to the changing nature of predatory lending in a flexible manner and to assess the impact of predatory practices at any particular institution without imposing large administrative burdens on lending institutions or otherwise impeding the flow of responsible credit to low-income and minority communities.

Lenders can choose which loans to have examined, under the current regulatory scheme, by deciding whether lending will be done by an affiliate or by the main institution and then by further deciding whether or not to have the loans at an affiliate examined. Having selected loans at an affiliate to include for the purpose of CRA credit, lenders should not be able to prevent examiners from assessing those loans in context. Lenders should not be able to have loans to low- and moderate-income borrowers included for CRA credit without some penalty if, in effect, those loans are injurious and contrary to the spirit of the CRA.

[1] 69 Fed. Reg. 5729, 5739 (Feb. 6, 2004).

Abusive Practices

One list of predatory practices that could be used by the agencies would be those identified in the recent GAO Report on Predatory Lending.[2] The practices identified by the GAO Report include excessive fees, excessive interest, single premium credit insurance, loan flipping, balloon payments and prepayment penalties. Although some of these practices can, as the GAO Report points out, sometimes be beneficial, often they are not, and their common presence in a loan portfolio should trigger heightened scrutiny of the CRA record of the lender.

Another possible reference list is the list of prohibited practices already adopted by the Federal Reserve Board in the regulations enacted under the Homeownership Equity Protection Act (HOEPA).[3] Those are practices that are already regulated, about which there is widespread agreement as to their predatory nature, and whose regulation has not significantly reduced the supply of responsible credit to low- and moderate-income communities.

In addition to the GAO list and the list embodied in the HOEPA regulations, there are two additional areas of concern that the agencies should address, mandatory arbitration and no document loans.

Practices Identified in the GAO Report

High fees/ Packing fees

Most legitimate loans have relatively low financed fees, of 3% or less. A pattern of loans made with high financed fees should create concern and should be cause for a reduction of the CRA rating. Most lenders now are careful in the refinance context to finance less than 8% of the loan amount, in order to avoid HOEPA coverage.[4] There is no significant concern or evidence that HOEPA coverage has reduced the availability of responsible credit to consumers. Any institution that routinely finances more than 8% of the total loan amount in fees should receive additional scrutiny as to its potentially predatory practices.

Excessive Interest/ Steering

One of the most pernicious consequences of the dual mortgage market is the decoupling of interest rate and risk. There is much debate over the extent of this practice, and a bright line test may not always be feasible.[5] Bank exams already look for evidence of interest rate higher than the risk in fair lending reviews; similar reviews should be incorporated into the CRA exam process, regardless of whether or not borrowers are treated differently depending on their membership in a protected class, where feasible. Any lending institution that engages in a pattern and practice of steering borrowers to higher priced credit than they qualify for should receive adverse CRA treatment, even if it is not a fair lending violation. Charging low- and moderate-income borrowers more for credit than they are eligible for strips low- and moderate-income communities of the very wealth the CRA was meant to increase.

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[2] GAO, Consumer Protection:Federal and State Agencies Face Challenges in Combating Predatory Lending, January 2004, p. 18-19.
[3] 12 C.F.R. §226.23.
[4] 12 C.F.R. §226.32(a)(1)(ii).
[5] Joint Center for Housing Studies of Harvard University, , Credit, Capital, and Communities: The Implications of the Changing Mortgage Banking Industry for Community Based Organization, p. 42 (March 2004).

Single premium credit insurance

When the Board reviewed the HOEPA test in 2001, it mandated that single-premium credit insurance should always be counted as a point and fee for HOEPA purposes.[6] This decision came as many large subprime lenders, in adopting best practices, abandoned single-premium credit insurance. Given that both lenders and consumer advocates appear to be in agreement that single-premium credit insurance is seldom, if ever, a beneficial product, its presence in loans made or purchased by an examined institution should lead to adverse treatment under CRA.

Loan Flipping

One of the most common methods of stripping equity from low-income communities is the repeated refinancing of homes, with ever increasing principal, made up of new fees and costs for the refinancing. Many state statutes that attempt to address abusive lending practices place a limit on repeated refinancing of at least home loans[7]. Collecting a prepayment penalty on a loan refinanced by the same lender or an affiliate is already prohibited for HOEPA loans.[8]

For most borrowers, there is no reason to refinance a loan that is less than 12 months old. Certainly there is no reason for most borrowers to refinance a loan less than 12 months old without a significant drop—of at least 300 basis points—in the interest rate. In order for a refinancing to benefit a borrower who is not in urgent financial distress, the borrowers' monthly loan payments should drop and the total amount the borrower is paying over the life of the loan should also decline, adjusted perhaps for real cash to the borrower and not simply cash paid for unsecured debt or the costs of refinancing.

Any individual refinancing may make sense, but in the aggregate, most lenders and most borrowers should not be refinancing loans within 12 months of the initial transaction. A pattern and practice of refinancing loans less than 12 months old should subject the lending institution to heightened scrutiny and adverse CRA treatment, if other circumstances warrant.

Balloon payments

Balloon payments can often be beneficial for higher income borrowers, for construction loans, or for borrowers with a reasonable prospect of increased income. They seldom, if ever, make sense for borrowers on a fixed income from any source. Balloon payments outside of home construction loans should be viewed with suspicion and subject the lending institution to heightened scrutiny and possible adverse CRA treatment. This would follow their treatment

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[6] 12 C.F.R. §226.32(b)(1)(iv).

[7] E.g., 815 ILCS 137/45("No lender shall refinance any high risk home loan where such refinancing charges additional points and fees within a 12-month period after the original loan agreement was signed, unless the refinancing results in a tangible net benefit to the borrower."); 815 ILCS 120/3(e) (complete ban on "loan flipping," defined as "refinancing a loan secured by the person's principal residence for the primary purpose of receiving fees related to the refinancing when (i) the refinancing of the loan results in no tangible benefit to the person and (ii) at the time the loan is made, the financial institution does not reasonably believe that the refinancing of the loan will result in a tangible benefit to the person.")

[8] 12 C.F.R. §226.32(d)(6)(ii).

under HOEPA, where they are forbidden with a term of less than five years, except for bridge loans in the construction context.[9]

Prepayment penalties

Prepayment penalties in the subprime market tie borrowers into expensive loans and seldom function to reduce the actual cost of credit. A pattern and practice of imposing prepayment penalties of more than 3 years in duration or of imposing prepayment penalties without a corresponding drop in the interest rate offered should subject the lending institution to heightened scrutiny and possible adverse CRA treatment.[10]

Additional areas of concern

Beyond the practices listed in the GAO report, there are three additional practices that should also trigger heightened scrutiny of a lender's portfolio: mandatory arbitration, negative amortization, and no document loans. Negative amortization is regulated by HOEPA and no document loans are not permitted with a prepayment penalty under HOEPA.

Mandatory arbitration

The presence of binding arbitration often guarantees that abusive practices will not be challenged, since it is often not economically feasible for an individual borrower to challenge an abusive practice, and arbitration agreements typically prevent class wide arbitration. Perhaps even more troubling from a policy viewpoint, mandatory arbitration prevents full disclosure as to the extent of a problem at an institution, since arbitration decisions are not public documents. While there are good policy arguments as embodied in the Federal Arbitration Act for encouraging arbitration to resolve disputes, arbitration is not a negotiated or freely chosen resolution for most subprime borrowers. Without a meaningful choice, the imposition of arbitration may become abusive.

Negative amortization

Although there may be limited times when negative amortization is appropriate—for a few payment periods of an Adjustable Rate Mortgage's life or in a regulated Home Equity Conversion Mortgage—in general, negative amortization is a per se predatory practice.[11] Its presence in loans made by a lending institution should subject the lender to heightened scrutiny and possible adverse CRA treatment.

No document loans

Fraud and deception are one of the leading abusive practices in lending.[12] Some of this is driven by brokers, and lenders vary widely in their ability and willingness to police the actions of

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[9] 12 C.F.R. §226.32(d)(1).

[10] Cf. 12 C.F.R. §226.32(d)(7), permitting prepayment penalties in HOEPA loans of less than years, if other conditions, including income verification, are met.

[11] See, e.g., 12 C.F.R. 226.32(d)(32) prohibiting loans with "regular periodic payments that cause the principal balance to increase" in HOEPA loans.

[12] GAO, Consumer Protection:Federal and State Agencies Face Challenges in Combating Predatory Lending, January 2004, p. 18-19.

rogue brokers.[13] Unfair and deceptive acts are already prohibited by the Federal Trade Commission Act, and should receive adverse treatment for CRA purposes in their own right.[14]

Much of the fraud and deception is facilitated by no- and low-document loans. While some of these products were originally created to reach borrowers who had trouble accessing credit, their overuse has helped fuel lending without regard to the ability to repay. Indeed, in a no-document loan, it is impossible to tell if abusive asset-based lending is occurring or not, since there is no evidence of the borrowers income.

Lenders should be discouraged from using no-document loans, both because of their role in facilitating abusive lending and for safety and soundness concerns. Regulations issued under HOEPA already prohibit no-document loans if there is a prepayment penalty.[15] A pattern or practice of making a large number of no-document loans should lead to heightened scrutiny of the lender's other practices.

Assessment area

Finally, consideration of the negative effects of an affiliate's lending should not be limited to the institution's assessment area. As a recent study by the Joint Center for Housing Studies at Harvard University confirms, the CRA has been extremely effective in promoting a high quality of lending by regulated lenders within their assessment areas.[16] To limit a review of predatory lending practices to the assessment area would be to deny most low- and moderate-income borrowers effective protection of the CRA, would encourage predatory behavior outside of the assessment areas, and would run counter to the realities of existing business plans and strategies.

Conclusion

I thank the agencies for this opportunity to submit comments on this important venture and congratulate them again on their efforts to make the promise of the Community Reinvestment Act a meaningful one.

Sincerely,

Diane E. Thompson

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[13] Joint Center for Housing Studies of Harvard University, , Credit, Capital, and Communities: The Implications of the Changing Mortgage Banking Industry for Community Based Organization, p. 42-44 (March 2004).

[14] 69 Fed. Reg. 5729, 5740 (Feb. 6, 2004).

[15] 12 C.F.R. §226.32(d)(7)(iii).

[16] Joint Center for Housing Studies of Harvard University, Credit, Capital, and Communities: The Implications of the Changing Mortgage Banking Industry for Community Based Organizations, p. 59(March 2004) (noting that "the lending channel matters" and that banks operating in their CRA assessment areas are the most likely to make prime loans, after controlling for borrower and neighborhood characteristics).