Comments of the National Consumer Law Center on bahalf of its Low Income Clients,
and
Consumer Federation of America, Consumers Union and National Association of Consumer Advocates

Community Reinvestment Act Regulations

12 CFR Part 25
Docket No. 04-06
Office of the Comptroller of the Currency

12 CFR Part 228, Regulation B
Docket No. R-1181
Board of Governors of the Federal Reserve System

12 CFR Part 345
RIN 3064-AC50
Federal Deposit Insurance Corporation

12 CFR Part 563e
No. 2004-04, RIN 1550-AB48
Office of Thrift Supervision

April 6, 2003

The National Consumer Law Center[1] files these comments on behalf of its low income clients, as well as the Consumer Federation of America, Consumers Union and the National Association of Consumer Advocates[2] with a special focus on low and moderate-income consumers who have been affected by predatory lending practices. Our primary goal in writing these comments is to persuade the federal banking regulatory agencies to either abandon or substantially change the proposal to include a specific predatory lending finding in an institution's CRA performance. Our secondary goal is to applaud the agencies for including loans made outside a particular geographic area in the institution's assessment, yet caution that even this expansion will not be helpful to addressing predatory lending unless the standard used is better articulated. Consideration of a bank's lending regardless of geographic area must also be extended to loans made in partnership with third parties such as payday loan companies that "rent" bank charters to make loans otherwise illegal under state law.

Unfortunately, we believe that the regulation, as currently proposed, would actually serve to facilitate and mask predatory lending activities by banking institutions and their affiliates. This is because the proposal is to evaluate only whether institutions are complying with –

1. current federal laws, which do not themselves prohibit activities which are abusive or predatory,
2. the FTC Act prohibiting unfair and deceptive trade practices, which – without additional specific prohibitions to Regulation AA3 – does not provide sufficient guidance to the examiners to determine whether the institution has engaged in predatory lending, and
3. the stated prohibition against equity stripping, which will not catch even the most blatant predatory loans based on the equity in the home rather than the income stream of the borrowers, because it does not require verification of income.

None of these three standards actually will enable a real evaluation of whether an institution is engaged in predatory or abusive lending. The standards do not ask the right questions to find predatory lending. If the right questions are not asked then the answers will be incorrect and misleading. The result will be that institutions will be found to have not engaged in predatory lending, even when they may have – just because the standards by which their lending activities are to be judged will not find abusive lending.

If the CRA assessment for predatory lending does not actually measure predatory lending, institutions may be given a positive grade which is incorrect – thereby justifying and shielding the institutions' real predatory lending activities. The result of the evaluation proposed will be that those institutions which have engaged in predatory lending will have an official assessment from their federal banking regulator finding that they have not engaged in a dangerous and abusive lending activity. This makes the proposal not only flawed, but actually affirmatively misleading. Efforts mounted in other arenas to address predatory lending by banking institutions, their operating subsidiaries, and their affiliates, will be significantly undermined by the false findings produced by this CRA measurement.

Making CRA Assessment of Predatory Lending Meaningful

It would be possible for the CRA analysis of an institution's compliance with the prohibition against engaging in predatory or abusive lending to be meaningful, but only if the clear standards articulating predatory or abusive behaviors were to be specified. However, as much as we and other representatives of consumer and community groups might agree that certain behaviors are clearly predatory, it is clear that much of the financial services industry would not agree, and thus the agencies are in the politically charged position of prohibiting activities which are technically legal under existing federal law. Given this dynamic, we find it unlikely that the Federal Reserve Board, the FDIC, the OCC and the OTS, will actually prohibit behaviors which are legal but abusive.

Arguably, under the current proposal despite the fact that the proposed regulations do not specify legal but abusive lending activities, the CRA examiners could find certain behaviors to be abusive. While we would always be hopeful that this would occur, we all are virtually certain that it will not. Banking agency employees regularly engaged in the process of determining institutional compliance based on standards proposed, which lack the specificity necessary to guide examiners, are not likely to articulate and implement their own standards in individual situations. Therefore, the crack in the door provided by the regulation's prohibition against engaging in unfair and deceptive activities, as prohibited by Section 5 of the FTC Act, is unlikely to yield any real determinations of predatory lending. Too much uncertainty and too much opposition from the institution are a lethal combination for CRA evaluators to struggle against to support a finding of predatory lending.

We agree with the commenters to the ANPRM who suggested that –

a number of particular loan terms or characteristics, whether or not specifically prohibited by law, that have been associated with predatory lending practices should adversely affect an institution's CRA evaluation. These include high fees, prepayment penalties, single-premium credit insurance, mandatory arbitration clauses, frequent refinancing ("flipping") , lending without regard to repayment ability, equity "stripping," targeting low- or moderate-income neighborhoods for subprime loans, and failing to refer qualifying borrowers to prime financial products.[4]

However, as the Supplementary Information to these Proposed Regulations indicates that the agencies have already considered and rejected this approach, it seems superfluous to reiterate the arguments and factual basis for including these specific identifying factors in these comments. Suffice it to say that the failure to specify these standards in a rule identifying predatory lending makes the rule completely meaningless.

Current Federal Laws Do Not Prohibit Predatory Lending

The primary way that the agencies propose to evaluate whether institutions have engaged in predatory lending is by ascertaining whether they have violated existing federal laws. Specifically, violations of the Equal Credit Opportunity Act (ECOA), Fair Housing Act, Home Ownership and Equity Protection Act (HOEPA), Truth in Lending Act (TILA), Real Estate Settlement Procedures Act (RESPA), and the Federal Trade Commission Act (FTC Act) only will be relevant to the question of predatory lending.[5]

With the exception of HOEPA, none of the federal laws on which institutions are to be evaluated were passed to address predatory lending. To find violations of the FTC Act it is necessary to make complex evaluations of the lending environment, the specific consumers, and the history of dealings between the parties – a highly unlikely analysis to be made by CRA evaluators in a meaningful way (see below for more discussion on the FTC Act). As a result, compliance with all of these other federal laws is not in any way indicative of an institution's avoidance of predatory lending. Findings that an institution has violated one or another of these laws can be useful for a consumer to defend against a predatory loan because these valuable federal laws can provide remedies to help save homes from foreclosure, and recover stripped equity. However, the specific provisions of these laws do not address predatory lending.

While a violation of HOEPA can be indicative of predatory lending, it is essential to recognize that the reverse is not necessarily true – a HOEPA loan can be in full compliance with HOEPA, and still be very abusive. Similarly, a lender's compliance with TILA, RESPA, the Fair Housing Act and the ECOA, does not indicate that the lender has not engaged in a predatory loan. Indeed, even lack of compliance with RESPA and TILA does not indicate, in and of itself, that the lender has engaged in predatory lending.

The FTC Act's prohibition against unfair or deceptive practices would indeed provide a framework for finding individual cases of predatory lending – as has been done on several occasions by the FTC itself in litigation. Indeed, in the instant proposed regulations, the agencies outline a list of potential activities which could be indicative of predatory lending: "loan flipping, the refinancing of special subsidized mortgage loans, other forms of equity stripping, and fee packing . . . ." However, again we must recognize the information that will be available in the CRA evaluation, as well as the dynamics.

To determine loan flipping one must have available all of the documents related to a series all of the loan transactions between the parties – not just the documents related to a specific loan. To determine the refinancing of subsidized mortgage loans, one must have information about the loan being paid off by the specific loan made by the institution. This information is not typically in the institution's loan file – certainly no law or regulation requires this information to be kept in this way. To determine fee packing, one must closely evaluate not only the Truth in Lending disclosures, but also the RESPA disclosures, and compare that information with similar loans in the geographic area. This is highly specific and scrutinizing work which has never been engaged in by bank examiners in the past, and is unlikely to be done in the future.

What do the agencies mean by "other forms of equity stripping?" The variety of ways which a lender can strip equity includes flipping, the charging of excess points and fees, single premium credit insurance financing, and prepayment penalties. Yet the agencies have already rejected the use of any of these criteria as a standard to determine predatory lending. So how are these assessments to be actually made?

To find that the FTC Act's prohibition against unfair or deceptive practices has been violated a series of complex evaluations about the relationship between the parties must be made. As was detailed by the OCC, for deception to be found, each and every of the following factors must be present:

- First, there is a representation, omission, act, or practice that is likely to mislead;
- Second, the act or practice would be likely to mislead a reasonable consumer (a reasonable member of the group targeted by the acts or practices in question); and
- Third, the representation, omission, act, or practice is likely to mislead in a material way.[6]

Deception is never evident from the loan documents. Deception of consumers by lenders can only be determined by talking to consumers. Bank examiners cannot and will not be engaged in individual conversations with consumers regarding an institution's potential violations of this important by vague law. Therefore it is virtually certain that deception will never be found.

A similar high standard is established to find a practice to be unfair, in violation of the FTC Act. Again, each of the following factors must be present:

- First, the practice causes substantial consumer injury, such as monetary harm;
- Second, the injury is not outweighed by benefits to the consumer or to competition; and
- Third, the injury caused by the practice is one that consumers could not reasonably have avoided.[7]

Unfairness under the FTC Act requires a finding that the injury caused by the practice could not reasonably have been avoided. This is a complex, economic analysis which requires establishing the consumer's situation in the marketplace.[8] These determinations are beyond the scope of bank examiners doing a CRA assessment. In fact, it is absurd to assume that examiners will ever determine that a practice is unfair under the FTC standard.

The Prohibition Against Equity Stripping Will Not Find or Stop Equity Stripping

Examiners of banking institutions will only have available to them the documents relating to the loans. In almost all situations, unaffordable loans which are based on the equity in the home, rather than the income of the borrowers, do not reveal these aspects on the face of the documents. Instead, the loan documents – the loan application, the loan acceptance letter, the note, the TILA and RESPA disclosures, etc. – will provide a paper trail which looks acceptable. It is only if there is an analysis of the actual income of the borrowers that the problems with the loan will become apparent.

Through our work with legal aid and private attorneys all over the country on predatory loans, we evaluate the details and the documents of hundreds of consumer loans every year. Many of these loans are actually based on the equity value in the home, rather than the income of the borrowers. However, this fact is never apparent from the loan documents. Instead, the borrowers' application always includes falsified income which would only be discovered to be false if the originator had been required to verify the income.

The proposed regulation specifically permits originators to rely on "stated" income, and does not require written documentation. Again, are the CRA examiners going to personally interview consumers to determine the factual justification for the paper trail in the bank's files? Obviously not. As a result, the prohibition against equity stripping as articulated in the proposed regulation will not stop any predatory activities.

Going Forward – What Can the Agencies Do to Address Predatory Lending?

If the federal banking regulators want to address predatory lending through their regulatory authority there is a great deal that they can do. First, they should do no harm – and adoption of the current proposal to add a CRA assessment for predatory based on the proposed standard will do harm. Harm will result from the CRA assessment that an institution is not engaged in predatory lending when the determination was based on factors which would not discover real abusive or predatory lending.

The Federal Reserve Board has the power and the duty under the FTC Act to define specific practices which are unfair or deceptive for banking institutions.[9] The Board has only exercised this regulatory authority once, when it adopted a version of the FTC's Credit Practices Rule and made it applicable to banks and thrifts.[10]

We recommend that the Board open a regulatory docket to determine which practices which are currently legal in the marketplace are nevertheless unfair or deceptive, as defined by the FTC Act. The specific suggestions detailed in this proposed Regulation should be revisited, including the essential question of the legality, fairness and morality of payday lending.

Expanded Assessment Area is Good, But Must Apply to Banks' Activities as well as Affiliates.

We applaud the agencies' proposal to include loans made by the affiliates of a bank in any geographical area in the CRA performance rating. However, the regulations must also include the activities of the institutions themselves which are outside of the assessment area. Specifically, this must include bank loans through partners in other geographic areas.

We are particularly concerned that banks engaged in renting their charter to payday loan partners have all their payday loans included in their CRA performance rating[11]. The first issue is to ensure that the geographic area in which the loans are made is included in the bank's CRA assessment. However, the second issue is to label as "illegal" any payday lending by a bank with a third-party in states where these loans would violate state law if the bank claim of exportation privileges were not invoked.

The lists of laws in the proposed regulations illustrating which types of illegal activities institutions will be evaluated upon to determine predatory lending, do not include state laws. However, the Supplementary Information in the Federal Register does state:

Evidence of violations of other applicable consumer protection laws affecting credit practices, including State laws if applicable, may adversely affect the institution's CRA evaluation. (Emphasis added.)[12]

The big question then becomes whether the federal banking agencies will recognize bank involvement in schemes to evade a state's laws or regulations to ban check-based loans, enforce a state usury law, or limit the terms and conditions of small loans within its borders as an indicator of predatory lending, thereby lowering the bank's CRA rating. If a bank in Delaware partners with a loan servicing agent to market payday loans at 520% APR in New York state which has a 16% civil usury law and a 25% criminal usury law, the FDIC should have to downgrade the bank's CRA rating.

Currently, ten state-chartered, non Federal Reserve member banks partner with payday loan companies, pawn shops, and check cashers in the making of small loans simply to circumvent state usury laws or small loan regulations that apply in many states to financial services companies under state law. The banks engaged in payday lending do not make these loans in their local areas, but only partner with third-parties in distant states.13

The fact that these banks are deliberately partnering with businesses for the purpose of circumventing state consumer protection laws should be clear evidence of predatory lending. However, the current proposed regulations do not appear to contemplate this standard.

Regulated financial institutions should simply be prohibited from engaging in abusive credit activities, such as payday lending. Again, we urge the Federal Reserve Board to use its considerable powers under the FTC Act to identify and prohibit institutions from engaging in payday lending, as well as other abusive lending practices. We stand ready to provide factual and legal assistance in this endeavor.

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1 **The National Consumer Law Center, Inc. (NCLC)** is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of sixteen practice treatises and annual supplements on consumer credit laws, including Truth In Lending, (4th ed. 1999) and Cost of Credit (2nd ed. 2000) and Repossessions and Foreclosures (4th ed. 1999) as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC became aware of predatory mortgage lending practices in the latter part of the 1980?s, when the problem began to surface in earnest. Since that time, NCLC's staff has written and advocated extensively on the topic, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to defend against such loans, and provided extensive oral and written testimony to numerous Congressional committees on the topic. NCLC?s attorneys were closely involved with the enactment of the Home Ownership and Equity Protection Act in Congress, and the initial and subsequent rules pursuant to that Act. Representatives of NCLC have actively participated with industry, the Federal Reserve Board, Treasury, and HUD in extensive discussions about how to address predatory lending. These comments are written by Margot Saunders, Managing Attorney.

2 **The Consumer Federation of America** is a nonprofit association of over 300 consumer groups, established in 1968 to advance the consumer interest through research, education, and advocacy.
Consumers Union is the nonprofit publisher of Consumer Reports magazine, is an organization created to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. Consumers Union's publications carry no advertising and receive no commercial support.
The National Association of Consumer Advocates (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

3 12 CFR 227, Regulation AA.

4 Supplementary Information to Proposed Rules on Community Reinvestment Act Regulations, 69 Fed. Reg. 5729, Feb. 6, 2004 at 5739.

5 Id.

6 OCC Advisory Letter, Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices, AL 2003-2, at 4.

7 Id.

8 See, e.g. Federal Trade Commission, Credit Practices Rule: Statement of Basis and Purpose and Regulatory Analysis, 49 FRB 7740, March 1, 1984 (hereinafter “FTC, Statement of Basis.”); American Financial Services Ass’n v. FTC, 767 F. 2d 957 (D.C. Cir. 1985), cert denied, 475 U.S. 1011 (1986).

9 15 U.S.C. § 57a(f).

10 12 CFR § 227.

11 However the role of the bank is really a sham. Although these payday loans are technically made by the bank so as to avoid the restrictions of state law, the payday lender typically takes most of the risk, holds the preponderant economic interest in the loan, and does the marketing and collections. However, these loans could not be made but for the bank’s involvement.

12 Supplementary Information to Proposed Rules on Community Reinvestment Act Regulations, 69 Fed. Reg. 5729, Feb. 6, 2004 at 5740.

13 Jean Ann Fox, Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury, Consumer Federation of America, March 30, 2004. www.consumerfed.org/pdlrentabankreport.pdf.