CENTER FOR RESPONSIBLE LENDING

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Ladies and Gentlemen:

The Center for Responsible Lending (CRL) appreciates the opportunity to comment on the proposed amendments to the regulations implementing the Community Reinvestment Act (CRA).

CRL is an organization dedicated to protecting home ownership and family wealth by working to eliminate abusive financial practices. A nonprofit, non-partisan research and policy organization, CRL promotes responsible lending practices and access to fair terms of credit for low-wealth families. Together with other members of a coalition with organizations representing over three million North Carolinians, CRL was instrumental in helping to pass North Carolina's ground-breaking, comprehensive statute against predatory lending. CRL continues to promote legislative and regulatory efforts to address predatory lending issues.

CRL is also an affiliate of Self-Help, one of the nation's largest nonprofit community development lenders. Self-Help has provided more than $3.5 billion in financing to help low-wealth borrowers in forty-seven states buy homes, build businesses, and strengthen community resources. CRL's affiliation with Self-Help provides CRL with important insight into lenders' needs and responsibilities to communities. Through its Secondary Market program, Self-Help has financed over $3.1 billion in CRA affordable home loans since 1994, benefiting over 36,000 households. Self-Help's Secondary Markets program helps lenders serve their communities and increase lending to lower-income borrowers.

CRL believes that proposed changes to the CRA regulations would do more harm than good. Though CRL supports the inclusion of a predatory lending standard in the CRA regulations, CRL believes that it is critical that the final rule list specific abusive lending practices that will adversely affect an institution's CRA rating. CRA was intended to promote "more coordinated efforts between private investments and federal grants and insurance in order to increase the viability of our urban communities."[1] Predatory lending destroys the work of government, for-profit and non-profit entities that work to revitalize struggling neighborhoods. In fact, seeing the devastating impact predatory abusive lending practices were having on its community development efforts led Self-Help to create CRL. The CRA regulations should clearly show that the agencies will penalize institutions whose practices reverse the work of community reinvestment.

CRL recommends three categories of changes to the proposed rule in order to ensure that it better supports the intentions of the Community Reinvestment Act. First, the proposed 12 C.F.R. § __.28(c) standard should include a much larger list of abusive lending practices and illegal conduct. The proposed regulation should list abusive mortgage lending terms and conditions other than asset-based lending, including practices that strip equity, practices that increase the risk of or decrease the ability to

[1] H.R. CONF. REP. No. 95-634, at 76 (1977), *reprinted in* 1977 U.S.C.C.A.N. 2965, 2995.

defend against foreclosure, and practices that target vulnerable groups. These acts and practices should be deemed unfair or deceptive and should not only be referenced in the CRA regulations, but also should be included in the unfair and deceptive acts or practices (UDAP) regulations applicable to banks, savings and loan institutions, and credit unions.

Beyond the mortgage lending context, 12 C.F.R. § __.28(c) should address abuses related to rent-a-charter partnerships between payday lenders and the institutions the agencies regulate. In addition, institutions should be penalized if they utilize bounce loan products with features that take advantage of consumers with few savings. Any predatory lending standard should also require consideration of violations of state law, as well as to TILA provisions regarding disclosures and certain loan term restrictions and RESPA provisions on disclosures, seller-required title insurance, and limits on escrow accounts.

Second, the standard should apply to all affiliates of an insured depository institution, whether or not the institution has chosen affiliates in the same category for CRA consideration. A predatory lending standard within CRA is unlikely to be effective if a lender can simply shift abusive behaviors to an excluded entity to avoid scrutiny.

Third, CRL objects to the proposed change to the small bank definition, which would decrease the level of review of, and available data on, banks with assets between $250 million and $500 million to unacceptably low levels.

I. <u>While lenders' illegal and other abusive practices should be considered in CRA review, the proposed predatory lending standard is woefully inadequate.</u>

CRL supports the efforts of the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation, (FDIC) and the Office of Thrift Supervision (OTS) (collectively, the "agencies") to integrate a predatory lending standard into the CRA regulations.[2] The use of illegal and abusive practices is inimical to the CRA goal of requiring insured depository institutions to fulfill their "continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered."[3] It is necessary and entirely appropriate for the CRA regulations to require that abusive and illegal financial practices adversely affect an institution's CRA rating. Predatory lending practices do not meet credit needs, but rather harm existing wealth-building efforts. However, CRL believes the proposed standard to be woefully inadequate.

CRA was enacted to counteract "redlining," the practice of refusing to lend in certain areas, usually low- or moderate-income neighborhoods. Redlining hindered the ability of residents in redlined communities to have access to credit and thereby to build wealth and economic security. While there has been progress in the effort to make credit

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[2] The agencies' CRA regulations are codified as follows: 12 C.F.R. Part 25 (OCC), 12 C.F.R. Part 228 (FRB), 12 C.F.R. Part 345 (FDIC), and 12 C.F.R. Part 563E (OTS). The subsection numbers for the provisions referenced herein are the same in all of the regulations.

[3] 12 U.S.C. § 2901(a)(3).

available on fair terms to all communities, predatory practices threatens the wealth that underserved communities have been able to build. Not all credit is equal—communities need constructive credit, not destructive credit.

The Community Reinvestment Act states that its purpose is to require federal financial supervisory agencies to use their authority, when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered, consistent with the safe and sound operation of such institutions. The agencies should use the CRA process to spur financial institutions to ensure that their lending, service, and investment activities are fair and responsible. Abusive lending practices are detrimental to communities and their members and are contrary to the purposes of CRA. Institutions that engage in these practices truly need to improve, and should not receive a CRA rating higher than "needs to improve."

It is not enough to list asset-based lending as the sole abusive lending practice specifically listed in § __.28(c)(1). The standard must be expanded to address numerous specific practices that are known to abuse borrowers. Having no predatory lending standard at all would be preferable to having a weak standard that erroneously indicates that all institutions that satisfy that standard are responsible lenders.[4]

In their joint notice of proposed rulemaking, the agencies stated that "other abuses [besides asset-based lending] not expressly prohibited by HOEPA, TILA, RESPA, or ECOA, may be better addressed on a case-by-case basis under the unfair-or-deceptive standard of the FTC Act, rather than by regulatory definitions."[5] Congress, however, has reached a different conclusion. Section 18(f)(1) of the Federal Trade Commission (FTC) Act, 15 U.S.C. § 57a(f)(1), requires the Board of Governors of the FRB, the Federal Home Loan Bank Board (now the OTS), and the National Credit Union Association (NCUA) to "prescribe regulations to carry out the purposes of this section, including regulations <u>defining with specificity such unfair or deceptive acts or practices</u>, and containing requirements prescribed for the purposes of preventing such acts or practices." (Emphasis added.) The current UDAP regulations applicable to banks, savings and loan institutions, and credit unions[6] are inadequate and do not fulfill the congressional mandate to promulgate regulations that specifically define unfair acts and practices. Additional UDAP regulations should be issued regarding the abuses discussed below.

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[4] There is evidence that grade inflation already limits the significance of the CRA ratings. <u>See, e.g.</u>, KENNETH H. THOMAS, CRA GRADE INFLATION (Levy Economics Institute, Working Paper No. 313,2000). One study found that between 1996 and 2001, only 1% of examined institutions received a score of "needs to improve" or "substantial noncompliance" on the lending test, and only 0.7% received a score of "needs to improve" or "substantial noncompliance" on the service test. In comparison, 17.5% of examined institutions received a score of "needs to improve" or "substantial noncompliance" on the investment test. <u>See</u> STEGMAN ET AL., CREATING A SCORECARD FOR THE CRA SERVICE TEST 2-3 (The Brookings Institution, Policy Brief No. 96, 2002).

[5] Community Reinvestment Act Regulations, 69 Fed. Reg. 5729, 5740 (Feb. 6, 2004).

[6] <u>See</u> Regulation AA, 12 C.F.R. Part 227, Subpart B (applicable to banks and credit unions) and in 12 C.F.R. Part 535 (applicable to savings and loan institutions).

Violations of these new regulations should be referenced in the new predatory lending standard in § __.28(c)(1)(i).[7]

A. *Residential Mortgage Lending*

Proposed § ___.28(c)(1)(ii) discusses only one predatory practice, asset-based lending. **A** pattern or practice of home mortgage lending based predominantly on the foreclosure or liquidation value of collateral, where the borrower cannot be expected to be able to make required payments, is certainly abusive and should adversely affect an institution's CRA rating. By focusing on a single abusive practice, however, the agencies ignore the crux of the question of fair pricing-equity stripping. Most of the adverse effects of predatory lending practices take the form of high upfront or back-end fees that are not a justified cost of credit. Other practices have similarly devastating effects on borrowers. CRA examinations should consider abusive terms and conditions other than asset-based lending.

There are at least three categories of abuses that should be incorporated into the CRA regulations:

1. *Practices that strip equity.*

For example:

a) *Exorbitant fees.* Charging and often financing subprime borrowers' points and fees in excess of what is required to account for any increased risk from a subprime loan is an abusive practice that strips equity up front. Such fees include broker fees, yield spread premiums, and back-end prepayment penalties. Yield spread premiums compensate brokers for selling borrowers loans with a higher interest rate than the par rate at which the lender was willing to issue the loan and for which the borrower qualified. The CRA regulations should encourage lenders to provide credit on the best terms for which the borrower is eligible. Fannie Mae and Freddie Mac will not purchase loans where the points and fees constitute more than 5% of the loan amount.[8] Several state laws also have used points and fees exceeding five percent as a trigger for important consumer protections.[9] Several of the largest

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[7] The proposed § __.28(c)(1)(i) should continue to include reference to violations of Section 5 of the FTC Act, which would serve as a "catch-all" provision to apply to abuses that have not yet surfaced.

[8] See Lender Letter 03-00 (April 11, 2000), available at http://www.efanniemae.com/singlefamily/forms_guidelines/lender_letters/db_lender_letters.jhtml#03-00; Industry Letter (December 28, 2000), available at http://www.freddiemac.com/sell/guide/bulletins/pdf/1228indltr.pdf

[9] See ARK. CODE ANN. §25-53-103(7)A(ii); GA. GODE ANN. § 7-6A-2(17)(B)(i); 815 ILL. COMP. STAT. 137/10; N.J. STAT. ANN. 46:10B-24; N.M. STAT. ANN. § 58-21A-3.N(1); N.Y. BANKING LAW § 6-l(g)(ii); N.C. GEN. ST. §24-1.1E(6)b.

subprime home mortgage lenders cap their fees at 5% or lower. Charging excessive points and fees should adversely affect an institution's CRA rating.

b) Loan flipping. Some lenders "flip" loans in order to garner origination and other fees. An institution that refinances an existing consumer home loan when the new loan does not have a reasonable, tangible net benefit to the borrower, considering all the circumstances, should be penalized by receiving a lower CRA rating. Some lenders intentionally "flip" borrowers from loans with good terms, including zero-interest loans, into unfavorable loans in order to collect origination and other fees. These lenders do not provide borrowers with a net tangible benefit but rather extend credit in order to strip homeowner equity. This predatory practice not only devastates individual borrowers, but also undoes the money and effort expended by government agencies, non-profit institutions, and other entities that work to provide responsible loans to borrowers. Institutions that nullify the community reinvestment undertaken by others certainly should have their CRA ratings adversely affected because of this practice.

c) *Packing andfinancing of ancillary products.* Financing premiums for credit insurance, debt cancellation coverage, or debt suspension coverage strips equity up front. Borrowers generally can obtain these products much more cheaply from another source. They often do not realize that coverage by the product may cease decades before the end of the mortgage term. Many lenders use high-pressure sales tactics or outright deception to include fees for overpriced, often unnecessary ancillary products, including life insurance and accidental death and dismemberment insurance, in home mortgage transactions. Premiums for these products should not be financed but rather should be paid in monthly installments. Lenders do not meet community credit needs when they strip equity up front by financing such products into the loan amount.

2, *Practices that make borrowers vulnerable toforeclosure—particularly the imposition of loan terms and structures that make it difficultfor borrowers to reduce or repay their indebtedness—andpractices that restrict borrowers' ability to defend againstforeclosure.*

For example:

a) *Subprime prepayment penalties.* Costly prepayment penalties on subprime loans prevent borrowers from refinancing to a less-expensive loan. Prepayment penalties are rare in the prime or conventional market—a joint report by the U.S. Department of the Treasury and the U.S. Department of Housing and Urban

Development estimated that only between 1% and 2% of prime loans contained prepayment penalties.” In contrast, prepayment penalties are the rule in the subprime market. In 2002, Standard & Poor’s stated that “[w]ell over 80%” of the subprime loans currently analyzed by Standard & Poor’s structured finance residential mortgage group are originated with prepayment penalty fees.”” The subprime sector should provide borrowers a bridge to conventional financing as soon as the borrower is ready to make the transition. Prepayment penalties are designed to prevent this from happening. By locking subprime borrowers into high-rate loans when better loans are available, prepayment penalties increase the risk of foreclosure.

b) Balloon payments and negative amortization in subprime loans. Balloon loans lower monthly mortgage payments, a fact some lenders use to hide high rates and fees, enticing unsophisticated borrowers into taking out a “debt consolidation” loan at a high cost. The monthly mortgage payments the borrower makes are not designed to reduce the balance due on the loan to zero by the end of the term, so the borrower must make a large lump-sum payment when the loan term ends. With negative amortization, the monthly mortgage payments cover only a portion of the interest due, and no principal. Therefore, the loan amount due actually increases over time. In the context of high-cost loans, balloon loans and negative amortization mislead the borrower and greatly increase the rate of foreclosure.

c) *Making arbitration the mandatory means of resolving disputes.* The combined cost of filing fees and other administrative fees in arbitration are prohibitive to many homeowners, especially to those who face foreclosure. Filing and other administrative fees for mandatory arbitration routinely cost thousands of dollars. Fees charged by private arbitrators generally are significantly higher than court fees. Also, lenders are likely to be repeat-players in arbitration. In form loan documents can select a private arbiter or an arbitration forum known to favor industry. Arbitration is almost always a confidential process, without a public record. This denies other homeowners information that might facilitate their claims and permits lenders to continue unjust or illegal actions in relative safety. Private arbitrators do not have to meet minimal measures of competence or even to be licensed as an attorney. The arbitration process is not required to provide homeowners with a

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[10] See U.S. DEPT. OF THE TREASURY & U.S. DEPT. OF HOUSING & URBAN DEVELOPMENT, JOINT REPORT ON RECOMMENDATIONS TO CURB PREDATORY HOME MORTGAGE LENDING (June 20, 2000), 93.
[11] “Legal Criteria Reaffirmed for the Securitization of Prepayment Penalties,” *Standard & Poor’s Online* (May 29,2002).

full opportunity to develop and present their case through discovery and other means available in courts. Injunctive relief, class actions, and punitive damages generally are not permitted. **A** lender that uses adhesion contracts to force homeowners to arbitrate disputes should see its CRA rating adversely affected.

3. *Practices that exploit vulnerable populations and/or are discriminatory.*

For example:

a) Steering borrowers towards subprime products. Steering borrowers into more expensive loans than those for which they qualify is inimical to the CRA goal of meeting community credit needs. In 1999, Fannie Mae found that one-half of the borrowers in its subprime portfolios should have received loans in the prime market. In that same year, Freddie Mac found that one-third of the borrowers in its subprime portfolios should have qualified for prime loans.[12] Evidence that an institution has a pattern or practice of steering borrowers into subprime rather than prime loans should adversely affect the institution's CRA rating.

b) *Targeting particular ethnic groups, the elderly, or low-income or moderate-income people or neighborhoods.* The targeting of vulnerable populations for subprime loans or abusive terms is fundamentally at odds with CRA's purposes. Given that CRA was enacted to prevent the devastating effects of redlining, which limits the ability to build wealth and financial security, the agencies should consider evidence of harmful "reverse redlining," the extension of credit in certain areas or to certain groups on abusive terms and conditions. Some lenders target subprime loans with abusive features to people who have a low or moderate income, or to people who live in low- or moderate-income neighborhoods. The concentration of predatory loans in low- or moderate-income and minority communities increases the risk of concentrated foreclosures, which in turn devalues property values and reduces safety, as vacant homes abound. CRA should promote reinvestment in communities, and the availability of credit to groups, that have been left behind. Targeting such groups or neighborhoods weakens communities, including those into which much money and effort already have been invested through revitalization projects. Low- and moderate-income persons and residents of low- or moderate-income neighborhoods are not

[12] Dennis Hevesi, "**A** Wider Loan Pool Draws More Sharks," *New York Times*, March 24, 2002, sec. 11, **p.** 1.

> protected groups under either the Equal Credit Opportunity Act or the Fair Housing Act.
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> Other targets of subprime loans with unfavorable terms are the elderly, many of whom have built up substantial home equity and are house-rich but cash-poor. Some lenders aggressively market abusive loans to blacks or Latinos, groups that have less access to prime loans. Upper-income African-Americans were more likely than low-income whites to receive a refinance loan from a subprime lender in 2000.[13] Furthermore, the likelihood of receiving a refinance loan from a subprime lender increases with the percentage of blacks or Latinos in a borrower's neighborhood,.[14] CRL recommends that, in addition to cross referencing the Equal Credit Opportunity Act and the Fair Housing Act, the CRA regulations clearly state that targeting a particular group of borrower for loans with abusive terms and conditions will adversely affect an institution's CRA rating. By specifying targeting as an abusive practice under § __.28(c)(1)(ii), the agencies would convey the important message that pushing destructive credit onto particular groups runs directly counter to CRA's community reinvestment goals.

Contrary to the view expressed in the joint notice of proposed rulemaking, it is entirely appropriate and possible to promulgate regulations that identify particular unfair and deceptive acts and practices. CRL urges the agencies to fulfill the congressional mandate under Section 18(f)(1) of the FTC Act by issuing regulations "defining with specificity such unfair or deceptive acts or practices . . . ."[15] and to list these abuses in § __.28(c)(1) as practices that will adversely affect an institution's CRA rating.

While some agencies have taken positive steps to address unfair and deceptive acts and practices, they have issued guidance rather than regulations to address them. Such guidance has tended to privilege disclosure of such practices over the specific identification and prevention that the FTC Act requires. For example, the OCC Guidance on Unfair or Deceptive Acts or Practices provides that, in the OCC's view, an injury

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[13] See CENTER FOR COMMUNITY CHANGE, RISK OR RACE? RACIAL DISPARITIES IN THE SUBPRIME REFINANCE MARKET 8 (2002).

[14] RANDALL M. SCHEESSELE, BLACK AND WHITE DISPARITIES IN SUBPRIME MORTGAGE REFINANCE LENDING 6 (U.S. Dept. of Housing and Urban Development, Working Paper No. HF-014, 2002) (finding that in 2000 neighborhoods where blacks comprised at least 80% of the population were 2.2 times more likely than the nation as a whole to have a subprime refinance mortgage and where Hispanics coinprised at least 80% of the population were 1.5 times more likely to have a subprime refinance mortgage. **A** recent study by the Joint Center for Housing Studies at Harvard University cites numerous studies that have found that African-American borrowers receive subprime loans at a greater rate than risk can justify, and presents its own econometric analysis that leads to the same conclusion. See CREDIT, CAPITAL AND COMMUNITIES: THE IMPLICATIONS OF THE CHANGING MORTGAGE BANKING INDUSTRY FOR COMMUNITY BASED ORGANIZATIONS 36-59 (2004).

[15] 15 U.S.C. § 57a(f)(1).

"could reasonably have been avoided if the consumer had sufficient information to make an informed choice."[16] Thus it appears that an abusive practice would not be deemed unfair if the practice were sufficiently disclosed. Disclosures, however, do not necessarily protect borrowers against abuse. As the General Accounting Office reported recently, "disclosures may be of limited usefulness in reducing the incidence of predatory lending practices."[17] In addition, the FRB and the FDIC guidance on Unfair or Deceptive Acts or Practices by State-Chartered Banks issued on March 11, 2004 lists twenty practices that institutions should adopt to avoid unfair and deceptive acts and practices. Of those twenty practices, fully sixteen deal with disclosures or advertising by institutions. The remaining four practices generally involve implementing risk and supervisory policies and employee training procedures and monitoring third-party relationships. None of the items defines any unfair or deceptive acts or practices, as required by the FTC Act.

Furthermore, agency guidance often fails to declare an act or practice to be unfair or deceptive, but rather sets forth general principles to be considered on a case-by-case basis. The OCC's Guidelines for National Banks to Guard Against Predatory and Abusive Lending ("Predatory Lending Guidelines), for example, states that loan flipping and equity stripping *may* be unfair or deceptive acts under the FTC Act.[18] In addition, the OCC Predatory Lending Guidelines state that "[n]ational banks should also <u>consider</u> articulating clear policies and procedures to specify, if applicable, whether and under what circumstances the banks will make loans involving features or circumstances that have been associated with abusive lending practices."[19] While some agencies may prefer to rely on self-regulation or individualized investigations to address unfair or deceptive acts or practices, Congress has explicitly mandated that the FRB, the OTS and the NCUA promulgate regulations that define with specificity unfair or deceptive acts or practices and prescribe requirements to prevent them.[20]

Pursuant to 15 U.S.C. § 57a(f)(1), the abusive practices discussed herein should be incorporated into the UDAP regulations applicable to banks, credit unions, and savings and loan institutions, and in turn § __.28(c)(1)(i) of the CRA regulations should reference those UDAP regulations. Until new UDAP regulations are enacted, the agencies should expand the proposed § __.28(c)(1)(ii) to include specific standards for the abusive mortgage lending practices listed above. Furthermore, no institution that uses any of the discussed practices should be permitted to receive a CRA rating higher than "needs to improve."

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[16] Advisory Letter 2002-3, Mar. 22, 2002, at 5.
[17] GENERAL ACCOUNTING OFFICE, CONSUMER PROTECTION: FEDERAL AND STATE AGENCIES FACE CHALLENGES IN COMBATING PREDATORY LENDING 14 (GAO-04-280 2004).
[18] <u>See</u> Advisory Letter 2003-2, Feb. 21, 2003, at 4-5.
[19] <u>Id</u>. at 8 (emphasis added). The guidelines do list several practices about which national banks should consider stating policies, but does not address the recommended content of such policies.
[20] <u>See</u> 15 U.S.C. § 57a(f)(1).

B. *Rent-a-Charter Partnerships*

Another troubling practice is the development of partnerships between institutions supervised by the agencies and third-party lenders designed to permit the third party lenders to avoid state laws on usury and other consumer protection matters. The third party generally originates and services the loans and retains the predominant economic interest in the loans.[21] Nevertheless, the third party arranges to partner with a supervised federally institution to try to "rent" the benefits of the supervised institution's charter, namely, federal preemption of certain state laws. Courts who have considered such arrangements in the payday lending context have rejected the argument that the third party lender are entitled to the federal preemption that applies to their partner financial institutions. The OCC, the OTS and the FRB have taken significant action to prevent the institutions they regulate from partnering with payday lenders. However, rent-a-charter arrangements continue to exist because the FDIC has failed to pressure the institutions it regulates to end this subterfuge.

It is CRL's understanding that ten FDIC-regulated institutions currently partner with payday lenders. The FDIC's silence and inaction in the face of rent-a-charter payday lending in violation of state usury and other laws lends credence to third party payday lenders' false assertions that federal preemption extends to them. These false assertions lead some state officials and private parties not to challenge illegal payday lending. State officials and private parties who do fight violations of state law must devote time and resources to disputing issues of federal preemption and jurisdiction before a court. The FDIC should take action to end these risky and harmful partnerships that prey on vulnerable communities that lack access to short-term credit on reasonable terms.

In addition, the agencies should address the practice of renting charters in the CRA regulations. Financial institutions shirk their responsibility to promote responsible lending in the communities they serve when they "rent" their charters to third-party lenders. Payday lending is an egregious example of the ills of rent-a-charter. The payday lending business model is inherently abusive. It is designed to exploit borrowers caught in a cycle of repeat loan transactions who must borrow again and again to pay outrageous fees on an existing small loan that they cannot afford to repay. Payday lending locks borrowers into a debt trap of revolving, high-priced, short term credit rather that providing longer-term credit for reasonable rates. CRL conservatively estimates that predatory payday lending fees from borrowers caught in a debt trap of repeated transactions costs U.S. families **$3.4** billion annually.[22]

The CRA regulations should penalize banks that promote this practice by "renting" their charters to payday lenders that wish to avoid state laws. The weight of

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[21] Given these facts, the "third party" is the true lender, so it would be more accurate to refer to the institutions supervised by the agencies as the third parties to the loan transactions. Nevertheless, this letter will follow the practice of guidance from the agencies and will refer to the non-bank/thrift/credit union as the "third party."

[22] See KEITH ERNST ET AL., QUANTIFYING THE ECONOMIC COST OF PREDATORY PAYDAY LENDING (2003), available at **http:liwww.responsiblelending.orgipdfs/CRLpaydaylendingstudyl2**03.pdf.

authority holds that non-bank payday lenders are not entitled to federal preemption and that both they and the loans they make are subject to state law. Still, many payday lenders continue to rent charters and make illegal loans. An institution that "rents" its charter to a third-party who makes loans in violation of state law should not receive higher than a "needs to improve" rating on its CRA examination. This penalty should apply whether or not the illegal loans occur in an assessment area. Some banks that rent their charters intentionally do not permit their partners to make payday loans in their own backyards. For example, even though partners of County Bank of Rehoboth Beach, DE make payday loans at interest rates and on other terms that violate the laws of many states, it is CRL's understanding that County Bank does not allow its partners to make payday loans in Delaware, which has no usury cap, nor does County Bank itself make "its" payday loan product available to its customers in County Bank's branch network.

C. <u>*Bounce Loans*</u>

Financial institutions' increasing use of "bounce protection" loan products that charge exorbitant rates of interest is a disturbing trend that reflects a failure to provide small loans on reasonable terms. Fee-based overdraft loans are aimed at low- and moderate-income account holders with little or no savings, a category of people CRA is intended to assist. While CRL has many concerns about bounce loan product,[23] at a minimum, § __.28(c) should provide that financial institution will not receive a CRA rating higher than "needs to improve" if it utilizes a bounce loan product:

> 1. That imposes "bounce protection" products on consumers without their opting in—including bounce loans that are automatically included with free or low-cost checking accounts—but does not offer those same customers more reasonable alternatives, such as overdraft lines of credit and transfers from savings accounts; or
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> 2. That does not provide Truth in Lending Act credit disclosures, including the finance charge and annual percentage rate (APR); or
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> 3. Through which the institution seizes Social Security, Supplemental Security Income, veteran's benefits or other governmental benefits to repay bounce loans.

The proposed § __.28(c)(1)(ii) applies only to home mortgage and secured consumer loans. Assuming that the agencies consider bounce loans to be unsecured, for the foregoing bounce loan standards to apply the provisions incorporating such a standard would need to apply to unsecured consumer loans.

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[23] These concerns are discussed in Letter from Martin D. Eakes, CEO, Center for Responsible Lending, to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System (Jan. 27, 2003), available at http://www.responsiblelending.org/pdfs/Bounce_Protection_Overdraft_Comment040203.pdf.

D. Additional laws should be listed in § ____.28(c)(1)(i)

The proposed § ___.28(c)(1)(i) properly lists important laws whose violation should aversely affect an institution's CRA ratings. In addition, several other laws should be added to the provision.

1. *State laws.* Section __.28(c)(1)(i) should list violations of state law as violations subject to CRA consideration. Recent actions by regulators such as the OCC to preempt state consumer protection laws and enforcement authority undermine creative state efforts to protect citizens from evolving financial abuses and create safe havens for predatory lenders. A financial institution's unwillingness to respect the laws that a state implements to protect the communities therein should adversely affect the institution's CRA rating.[24]

2. *Truth in Lending Act (TILA).* The proposed § ___.28(c)(1)(i) mentions only violations of TILA's provisions regarding borrowers' right of rescission. By restricting its coverage to the right of rescission, the provision suggests that other TILA violations will not be considered. This marks a change from the Inter-Agency Questions and Answers, which currently provide that evidence of violation of TILA provisions that deal with disclosures and certain loan term restrictions also will be considered. Section __.28(c)(1)(i)(E) should mirror the Inter-Agency Questions and Answers.

3. *Real Estate Settlement Procedures Act (RESPA).* Proposed § __.28(c)(1)(i)(D) lists only violations of Section 8 of RESPA, regarding kickbacks. In addition, the final rule should state that RESPA provisions regarding disclosures, seller-required title insurance, and limits on escrow accounts also will be considered.

4. *UDAP Regulations.* As noted, additional abusive practices need to be addressed in the existing UDAP regulations contained in Regulation AA, 12 C.F.R. Part 22'7, Subpart B and 12 C.F.R. Part 535. The existing and any new UDAP regulations should be listed in § __.28(c)(1)(i)(C), which also should continue to list violations of Section 5 of the FTC Act.

11. <u>The predatory lending standard should apply to all affiliates, not just those whose loans the bank has elected to have considered.</u>

The agencies have taken a positive step by providing in 12 C.F.R. § __.28(c)(1) that an institution's CRA evaluation will be adversely affected by evidence, in any

[24] Such a change would require a concomitant change to the Inter-Agency Questions and Answers Regarding Community Reinvestment (CRA Q&A). Currently, Section ____.28(c)-1 of the CRA Q&A and the associated text in the preamble states that violations of other consumer protection laws generally will not adversely affect an institution's CRA rating, but may warrant inclusion of comments in an institution's performance evaluation. The statement should be revised to state that such violations will adversely affect a bank's CRA rating.

geography, of discriminatory, other illegal, and abusive credit practices. With respect to affiliates, however, evidence of such practices by an affiliate would be considered only if an institution had elected to have the problematic affiliate's loans considered pursuant to 12 C.F.R. § __.22(c),[25] and only if the practices occurred in an assessment area. The proposed rule should be expanded to apply to such practices by any affiliate, in any geography.

Examined institutions themselves select which, if any, affiliates' loans are evaluated for CRA purposes.[26] The proposed rule permits institutions to easily avoid review of illegal or otherwise abusive practices by a problematic affiliate. Institutions simply can elect not to have affiliate loans considered in a particular lending category in assessment areas where a problematic affiliate makes loans in that category.[27] Institutions nevertheless can receive positive credit for activities in other lending categories by "good" affiliates in those same assessment areas, and in all lending categories in assessment areas where the "bad affiliate" does not operate. This selective review severely weakens the effectiveness of the proposed standard in addressing discriminatory, other illegal and abusive credit practices.

Furthermore, affiliates undertake significant levels of lending in areas that are not assessment areas at all. Institutions determine their own assessment areas, which basically are geographies in which the bank has its main office, branches, and its deposit-taking automated teller machines (ATMs).[28] Predatory lending destabilizes communities regardless of whether an institution has a deposit-taking branch or an automated teller machine (ATM) in that community. The effect on neighborhoods is especially striking in connection with residential mortgage lending. Communities suffer when an institution makes mortgage loans with abusive terms and conditions and strips the wealth of residents of a community. If predatory lending results in a rash of foreclosures in an area, that community faces reduced property values and widespread disinvestment. Predatory lending is just as devastating as, if not more devastating than, the denial of access to credit that CRA was enacted to confront. The U.S. Department of the Treasury (Treasury Department) and the U.S. Department of Housing and Urban Development (HUD) have

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[25] The agencies should clarify that 12 C.F.R. § __.28(c)(1) would apply to an affiliate's loans in *any* lending category regardless of the particular lending category in which the affiliate's loans were considered pursuant to § __.22(c).

[26] This treatment of affiliates inay encourage banks to overlook affiliates' actions, which poses risks to banks' safety and soundness. CRA requires that the agencies encourage institutions "to help meet the credit needs of the local coininunities in which they are chartered *consistent with the sufe and sound operation of such institutions.*" 12 U.S.C. § 2901(b) (emphasis added).

[27] It is true that, pursuant to 12 C.F.R. § __.22(c)(2)(ii), if the loans of any affiliate in a particular lending category are considered in an assessment area, then the loans of all affiliates in that lending category and assessment area will be considered. Still, if an affiliate engages in predatory mortgage lending in an assessment area, an institution nevertheless could avoid "negative" credit for that affiliate's actions by electing not to have affiliate mortgage loans in that assessment area considered. The institution nevertheless could get "positive" credit for affiliate loans in that same assessment area in <u>other</u> lending categories in which the predatory affiliate did not lend.

[28] Even if an institution originates or purchases a substantial portion of its loans in an area, the institution only has to include that area in an assessment area if it is in the surrounding area of a location where the institution has a main office, a branch, or a deposit-taking ATM.

recommended that the agencies "consider, in the context of their CRA examinations of banks and thrifts, whether those institutions may be supporting predatory lending through activities other than origination/purchase."[29]

Under the proposed rule, the agencies will consider discriminatory, other illegal, or abusive credit practices by affiliates only if they take place in assessment areas. Affiliates' actions in communities where an institution did not offer deposit services would not be scrutinized. Unfortunately, this rule would benefit institutions that make abusive loans through affiliates but do not offer any "offsetting" benefit to a community from depository services.[30] This flaw may have the undesirable consequence of discouraging institutions from placing branches or deposit-taking ATMs in particular areas in order to maximize the number of areas in which their affiliates may lend without scrutiny under § __.28(c).

The proposed limited consideration of the activities of affiliates does not effectuate the overall goals of CRA. CRA is intended to ensure that institutions do not simply profit from communities in which they do business without meeting the credit needs of those communities. It is illogical to ignore abusive loans—which certainly do not meet community credit needs—made by affiliates that collect significant fees and other income simply because the loans are made outside of an assessment area, or because an institution chooses not to have affiliate loans in that assessment area and lending category examined.

Depository institutions often profit from loans made by affiliates whether or not they seek positive CRA credit for affiliate loans. Many depository institutions buy and profit from loans originated by affiliates.[31] Also, affiliates profit from the name and reputation of an affiliated insured depository institution. Borrowers may decide to borrow from an affiliate because they expect the affiliate to provide loans of the same quality, and to face similar oversight, as the depository institution does. An affiliate with an atrocious record of predatory lending can still benefit from the good reputation and CRA rating of the depository institution with which it is affiliated. Of course, the proposed 12 C.F.R. § __.28(c) should apply to affiliates whether or not they have a

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[29] U.S DEPT. OF THE TREASURY AND U.S. DEPT. OF HOUSING AND URBAN DEVELOPMENT, JOINT REPORT ON RECOMMENDATIONS TO CURB PREDATORY HOME MORTGAGE LENDING 106 (2000).

[30] CRL believes that an institution's positive activities cannot outweigh the harmful effects of its predatory lending. Still, it is noteworthy that, with respect to scrutiny of affiliate practices, the proposed rule privileges institutions that have no branches in a community over those that have branches.

[31] The HUD/Treasury joint report recognized the many ways in which institutions may become linked to predatory practices by affiliates:

> Banks, thrifts and other prime lenders may not have in place adequate processes to ensure that they do not support predatory lending through their loan purchases, securitizations or lines of credit issued to other lenders. **As** these institutions increasingly become involved in the subprime mortgage market through their affiliates, opportunities for abusive lending activities to occur at the affiliate level may also increase.

U.S. DEPT. OF THE TREASURY AND U.S. DEPT. OF HOUSING AND URBAN DEVELOPMENT, *supra* note29, at 106.

similar name as a depository institution. Still, the CRA ratings do not provide meaningful information to consumers who borrow from one arm of a depository institution's family believing that the depository institution's "outstanding" rating indicates that they can safely borrow from the institution's affiliates.

For example, on the latest publicly available CRA Performance Evaluation for Wells Fargo Bank, **N.A.** (Wells Fargo), dated October 1, 2001, the bank received a rating of "Outstanding." Wells Fargo did not elect to have any affiliates considered as part of the examination.[32] However, Wells Fargo affiliates are important players in the home mortgage market, particularly with respect to subprime loans. In 2003, Wells Fargo Home Mortgage, Inc. (WFHMI) was the ninth largest subprime mortgage originator in the nation, with a 4.1% market share and over $11 billion in loans during the first nine months of 2003. Wells Fargo Financial, Inc. (WFFI) held approximately 1% of the subprime mortgage origination market in 2003 and originated approximately $3.5 billion in loans. The activities of these affiliates have been the subject of much scrutiny in the wake of allegations of lending abuses. Under the proposed § __.28(c), however, such abuses would not be considered except at Wells Fargo's election.

On May 1, 2003, the California Corporations Commissioner revoked the state Finance Lender Licenses, Residential Mortgage Lender License, and Residential Loan Servicer License of Wells Fargo Home Mortgage, Inc.[33] Wells Fargo and WFHMI sued, however, to prevent the Commissioner from exercising visitorial power over WFHMI, arguing that a regulation promulgated by the OCC (12 C.F.R. § 7.4006) preempted California state law as applied to WFHMI because the company was an operating subsidiary of Wells Fargo.[34] Though the Commissioner had sought to act only against WFHMI, Wells Fargo successfully argued that it had standing to sue the Commissioner, since it made residential mortgage loans through WFHMI and thus had sufficient interest in the action.[35] It is ironic that, while the OCC claims exclusive visitorial rights over WFHMI,[36] under the proposed 12 C.F.R. § __28(c) the OCC would not have the authority to examine the credit practices of WFHMI in conjunction with a CRA

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[32] The OCC's evaluation apparently included a fair lending review of Wells Fargo, as well as a statistical regression analysis of the home purchase loan product of Wells Fargo Home Mortgage, Inc. (WFHMI). The WFHMI analysis consisted of comparing the mortgage company's underwriting of Black and Hispanic applicants to that of white applicants and of a review of fair housing complaints registered against the bank and mortgage company. See Community Reinvestment Act Performance Evaluation of Wells Fargo Bank, N.A. (Oct. 1, 2001) at 12. The OCC did not find illegal discrimination or substantive violations of applicable fair lending laws and regulations. See id. It is not clear whether the review considered the terms and conditions of credit provided, in addition to the fairness of the underwriting process. Examination of abusive loan terms and conditions are warranted, and 12 C.F.R. § __.28(c) should require consideration of evidence of abuses by any affiliate.

[33] See Decision in the Matter of the Accusation of the California Corporations Commissioner v. Wells Fargo Home Mortgage, Inc., Case No. 413-0088, OAH No. N2003020615 (May 1, 2003), available at http://www.corp.ca.gov/enf/info/lit/wf/cfldecision.pdf, and Decision in the Matter of the Accusation of the California Corporations Commissioner v. Wells Fargo Home Mortgage, Inc., Case Nos. 603-6147, 603-6148, 603-5658, & 605-1436, OAH No. N2003020658 (May 1, 2003), available at http://www.corp.ca.gov/enf/info/lit/wf/crmladecision.pdf.

[34] See Wells Fargo v. Boutris, 265 F.Supp .2d 1162, 1171 (E.D. Cal. 2003).

[35] See id. at 1163.

[36] See Bank Activities and Operations, 69 Fed. Reg. 1895 et seq. (codified at 12 C.F.R. § 7.4000).

examination unless Wells Fargo itself requested that the OCC consider WFHMI loans. Since Wells Fargo is able to receive an "Outstanding" CRA rating without consideration of affiliates, however, it has little incentive to request that WFHMI be considered.

There also is substantial evidence that Wells Fargo Financial, Inc. (WFFI) has engaged in a variety of predatory practices. These practices include the charging of excessive points and fees, flipping, regular imposition of extremely high prepayment penalties, use of yield spread premiums, deceptive marketing/use of live checks, and egregious underreporting of Home Mortgage Disclosure Act data, particularly regarding race.[37] Abusive practices by WFHMI and WFFI clearly are relevant to an examination of Well's Fargo performance in meeting community credit needs.

Of course, Wells Fargo is not the only institution whose affiliate credit practices raise concerns. State and federal regulators have approved acquisitions by large banks of institutions whose abusive lending practices have triggered significant objections by consumer and community advocates. For example, HSBC Holdings plc acquired Household International, Inc. and affiliated institutions, and Citigroup, Inc., acquired Associates First Capital Corporation and affiliated institutions. Any continued concerns about the practices of HSBC and Citigroup affiliates should be investigated during CRA examinations. The proposed 12 C.F.R. § __.28(c) should be revised to require automatic consideration of abuses by affiliates.

III. <u>Increasing the small bank threshold would improperly decrease the review of and available data on banks with assets between $250 million and $500 million</u>

Under the new "small bank" definition, over 1,100 additional banks with over $387 billion in combined assets would face inadequate review. The current small bank performance standard contains a less stringent lending standard than the large bank test and does not contain an investment test or a services test. The proposed change to the small bank definition would remove the incentive banks with assets between $250 million and $500 million have to open or maintain bank branches and to develop effective services, such as low-cost checking accounts, that offer much-needed alternatives to such fringe financial services as check cashing and postal money orders. Increasing the small bank threshold also reduces the likelihood that the more than 1,100 institutions that would become small banks will invest in community development through such mechanisms as the Low Income Housing Tax Credits, a critical means of affordable housing development. Small towns and rural areas, where small banks account for a significant market share, will receive less investment and decreased services.

CRA disclosure also will suffer under the proposed rule. Under the proposed rule, banks with assets between $250 million and $500 million no longer would have to

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"Some of these abuses are detailed in Wells Fargo's Application to Acquire Pacific Northwest Bancorp: An Analysis of Its Implications for Consumers in Washington State, submitted by Martin D. Eakes, CEO, Center for Responsible Lending, to Federal Reserve Board of San Francisco (July 25, 2003), available at http://www.predatorylending.org/pdfs/WF_Research_to_FRB_072503.pdf.

collect or report data on loans to small businesses and small farms. This fact is striking given that smaller institutions are more active in lending to small businesses than larger institutions.[38] Presumably, small banks maintain rudimentary information regarding loans to small businesses and farms, since the small bank review requires consideration of a bank's lending record to businesses and farms of different sizes. All small banks should have to collect the basic loan data on small businesses and small farm loans required by 12 C.F.R. § __.42(a) and to report the data required by 12 C.F.R. § __.42(b)(1).[39]

Allowing more than 1,100 institutions to now avoid the more stringent large bank examination ignores the fact that smaller institutions may be more likely than larger ones to try to increase profits through risky activities, such as partnerships with payday lenders. Unscrupulous payday lenders enter into rent-a-charter arrangements with depository institutions in order to circumvent state consumer protection laws that regulate or ban the predatory payday loan industry. Recognizing safety and soundness, reputational and other risks to the institutions they oversee, the OCC, the OTS and the FRB have acted to end such partnerships by institutions they regulate. The ten banks currently engaged in rent-a-charter arrangements all are supervised by the FDIC, which permits them to continue to engage in this risky and predatory arrangement.

Six of the ten banks are small banks under the current CRA standard and receive weak small bank review. Under the proposed change to the small bank definition, two additional rent-a-charter banks would become small banks—County Bank of Rehoboth Beach, DE (Delaware) and BankWest, Inc. (South Dakota). Partners of these banks make illegal payday loans in several states. For example, the Georgia Industrial Loan Commissioner has investigated usurious payday loans made by Advance America, which partnered with BankWest, Inc.[40] County Bank of Rehoboth Beach, DE has only eight branches but partners with over a dozen third-party storefront payday lenders and dozens

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[38] See JOINT CENTER FOR HOUSING STUDIES, THE 25TH ANNIVERSARY OF THE COMMUNITY REINVESTMENT ACT: ACCESS TO CAPITAL IN AN EVOLVING FINANCIAL SERVICES SYSTEM 18 (2002).

[39] The examining agency also should have to prepare a CRA Disclosure Statement on small business/small farm lending by each small bank, as now required for large banks pursuant to 12 C.F.R. § __.42(h)(1)-(3).

[40] Georgia's Industrial Loan Commissioner has investigated Advance America for making payday loans at an annual interest rate of 443.21%, in violation of the Georgia Industrial Loan Act. In a case determining the Commissioner's authority to conduct an investigation, the court stated:

> The terms of the [Marketing and Servicing] Agreement provide some support for the Commissioner's concern about the relationship between Advance Ainerica and Bank West. Advance America receives the majority of the fee or interest charged on each loan and retains almost all of the risk of loss on each loan. Advance America also agrees to indemnify Bank West for claims relating to the loans where Bank West is named and Advance America and not Bank West is found to have violated the law; Bank West does not indemnify Advance America for reciprocal claims. The Commissioner also introduced evidence showing that Advance America offers loans in its own name in Florida, where payday lending is legal, but that it affiliates with an out-of-state bank in states where payday lending is illegal, such as Georgia.

BankWest. Inc. v. Oxendine, 2004 WL 550754 at *4.

of internet-based payday lenders. One such partner is Check 'n Go,[41] which has over 40 branches in North Carolina at which it makes payday loans that violate North Carolina law.

Given that CRA promotes the meeting of community credit needs with appropriate products, close CRA review is required of institutions that instead enter into rent-a-charter relationships with payday lenders who sell borrowers high cost credit. Smaller institutions appear to be more prone to engage in this predatory practice. Regardless of the test under which an institution is examined, the agencies should stringently apply the standard regarding discriminatory, other illegal, and abusive credit practices.

IV. Conclusion

The agencies should strengthen proposed 12 C.F.R. § __.28(c) to address specific mortgage lending practices that strip equity, increase the risk of or decrease the ability to defend against foreclosure, and target vulnerable groups. Furthermore, the FRB, the OTS and the NCUA should list specific abuses in the UDAP regulations, as required by Section 18(f)(1) of the FTC Act. The proposed standard regarding discriminatory, other illegal, and abusive credit practices should be revised to list rent-a-charter partnerships pursuant to which loans are made in violation of state law, as well as bounce loan products that do not meet the standards discussed herein, as abuses subject to consideration.

CRL also recommends that the standard require consideration of violations of state law, as well as TILA provisions regarding disclosures and certain loan term restrictions and RESPA provisions regarding disclosures, seller-required title insurance, and limits on escrow accounts. The standard also should apply to all of the affiliates of an insured depository institution. In addition, CRL objects to the proposed change to the small bank definition, which would lead to an unacceptable decrease in the review of, and available data on, more than 1,100 financial institutions.

Thank you for your consideration of CRL's comments. Please do no hesitate to contact us should you desire additional information.

Sincerely,

Mark Pearce
Assistant Director

Jamie Z. Goodson
Policy Counsel

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[41] The fact that Check 'n Go inakes loans in North Carolina through County Bank is clearly stated at **http:llwww.checkngo.conl/teiiiplateslfind.asp.**