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Public Information Room
Mailstop 1-5
Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, DC 20219
regs.comments@occ.treas.gov
Docket No. 04-05

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551
regs.comments@federalreserve.gov
Docket No. R-1180

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
comments@fdic.gov

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552
regs.comments@ots.treas.gov
Attention: No. 2003-67

Ladies and Gentlemen:

The Center for Responsible Lending (CRL) appreciates the opportunity, in connection with the Economic Growth and Regulatory Paperwork Reduction Act of 1996, to comment on changes needed with respect to several lending-related consumer protection regulations.

Durham, NC Office
302 W. Main Street
Durham, NC 27701
P: (919) 956-4400
F: (919) 313-8595

Washington, DC Office
1420 K Street, N.W.
Suite 200
Washington, DC 20005
P: (202) 349-1850
F: (202) 289-9009

CRL is a non-profit, nonpartisan policy and research organization that works to eliminate abusive financial practices. Dedicated to protecting homeownership and family wealth, CRL promotes responsible lending practices and access to fair terms of credit for low-wealth families. As a member of a coalition with organizations that represented over three million North Carolinians, CRL helped to pass North Carolina's strong, statute against predatory lending. CRL continues to promote legislative and regulatory efforts to address predatory lending issues. CRL is also affiliated with 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.

In our comments, we will focus on those issues that were most prevalent in the public discussions of EGRPRA concerns conducted by the agencies, rather than address every possible topic covered by the EGRPRA categories. CRL's comments will focus on three of the listed categories:

- The Home Mortgage Disclosure Act (HMDA) and Regulation C: We strongly recommend maintaining existing rules under Regulation C. While HMDA data collection could be improved, at a minimum, recent changes significantly enhanced HMDA data collection and should be given time to take effect.
- The Truth in Lending Act (TILA) and Regulation Z: It is essential that the three-day-right of rescission remain intact in order to provide consumers with critical time to weigh the costs of encumbering their home. We also recommend two adjustments to existing rules — modernizing caps on statutory damages and jurisdiction, and updating Regulation Z to reflect that “bounce protection” products are loans subject to TILA.
- Unfair and Deceptive Acts and Practices: CRL recommends updating regulations on unfair and deceptive acts and practices applicable to banks, thrifts, and credit unions to reflect current mortgage lending abuses.

I. HMDA

Some lenders argue that data retrieved pursuant to HMDA and Regulation C lacks utility. Though HMDA data have their limitations, it would be extremely difficult to obtain reliable information about financial institutions' credit practices if collection and disclosure of HMDA data were not mandated. CRL believes that HMDA data collection could be improved.¹ Still, HMDA data has proven to be invaluable in meeting the goals

¹ The most significant change that CRL recommends for HMDA reporting is that the HOEPA Yes/No field be replaced with a field for disclosure of the number of points and fees, as defined by the Home Ownership and Equity Protection Act of 1994 (HOEPA), if they exceed 2%. The average origination fee in conventional loans is just 1.1%, so a 2% threshold is designed to capture high points and fees. Required reporting of annual percentage rate without mandated reporting of points and fees gives lenders and incentive to receive their compensation in fees rather than rate, contrary to responsible lending practices.

set forth in HMDA and Regulation C. As succinctly stated in 12 C.F.R. § 203.1(b), the purposes of Regulation C are:

- (i) To help determine whether financial institutions are serving the housing needs of their communities;
- (ii) To assist public officials in distributing public-sector investment so as to attract private investment to areas where it is needed; and
- (iii) To assist in identifying possible discriminatory lending patterns and enforcing antidiscrimination statutes.

HMDA data was instrumental in the passage of the Community Reinvestment Act (CRA), which has benefited communities nationwide. HMDA data remain a critical component of CRA reporting² and contribute greatly to an understanding of the CRA's effectiveness.³ Furthermore, data collected pursuant to HMDA have enabled numerous government agencies⁴ and other researchers⁵ to study how financial institutions serve or fail to serve the housing needs of different communities and to investigate discrimination by financial institutions. HMDA data also have been useful in determining the success of

For discussion of this and additional recommendations, see Letter from Martin D. Eakes, Coalition for Responsible Lending, to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System (Docket No. R-1001) (Mar. 9, 2001); Letter from Martin D. Eakes, Coalition for Responsible Lending, to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System (Docket No. R-1120) (Apr. 12, 2002).

² See 12 C.F.R. § __.42(b)(3) of the CRA regulations of the Federal Reserve Board (§ 228.42(b)(3)), the Federal Deposit Insurance Corporation (§ 345.42(b)(3)), the Office of the Comptroller of the Currency (§ 25.42(b)(3)), and the Office of Thrift Supervision (§ 563e.42(b)(3)).

³ See, e.g., JOINT CENTER FOR HOUSING STUDIES, THE 25TH ANNIVERSARY OF THE COMMUNITY REINVESTMENT ACT: ACCESS TO CAPITAL IN AN EVOLVING FINANCIAL SERVICES SYSTEM viii (2002) ("No other data source affords the opportunity to analyze lending patterns and trends by borrower income, race/ethnicity or gender in such detail. Further, HMDA loans are geo-coded to census tracts, allowing a rich exploration of the impact on CRA on lending in lower-income, minority, or other historically underserved market areas.")

⁴ See, e.g., 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 (2000), U.S. DEPT. OF HOUSING AND URBAN DEVELOPMENT, UNEQUAL BURDEN: INCOME AND RACIAL DISPARITIES IN SUBPRIME LENDING IN AMERICA (2000); RANDALL M. SHEESSELE, BLACK AND WHITE DISPARITIES IN SUBPRIME MORTGAGE REFINANCE LENDING (U.S. Dept. of Housing and Urban Development, Working Paper No. HF-014, April 2002).

⁵ See, e.g., NATIONAL COMMUNITY REINVESTMENT COALITION, THE BROKEN CREDIT SYSTEM: DISCRIMINATION AND UNEQUAL ACCESS TO AFFORDABLE LOANS BY RACE AND AGE (2003); BUNCE, HAROLD ET AL., SUBPRIME FORECLOSURES THE SMOKING GUN OF PREDATORY LENDING? (U.S. Department of Housing and Urban Development, 2001); NATIONAL TRAINING AND INFORMATION CENTER, PREYING ON NEIGHBORHOODS: SUBPRIME MORTGAGE LENDING AND CHICAGOLAND FORECLOSURES (1999); Dan Immergluck, *Stark Differences: Explosion of the Subprime Industry and Racial Hypersegmentation in Home Equity Lending*, in HOUSING POLICY IN THE NEW MILLENNIUM CONFERENCE PROCEEDINGS (U.S. Dept. of Housing and Urban Development, 2001); ASSOCIATION OF COMMUNITY ORGANIZATIONS FOR REFORM NOW (ACORN), SEPARATE AND UNEQUAL: PREDATORY LENDING IN AMERICA (2000); BRADFORD, CALVIN, RISK OR RACE: RACIAL DISPARITIES AND THE SUBPRIME REFINANCE MARKET (Center for Community Change, 2002).

state anti-predatory lending laws in addressing abusive practices without unduly restricting access to subprime credit.⁶ Recent enhancements to HMDA data will improve the ability of government agencies and others to identify and address predatory lending practices that cost American households millions of dollars and weaken the safety, soundness, and fairness of our nation's financial institutions.

The Federal Reserve Board (FRB) has recently undertaken a careful review of Regulation C's provisions and considered hundreds of comments on several recent proposed rules. The FRB issued a series of substantive final rules in 2002.⁷ Due to complaints from financial institutions about the deadline for compliance with the first of those rules, however, the FRB postponed the effective date for most changes under that rule for an entire year, until January 1, 2004.⁹ Therefore, many of the significant changes to Regulation C have been in effect for only a few months. The implementation of regulations that will provide critical information regarding the availability and terms of credit to Americans has already been postponed in order to accommodate concerns with regulatory burden.⁹ Insufficient time has passed to permit a fair consideration of the benefits and burdens of those changes.

Furthermore, it is necessary to consider the extent to which complaints about HMDA reflect institution's concerns about competition from institutions that are not covered by HMDA. Leveling the playing field by including more institutions in the definition of "financial institution" under § 203.2(e) would address concerns about competitive disadvantage. To exempt lenders who are not significant mortgage lenders from HMDA reporting, 12 C.F.R. § 203.2(e)(2) provides that a for-profit mortgage-lending institution (other than a bank, savings association, or credit union) is required to report under HMDA only if the institution:

- (i) In the preceding calendar year, either:
 - (A) Originated home purchase loans, including refinancings of home purchase loans, that equaled at least 10 percent of its loan-origination volume, measured in dollars; or
 - (B) Originated home purchase loans, including refinancings of home purchase loans, that equaled at least \$25 million; and
- (ii) On the preceding December 31, had a home or branch office in an MSA; and

⁶ See, e.g., ERNST, KEITH, FARRIS, JOHN, & STEIN, ERIC, NORTH CAROLINA'S SUBPRIME HOME LOAN MARKET AFTER PREDATORY LENDING REFORM (Center for Responsible Lending, 2002)

⁷ See 67 Fed. Reg. 7222 *et seq.* (February 15, 2002), 67 Fed. Reg. 43,218 *et seq.* (June 27, 2002), and 67 Fed. Reg. 79,844 *et seq.* (December 31, 2002).

⁸ See 67 Fed. Reg. 30,771-30,772 (May 8, 2002).

⁹ One specific change to Regulation C suggested in banker outreach meetings was to increase the asset size threshold for exemption from data collection and reporting requirements or, alternatively, to use a different test for exemption, such as a market share test. As discussed in the final rule published at 67 Fed. Reg. 7221, 7224-7225 (Feb. 15, 2002), the FRB already has considered in depth the appropriate scope of Regulation C's coverage. Like most of the other regulations implemented through that final rule, however, the exemption thresholds did not become effective until January 1, 2004.

(iii) Either:

- (A) On the preceding December 31, had total assets of more than \$10 million, counting the assets of any parent corporation; or
- (B) In the preceding calendar year, originated at least 100 home purchase loans, including refinancings of home purchase loans.

As CRL recommended in a comment letter to the FRB dated March 9, 2001,¹⁰ the FRB should remove the 10% threshold in subsection (i)(A) and should substitute the 100 loan threshold currently located in subsection (iii)(B). The 10% threshold permits some of the largest and fastest growing subprime lenders to avoid HMDA reporting because their activities in other areas far outstrip their home mortgage lending. The FRB also should reduce the \$25 million threshold in subsection (i)(B) to \$10 million. Smaller lenders can be significant players in local housing markets.

In addition, 12 C.F.R. § 203.2(e)(2) should require consideration not only of an institution's home purchase loans and refinancings of home purchase loans, but rather all of an institution's HMDA-reportable originations. Under the current definition of "refinancing" in 12 C.F.R. § 203(k), a refinancing of a previously refinanced home purchase loan could be excluded from coverage. This result is problematic given the predatory practice of repeatedly refinancing loans without a net tangible benefit to the borrower. Furthermore, the refinancing of unsecured debt with a home-secured loan is another troubling practice, and Regulation C should require that such loans be reported.

11. TILA

The Truth in Lending Act is an important consumer protection act that benefits borrowers. CRL believes that (1) the three-day right of rescission should remain intact, (2) the statutory and jurisdictional caps should be increased, or at a minimum adjusted for inflation, and (3) Regulation Z needs to be updated to reflect that "bounce protection" products are in fact loans to which TILA applies.

1. Right of Rescission

- a. *The three-day right of rescission is critical for borrowers who are deciding whether to encumber their home.*

The three-day right of rescission under TILA is critical and should remain intact. Contrary to the arguments of some lenders, the right of rescission works to protect consumers. In the U.S. today, one-half of all homeowners in the bottom quintile of income distribution hold at least 80% of their net worth in home equity, and fully 61.8%

¹⁰ Letter from Martin D. Eakes, Coalition for Responsible Lending, to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System (Docket No. R-1001) (Mar. 9, 2001).

of black households' net worth consisted of the equity in their home.¹¹ Taking out a loan secured by one's home, is an important decision, and borrowers should be afforded the time to consider it carefully. Congress prudently has provided the consumer with "an opportunity to reconsider any transaction which would have the serious consequence of encumbering the title to his home."¹² The three-day rescission period allows consumers to weigh the costs and benefits of the transaction in question without pressure from lenders or brokers. Furthermore, whether or not consumers do rescind, knowing that the consumer has the option to rescind provides an incentive for lenders to act honestly and comply with the law.

Realistically, consumers also need time to carefully review loan documents to determine whether the provisions indeed reflect the agreement of the consumer and the lender and the representations of the lender or mortgage broker to the consumer. Loan documents often change until the day of closing. Under the Real Estate Settlement Procedures Act, the settlement agent does not have to provide the HUD-1 Settlement Statement until one business day before closing. Many predatory lending abuses occur in the context of mortgage refinancing, which under certain conditions is covered by the three-day right of rescission. Further, we have heard numerous stories in which the borrower is presented at closing with a new set of loan documents that list previously undisclosed costs associated with the mortgage. This three-day period provides an essential final opportunity for borrowers to uncover abusive terms and conditions. Now that predatory practices are receiving more attention, consumers may scrutinize their loan documents more carefully. At a time when evidence of mortgage lending abuses is increasing, it would be inappropriate for the three-day right of rescission to be eliminated.

b. Existing exception for emergencies and delay in creditor's performance.

While lenders have raised concerns about customers desperate for funds to pay for a medical or other emergency who are forced to wait because of the rescission right, Regulation Z already addresses this issue. A consumer may waive his or her rescission right in the case of a bona fide personal financial emergency that must be met before the end of the rescission period. Sections 226.15(e) and 226.23(e) of Regulation Z provide that all a consumer must do to waive the rescission right is to give a written, signed statement that specifically waives or modifies the right and includes a brief description of the emergency. Similarly, concerns about funding loans in an emergency could be addressed through adjustments to the delay of creditor's performance regulations at 12 C.F.R. §§ 226.15(c) and § 226.23(c). It is not necessary to withdraw the three day rescission to accommodate these issues.

¹¹ JOINT CENTER FOR HOUSING STUDIES OF HARVARD UNIVERSITY, STATE OF THE NATION'S HOUSING: 2003, at 7 (2003); "Net Worth and Asset Ownership of Households, 1998 and 2000," at 15 tbl. I (U.S. Census Bureau, P70-8, May 2003).

¹² S. REP. 96-368, at 28 (1980), *reprinted in* 1980 U.S.C.C.A.N. 236,264.

c. Premature Waiver

In some cases, lenders encourage borrowers to sign a document, in advance of the expiration of the unconditional three-day right of rescission, by which the borrower purportedly elects not to rescind the transaction or falsely states that the rescission period has ended. Such an election is inimical to the purpose of the rescission right. It is very likely that the consumer will not even have heard of the rescission right until the date of loan settlement. The consumer will not have had time to truly consider the advisability of waiving the right. It is a common abuse to provide such a waiver on a pre-printed form, increasing the potential that a consumer would not carefully consider the rescission right, but rather would inadvertently sign away the right. Regulation Z should not permit waivers of the rescission right except in the event of a bona fide financial emergency, as currently provided in the regulation.

2. Adjustment of Caps for Damages and Jurisdiction for Inflation

The agencies should recommend that Congress adjust the statutory damages available under TILA. The Joint Report on Recommendations to Curb Predatory Home Mortgage Lending issued by the U.S. Dept. of the Treasury and U.S. Dept. of Housing and Urban Development (Joint Report) recommended this change, stating that damages currently available under TILA “may not be sufficient to deter unscrupulous lenders and brokers from engaging in practices that are illegal under [TILA and the Real Estate Settlement Procedures Act].”¹³ At the very least, the statutory damages should be adjusted for inflation and should continue to adjust annually. In today’s dollars, the low maximum statutory damages deter individuals from bringing TILA actions; such actions often do not make sense from a cost perspective.

With respect to 15 U.S.C. § 1640(a)(2)(A)(i)&(ii), the \$1,000 cap instituted in 1968 would equal \$5,350.57 in 2004 dollars when adjusted for inflation.¹⁴ In 1995, Congress added subsection (iii), regarding credit transactions (other than open end credit plans) that are secured by real property or a dwelling. The minimum and maximum damages set for such transactions doubled the existing minimum and maximum under subsections (i) and (ii) and so were set at \$200 and \$2,000, respectively. Doubling the 1968 statutory damages maximum and minimum, as adjusted for inflation to 2004 dollars, would provide for a minimum of \$1,070.12 and a maximum of \$10,701.14 in statutory damages under subsection (iii). The \$500,000 cap (1976 dollars) on total recoveries in class actions in 15 U.S.C. § 1640(a)(2)(B) also should be adjusted for inflation and should continue to adjust each year.

Furthermore, 15 U.S.C. § 1603(3) currently provides that TILA does not apply to credit transactions in which the total amount financed exceeds \$25,000, unless a security

¹³ 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 70 (June 20,2000).

¹⁴ See Consumer Price Index, Inflation Calculator, U.S. Dept. of Labor, Bureau of Labor Statistics, <http://liwww.bls.eovibls/inflation.htIn>. The minimum statutory damages of \$100 would be \$535.06 in 2004 dollars.

interest is or will be acquired in real property or in personal property that is used or expected to be used as the consumer's principal dwelling. This cap leaves even moderately priced "family" automobiles without TILA coverage. The \$25,000 jurisdictional cap should be adjusted to account for inflation and should adjust annually.

On the other hand, tolerance levels for error¹⁵ should not be adjusted for inflation. Technology permits creditors to make increasingly more accurate calculations. There is no reason for lenders to be permitted to make larger errors as time passes.

3. *Bounce loans*

The treatment of bounce/overdraft loans by the FRB is outdated. The failure to treat bounce loans as credit transactions subject to TILA disclosures reflects an obsolete view of bounce loan charges as being equivalent to non-sufficient funds (NSF) fees. Bounce loans are more appropriately compared to payday loans. Bounce loan charges are a cost for extending credit, and Regulation Z should be revised to reflect this fact.

TILA defines "finance charge" as "the sum of all charges, payable directly or indirectly by the person to whom the credit¹⁶ is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit."¹⁷ Regulation Z defines "finance charge" as "the cost of consumer credit as a dollar amount" and states that "[i]t includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit."¹⁸ Both definitions exclude charges of a type payable in a comparable cash transaction."

As an example of a finance charge, 12 C.F.R. § 226.4(b)(2) lists "[s]ervice, transaction, activity, and carrying charges, including any charge imposed on a checking or other transaction account *to the extent that the charge exceeds the charge for a similar account without a credit feature.*"²⁰ Financial institutions argue that a charge levied in

¹⁵ See, e.g., 15 U.S.C. §§ 1605(f) and 1635(i)(2).

¹⁶ TILA defines "credit" as "the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment." 12 U.S.C. § 1602(e).

¹⁷ 12 U.S.C. § 1605(a).

¹⁸ 12 C.F.R. § 226.4(a).

¹⁹ See *supra* nn. 17&18.

²⁰ Arguably, the bounce loan charge is interest on the loan, which would automatically be included in the finance charge pursuant to 12 C.F.R. § 226.4(b)(1). Neither TILA nor Regulation Z defines "interest," however. Financial institutions also cite 12 C.F.R. § 226.4(c)(3), which excludes from the finance charge "[c]harges imposed by a financial institution for paying items that overdraw an account, unless the payment of such items and the imposition of the charge were previously agreed upon in writing." While institutions argue that their payment of funds drawn on accounts with insufficient funds is discretionary rather than contractual, in reality this is a ploy to exploit a TILA loophole. In practice, financial institutions make such advances unless an account is in default or a customer has exceeded overdraft limits. Bounce loan products generally are formal products for which there are profitability targets and which are administered by bank consumer lending units and personnel. Banks' securities filings often list bounce loan products as a target "profit center," indicating that they are not an incidental customer accommodation. Vendors who sell computer software used in connection with bounce loans market the bounce loan product to financial institutions as a source of revenue, and the product indeed serves to increase revenue significantly. Financial institutions use specially targeted marketing to promote the product. Despite fine print indicating

connection with a financial institution's advance of funds to a consumer for payment of an overdraft fits the foregoing exception, as long as the charge does not exceed an institution's NSF fee. This analysis ignores the critical point that it is impossible to equate a charge for the advance of funds to any charge on an account with no credit feature, since no advance of funds is possible on the latter account.²¹

Despite a superficial similarity between the charge for an advance on a checking account with an overdraft feature and an NSF fee, the two situations bear no real relationship to one another. A charge made in connection with a bounce loan is a charge a financial institution levies for the extension of credit.²² An NSF fee, in contrast, represents the cost of processing a draw on an account with insufficient funds, plus a penalty for attempting to draw on that account. The flat NSF fee is not connected at all to the cost of extending credit to the account holder. Using the NSF fee amount as the automatic charge for bounce loans eliminates price competition for bounce loans and makes it difficult for consumers to compare the cost of obtaining credit on their checking account.

This result flies in the face of the intent of TILA. As the FRB has stated,

TILA, as implemented by Regulation Z, reflects the intent of the Congress to provide consumers with uniform cost disclosures to promote the informed use of credit and assist consumers in comparison shopping. This purpose is furthered by applying the regulation to transactions, such as payday loans, that fall within the statutory definition of credit, regardless of how such transactions are treated or regulated under state law.

It is clear that a financial institution extends credit, as defined in 12 U.S.C. § 1602(e), when it advances funds to an account holder to cover amounts drawn on an account that lacks sufficient funds, and permits the account holder to repay the advance at a later date. Because a consumer receives a cash advance in exchange for the consumer's authorization to debit the consumer's deposit account, bounce loan charges are like fees on payday loans.

In connection with payday loans, the FRB has stated that "[t]ypically in such transactions, a cash advance is made in exchange for the consumer's personal check, or the consumer's authorization to debit the consumer's deposit account electronically. In

that an institution has discretion to decline to cover an overdraft, advertisements, account agreements, and other writings show that the bounce loan product is offered subject to an agreement, albeit an adhesion contract. It is clear that bounce loan products are a revenue-producing loan product rather than a simple courtesy extended to the customer at the institution's discretion.

²¹ This point assumes that the financial institution returns, rather than pays, amounts drawn on NSF accounts. If the institution paid the amounts drawn, then the account would have a credit feature and the exception in § 226.4(b)(2) would not apply.

²² 12 U.S.C. § 1602(e) defines "credit" as the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment. When a financial institution advances an account holder funds to cover a draw on an account and permits the account holder to repay the advance at a later date, the institution extends credit.

either case, the consumer pays a fee in connection with the advance.”²³ The FRB already has determined that payday loans constitute credit under TILA and that fees charged in connection with payday loans may be finance charges under 12 C.F.R. § 226.4 and therefore subject to Regulation Z disclosure requirements.²⁴ Like payday loans, bounce loans are a cash advance in exchange for a consumer authorization of an electronic debit from the consumer’s account, in the amount of the advance plus an additional charge.²⁵ Since the account has insufficient funds to cover the debited funds, payment of the debt is deferred.

Bounce loans are substantially similar to payday loans and should be treated the same under Regulation Z.²⁶ The FRB has acknowledged that applying Regulation Z to transactions that fall within the statutory definition of credit furthers the purposes of TILA. Charges for the advance of funds to cover overdrafts clearly are a cost of credit. Accordingly, the FRB should clarify that Regulation Z applies to bounce loans.

111. Unfair and Deceptive Acts or Practices

The unfair and deceptive acts or practices regulations applicable to banks²⁷ and thrifts²⁸ (UDAP regulations) have failed to keep up with mortgage lending abuses known to be unfair or deceptive to consumers. In order to prevent banks, thrifts and credit unions from engaging in unfair or deceptive acts or practices in or affecting commerce, including acts which are unfair or deceptive to consumers, Section 18(f)(1) of the FTC Act mandates the promulgation of regulations “defining with specificity such unfair or deceptive acts or practices, and containing requirements prescribed for the purpose of preventing such acts or practices.”²⁹ The UDAP regulations, however, do not address a

²³ See Truth in Lending, 65 Fed. Reg. 17129 (Mar. 31, 2000).

²⁴ See 12 C.F.R. §226.4(a)(14) and cmt. 2.

²⁵ Also like payday loans, bounce loans come at an exorbitant price. Assume a bank charges \$30 per overdraft paid. Some banks permit disbursement of cash at ATMs even when there are insufficient funds in the account to cover a requested transaction, without notifying the customer that the account lacks sufficient funds. If a customer with a balance of \$80 withdraws \$100 from an automated teller machine and repays the \$20 deficit at the end of one week, the annual percentage rate would be 7,821%. If the customer repaid the loan at the end of two weeks, the annual percentage rate would be 3,911%.

²⁶ Bounce loans share with payday loans the use of disturbing tactics to maximize revenue to the lender. In addition to failing to notify customers when a requested ATM withdrawal requires use of a costly overdraft product, other troubling practices include designing computer software to pay large checks first, which depletes a consumer’s account more quickly and allows the financial institution to impose a greater number of flat-rate overdraft charges when covering later smaller checks. Since in reality the presence of the overdraft feature means that none of the checks will bounce, there is no reason to pay larger checks first, unless the goal is to maximize fee income. Most institutions also continue to make advances and impose charges on accounts that are repeatedly overdrawn and even on accounts where the customer does not repay the overdrafts within the set time-period. The Office of the Comptroller of the Currency has recognized that bounce loans are extensions of credit and has expressed concern about a number of practices associated with bounce loan products. See OCC Interpretive Letter No. 914, at 3 (Aug.3, 2001).

²⁷ See Regulation AA, Subpart B, 12 C.F.R. § 227.11-16.

²⁸ See 12 C.F.R. Part 535.

²⁹ 15 U.S.C. § 57a(f)(1). The Congressional mandate to issue such regulations is directed specifically to the Board of Governors of the Federal Reserve System (FRB), the Federal Home Loan Bank Board (now the Office of Thrift Supervision) (OTS) and the National Credit Union Administration (NCUA). See *id.*

number of unfair or deceptive practices that cause significant harm to consumers. Though some agencies have taken positive steps to address unfair and deceptive acts and practices, they have issued guidance rather than regulations to address them. This guidance has tended to promote disclosure of such practices rather than to specifically identify practices and promulgate requirements, as 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 "could reasonably have been avoided if the consumer had sufficient information to make an informed choice."³⁰ This statement suggests that an abusive practice would not be deemed unfair if the practice were sufficiently disclosed. 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. Sixteen of those twenty practices address institution's disclosures or advertising. The other four practices generally relate to 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 Section 18(f)(1) of the FTC Act mandates. By overemphasizing disclosures, the guidance ignores the fact that disclosures do not necessarily shield borrowers from abuse. As the General Accounting Office recently reported, "disclosures may be of limited usefulness in reducing the incidence of predatory lending practices."³¹

Furthermore, agency guidance generally fails to declare an act or practice to be unfair or deceptive, but rather sets forth general principles for consideration. For example, the OCC's Guidelines for National Banks to Guard Against Predatory and Abusive Lending ("Predatory Lending Guidelines), states that loan flipping and equity stripping *may* be unfair or deceptive acts under the FTC Act.³² The OCC Predatory Lending Guidelines state that "[n]ational banks should also consider 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."³³ Some agencies have relied on self-regulation or case-by-case investigations to address unfair or deceptive acts or practices. Congress, however, has clearly directed the FRB, the OTS and the NCUA to promulgate regulations that specifically define unfair or deceptive acts or practices and prescribe requirements to prevent them.³⁴

Generally, for an act or practice to be considered unfair, the practice must cause or be likely to cause substantial consumer injury that is not reasonably avoided by consumers and is not outweighed by countervailing benefits to consumers or

³⁰ Advisory Letter 2002-3, Mar. 22, 2002, at 5.

³¹ GENERAL ACCOUNTING OFFICE, CONSUMER PROTECTION: FEDERAL AND STATE AGENCIES FACE CHALLENGES IN COMBATING PREDATORY LENDING 14 (GAO-04-280 2004).

³² See Advisory Letter 2003-2, Feb. 21, 2003, at 4-5.

³³ *Id.* 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.

³⁴ See 15 U.S.C. § 57a(f)(1).

competition.³⁵ The general standard the Federal Trade Commission has outlined, and the OCC, OTS and FRB have followed, for finding an act or practice to be deceptive is that: (1) there is a representation, omission, act or practice that is likely to mislead; (2) the act or practice would be likely to mislead a consumer acting reasonably (if an act or practice targets a particular group, considering reasonableness from that group's perspective); and (3) the misleading representation, omission, act or practice is material.³⁶

There are at least three categories of abuses that should be addressed in the UDAP 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. Fannie Mae and Freddie Mac will not purchase loans where the points and fees constitute more than 5% of the loan amount.³⁷ Several state laws also have used points and fees exceeding five percent as a trigger for important consumer protections.³⁸ Several of the largest subprime home mortgage lenders cap their fees at 5% or lower. Lenders who charge fees in excess of 5% of the loan amount engage in an unfair practice.

b. *Loan flipping.*

Some lenders "flip" loans in order to garner origination and other fees. One particularly egregious form of this practice is intentionally "flipping" 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

³⁵ See 15 U.S.C. § 45(n).

³⁶ See Policy Statement on Deception (Federal Trade Commission, Oct. 14, 1983). See also Unfair or Deceptive Acts or Practices by State-Chartered Banks (Board of Governors of the Federal Reserve System and Federal Deposit Insurance Corporation, Mar. 11, 2004); Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices 4-6 (Office of the Comptroller of the Currency, Advisory Letter 2003-2, Feb. 21, 2003); Guidance on Unfair and Deceptive Acts or Practices 3-5 (Office of the Comptroller of the Currency, Advisory Letter 2002-3, Mar. 22, 2002).

³⁷ 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>

³⁸ See ARK. CODE ANN. §25-53-103(7)A(ii); GA. CODE 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 § 6-1(g)(ii); N.C. GEN. ST. §24-1.1E(6)b.

tangible benefit but rather extend credit in order to strip homeowner equity. The UDAP regulations should state that it is an unfair and deceptive practice to refinance an existing consumer home loan when the new loan does not have a reasonable, tangible net benefit to the borrower.

c. Packing and financing of ancillary products.

Another practice that strips equity up front is financing premiums for credit insurance (CI), debt cancellation coverage (DCC), or debt suspension coverage (DSC) rather than providing for monthly payments. Among other problems with CI, DCC, and DSC is that borrowers generally can obtain these products much more cheaply from another source. Many borrowers do not realize that coverage by the product may cease decades before the end of the mortgage term. Lenders can 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. The UDAP regulations should list the financing of CI, DCC, DSC, and other ancillary products as an unfair practice.

2. Practices that make borrowers vulnerable to foreclosure — particularly the imposition of loan terms and structures that make it difficult for borrowers to reduce or repay their indebtedness—and practices that restrict borrowers' ability to defend against foreclosure.

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.³⁹ Prepayment penalties are the rule in the subprime market, however. 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."⁴⁰ The subprime market should permit borrowers to transition into conventional financing as soon as the borrower is able. Prepayment penalties on subprime loans are designed to prevent this move. Such prepayment penalties increase the risk of foreclosure by locking subprime borrowers into high-rate loans when better loans are available. The use of prepayment penalties in subprime loans is an unfair practice.

³⁹ 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.

⁴⁰ "Legal Criteria Reaffirmed for the Securitization of Prepayment Penalties," *Standard & Poor's Online* (May 29, 2002).

b. Balloon payments and negative amortization in subprime loans.

Some lenders use the fact that balloon loans lower monthly mortgage payments to hide high rates and fees. This unfair and deceptive practice entices 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. Therefore, 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. Thus the loan amount due actually increases over time. In the context of high-cost subprime 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.

Mandatory arbitration clauses in adhesion contracts force prohibitive filing and other administrative fees on homeowners who cannot afford them, especially if they face foreclosure. Fees charged by private arbitrators generally are significantly higher than court fees. Also, lenders are likely to be repeat-players in arbitration. In their form loan documents, they can select a private arbiter or an arbitration forum known to favor industry. Arbitration is almost always a confidential process, with no public record. This feature prevents other homeowners from receiving information that could assist their claims and allows lenders to continue unjust or illegal actions in relative safety. Private arbitrators do not have to meet minimal competence standards or even to be licensed attorneys. In the arbitration process, homeowners are not guaranteed a full opportunity to develop and present their case through discovery and other mechanisms that are available in courts. In general, injunctive relief, class actions, and punitive damages are not permitted. The use of mandatory arbitration clauses in adhesion contracts should be listed in the UDAP regulations as an unfair practice.

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

For example:

a. Steering borrowers towards subprime products.

It is an unfair and deceptive practice to steer borrowers into a higher-cost credit product than that for which the borrower qualifies. 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.⁴¹ Steering borrowers into subprime rather than prime loans is an unfair practice and should be listed as such in the UDAP regulations.

⁴¹ Dennis Hevesi, “A Wider Loan Pool Draws More Sharks,” *New York Times*, March 24, 2002, sec. 11, p. 1.

b. Targeting particular ethnic groups, the elderly, or low-income or moderate-income people or neighborhoods.

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. Foreclosures, in turn, can increase the presence of vacant homes, devaluing property values and decreasing safety. Low- and moderate-income persons and residents of low- or moderate-income neighborhoods are not protected groups under either the Equal Credit Opportunity Act or the Fair Housing Act.

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. In 2000, upper-income African-Americans were more likely than low-income whites to receive a refinance loan from a subprime lender.⁴² Furthermore, the likelihood of receiving a refinance loan from a subprime lender increases as the percentage of blacks or Latinos in a borrower's neighborhood increases.⁴³ CRL believes that the UDAP regulations should convey the important message that pushing destructive credit onto particular groups is an unfair practice.

The foregoing abuses are unfair and deceptive and need to be addressed in Regulation A, Subpart B and in 12 C.F.R. Part 535. In their Joint Report, the U.S. Department of the Treasury and the U.S. Department of Housing and Urban Development stated that “[i]dentifying and restricting certain terms and conditions that are associated with many of the more abusive transactions in this market can reduce opportunities for predatory lenders to exploit some borrowers’ lack of knowledge.”⁴⁴ Congress has mandated that the FRB, the OTS, and the NCUA prevent banks, thrifts and credit unions from engaging in acts or practices that are unfair or deceptive to consumers. These agencies should comply with Section 18(f)(1) of the FTC Act by issuing UDAP regulations that address the unfair and deceptive mortgage lending acts and practices discussed above.

⁴² See CENTER FOR COMMUNITY CHANGE, RISK OR RACE? RACIAL DISPARITIES IN THE SUBPRIME REFINANCE MARKET 8 (2002).

⁴³ 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 comprised 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).

⁴⁴ U.S. DEPT. OF THE TREASURY AND U.S. DEPT. OF HOUSING AND URBAN DEVELOPMENT, *supra* note 13, at 57.

Thank you for the opportunity to comment on these matters. Please do not hesitate to contact us with any questions or comments.

Sincerely,

Deborah Goldstein
Senior Policy Counsel

Jamie Goodson
Policy Counsel