



November 2, 2007

Regulation Comments  
Chief Counsel's Office  
Office of Thrift Supervision  
1700 G. St. NW  
Washington DC 20552

Attention: OTS-2007-0015

To Whom it May Concern:

The National Community Reinvestment Coalition is an association of more than 600 community-based institutions that promote access to basic banking services, including credit and savings, to create and sustain affordable housing, job development and vibrant communities for America's working families. Our members include community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority and women-owned business associations and social service providers from across the nation.

NCRC appreciates the Office of Thrift Supervision (OTS) issuing an Advance Notice of Proposed Rulemaking (ANPR) regarding unfair and deceptive lending practices and we and our members across the country are pleased that the OTS is considering a range of vigorous regulations for eliminating these practices. At the same time, we urge the agency to act expeditiously in deciding upon an approach and issuing a proposed rule for public comment. The nation stands on the edge of a mortgage crisis tilting us toward recession due, in large part, to many current practices in the lending market.

NCRC believes that the OTS must issue proposed rules that are both specific and principles-based. A number of loan terms and conditions need to be discontinued because they are inherently unfair, while other loan terms and conditions need to be limited in order to protect borrowers. In addition, principles-based rules need to be adopted since loan terms and conditions continually evolve. In some cases, specific prohibitions and limitations cannot address new practices that are found to be unfair. We ask that the OTS adopt the Federal Trade Commission's guidance and an "ability to repay" standard as core elements of a principles-based regulation. A considerable amount of predatory lending would cease if lenders assessed borrowers' ability to repay.

Strong regulation that protects against unfair lending but that does not restrict access to safe and sound lending is essential. The lending industry asserts that legislation and regulation will choke off access to credit. The current record default rates and looming resets of exotic adjustable rate mortgages demonstrate that too little legislation and regulation will create a marketplace detrimental to the wellbeing of both lending

institutions and consumers. An under-regulated marketplace creates a “race to the bottom” in which responsible lenders adopt ever-riskier practices in order to compete with the other lenders who are dangling unrealistic and unaffordable loans in front of borrowers. In sum, an under-regulated marketplace will restrict lending since investors will lose confidence and reduce their financing of lending institutions.

The current research has focused on anti-predatory legislation but the findings of that research suggest that strong regulations would not restrict all lending. The research demonstrates in fact that anti-predatory lending legislation reduces abusive lending while CRA increases safe and sound lending. Professor Michael Stegman and his colleagues at the University of North Carolina concluded that the North Carolina anti-predatory law did not restrict overall access to credit, but did decrease loans with predatory features such as loans with prepayment penalties beyond three years.<sup>1</sup> In addition, a study by Bostic, Engel, et al concluded that typical state anti-predatory laws do not reduce overall credit flows. In fact, broader coverage (more high-cost loans covered), stronger enforcement, more flexible private rights of action, and stronger assignee liability are associated with higher levels of subprime originations. The authors hypothesize that consumer demand is strengthened and that consumers feel more confident receiving subprime loans in states with broader coverage.<sup>2</sup>

The beneficial impacts of anti-predatory law are coupled with CRA; Federal Reserve economists and Harvard University document that CRA has increased lending to minority and low- and moderate-income borrowers and communities.<sup>3</sup> CRA has encouraged traditional lenders to focus on prime lending and has had a beneficial role in increasing product choice in traditionally underserved communities.

The conclusion from the research is that the OTS should promulgate a vigorous (UDAP) regulation that addresses abusive lending practices. At the same time, it should increase the rigor of its CRA oversight. As NCRC documented in its recent letter in response to the request for comments on the Interagency Question and Answer guidance, inadequate procedures regarding assessment areas, affiliates, and loan purchases is undermining CRA enforcement.

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<sup>1</sup> Roberto G. Quercia, Michael A. Stegman, and Walter R. Davis, *The Impact of North Carolina’s Anti-Predatory Lending Law: A Descriptive Assessment*, the Center for Community Capitalism, University of North Carolina at Chapel Hill, June 25, 2003.

<sup>2</sup> Raphael W. Bostic, Kathleen C. Engel, Patricia A. McCoy, Anthony Pennington-Cross, Susan M. Wachter, *State and Local Anti-Predatory Laws: The Effect of Legal Enforcement Mechanisms*, August 7, 2007, via <http://ssrn.com/abstract=1005423>.

<sup>3</sup> The Joint Center for Housing Studies at Harvard University, *The 25<sup>th</sup> Anniversary of the Community Reinvestment Act: Access to Capitol in an Evolving Financial Services System*, March 2002; Robert Litan, Nicolas Retsinas, Eric Belsky and Susan White Haag, *The Community Reinvestment Act After Financial Modernization: A Baseline Report*, produced for the United States Department of the Treasury, April 2000; *The Performance and Profitability of CRA-Related Lending*, Report by the Board of Governors of the Federal Reserve System, July 17, 2000; Raphael Bostic and Breck Robinson, *Do CRA Agreements Influence Lending Patterns?* July 2002, available via [bostic@usc.edu](mailto:bostic@usc.edu).

NCRC offers the following comments on specific issues raised by the ANPR:

**Comprehensive coverage:** The OTS needs to apply a UDAP regulation to savings and loans and their subsidiaries. If the OTS does not apply its rule to all parts of the thrift holding company, the agency may discover that some thrift holding companies will confine unfair and deceptive lending practices to the parts of the holding company not covered by the rule. The OTS indicates that it is not contemplating covering service providers directly with a rule. The agency suggests that thrifts would remain responsible for compliance with the rule, even if they outsource operations to a third party. The risk with this approach is that banks and thrifts are covered by a variety of rules and regulations, yet some brokers with which they do business engage in unfair practices. We urge the OTS to either directly cover service providers or impose steep penalties on thrifts when service providers engage in conduct contrary to the new rules.

**Failure to engage in loss mitigation:** NCRC is pleased that the OTS is contemplating incorporating a loss mitigation standard in a UDAP rule. We encourage the OTS to follow-up with its suggestion that failure to engage in reasonable loss mitigation efforts would be an unfair practice. Strong incentives must be instituted to encourage financial institutions to modify the exotic mortgages causing turmoil in the market. NCRC agrees with FDIC Chair Sheila Bair that the Moody's report indicating that less than 1 percent of problematic subprime mortgages have been modified is a significant cause for concern.

**Unaffordable Loans:** A core source of predatory lending is comprised of loans that are made beyond a borrower's repayment ability. The federal agencies have correctly identified that lenders making such loans are underwriting adjustable rate mortgage (ARM) loans at initial and low rates, leaving borrowers exposed to rapid rate increases. The recent guidance on subprime lending requires underwriting at the fully-indexed rate. While this is a step in the right direction, NCRC strongly recommends underwriting requirements at the maximum possible rate or rates above fully-indexed rates. There are times when the LIBOR or other benchmark rates are low, meaning that the fully-indexed rate may be an artificially low rate for underwriting purposes. We understand that it was common industry practice to underwrite loans at two percentage points above the fully-indexed rate. The OTS needs to consider either some suitable cushion above the fully-indexed rate or the maximum possible rate stipulated in the loan contract.

NCRC also believes that a UDAP rule needs to establish a presumption that a loan is unaffordable if the borrower's debt-to-income ratio exceeds a specified threshold level. A commonly used threshold is 50%. Yet, the experience of NCRC's national foreclosure prevention program, the National Homeownership Sustainability Fund (NHSF) suggests that the 50% threshold is too high. In a sample of NHSF loans close to foreclosure, NCRC discovered that the median debt-to-income ratio is 50%. Fully half the loans in the sample had debt-to-income ratios below 50%. Based on this experience, a lower ratio of around 45% may be a more appropriate threshold.

**Prepayment penalties:** NCRC believes that the OTS needs to apply strict limits to prepayment penalties. Prepayment penalties must not apply after the expiration of teaser rates in ARM prime and subprime loans. The recent interagency statement on subprime lending recommends that lenders terminate prepayment penalties 60 days before the expiration of teaser rates. NCRC believes at least a 90 day time period is needed so that borrowers have sufficient time to shop for and receive another loan if necessary. For fixed-rate subprime loans, prepayment penalties should not extend beyond two years. Responsible lenders have voluntarily applied limits to prepayment penalties similar to NCRC's recommendations. Limiting prepayment penalties prevents borrowers being trapped in predatory loans.

**Escrows for Taxes and Insurance:** NCRC believes that the OTS needs to require escrows for all subprime, fixed and adjustable rate, loans. Currently, since escrows are not required, unfair lending flourishes when brokers and lenders do not reveal to borrowers the true cost of their loans by not discussing payments for insurance and taxes. Most of the loans in NCRC's NHSF program consist of loans without escrows.

**Stated Income or Low Doc Loans:** NCRC agrees with the Comptroller of the Currency that stated income or "low doc" loans are prone to trouble when predatory lenders and brokers inflate borrowers' incomes to qualify them for unsustainable loans. This type of practice is most prevalent on subprime loans per NCRC's experience with the NHSF program. Stated income or low doc loans need to be prohibited on subprime and/or ARM loans. At the least, the OTS needs to establish clear protections and procedures for reduced documentation lending including the requirement that pay stubs, tax forms, and other acceptable verification of income must be received by the lender.

**Steering:** Steering borrowers who are creditworthy for lower rate loans into higher rate or subprime loans is inherently unfair and therefore needs to be prohibited by a UDAP rule. In addition, it is unfair for a lending institution to offer indirect and/or direct compensation (including yield spread premiums) that varies with loan terms and conditions. Such discretionary pricing has encouraged brokers and loan officers to steer unsuspecting borrowers into high cost loans.

NCRC's recent study, *Income is No Shield against Racial Differences in Lending*, documents that middle- and upper-income minorities are significantly more likely than middle- and upper-income whites to receive subprime loans. Moreover, previous NCRC research and other studies reveal that racial disparities in lending do not disappear after considering creditworthiness and other key variables. Borrowers lose substantial amounts of wealth when they are steered into high-cost loans.

**Lender liability:** The OTS must hold thrifts liable for the practices of brokers with whom they do business. Since up to 70% of the loans originated start with brokers, lenders must be motivated to carefully monitor broker behavior. Likewise, lenders and brokers must face serious financial penalties if they intimidate or pressure appraisers to



meet certain home values. Fraudulent appraisals have contributed significantly to the rise of delinquencies and defaults.

**Other Unfair Practices:** Single premium credit insurance, flipping, fee packing and mandatory arbitration are inherently unfair practices and need to be prohibited by a UDAP rule. The OTS should adopt the standard established in the Department of Housing and Urban Development’s affordable housing goals that points and fees not exceed 5% of the loan amount. Finally, the OTS’ ANPR lists a number of practices in credit card lending, gift cards, and deposit accounts that need to be part of an OTS UDAP.

**Deceptive Advertising:** The OTS mentions that it is considering additional UDAP regulations concerning deceptive advertising. NCRC encourages the agency to adopt additional rules against bait and switch tactics, particularly regarding ARM lending. FDIC Chair Sheila Bair recently expressed dismay that certain lenders were still focusing borrowers on initial teaser rates as if these rates applied for the entire term of the loan. These practices had a significant role in the current mortgage crisis.

## **Conclusion**

NCRC asks the OTS to quickly move to a rulemaking regarding unfair and deceptive acts and practices. We are witnessing the negative effects of too little oversight. When lending institutions compete against their peers by making riskier and riskier loans, everyone loses - consumers default, foreclosures follow, and the standards and practices of the lending industry are lowered in a “race to the bottom”.

Strong law and effective regulation inspires confidence among borrowers and lenders alike, and bolsters the amount of affordable and responsible credit in the market.

Thank you for the opportunity to comment on this important matter. If you have any questions, please feel free to contact Josh Silver, Vice President of Policy and Research or myself on 202-628-8866.

Sincerely,

A handwritten signature in black ink, appearing to read "John Taylor". The signature is written in a cursive, somewhat stylized script.

John Taylor  
President and CEO  
National Community Reinvestment Coalition (NCRC)