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BY ELECTRONIC MAIL

Communications Division
Office of the Comptroller of the Currency

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation

Chief Counsel's Office
Office of Thrift Supervision

Re: Proposed Revisions to CRA Rule
OCC Docket No. 04-06
FRB Docket No. R-1181
FDIC RIN 3064-AC50
OTS Docket No. 2004-04

Dear Sirs and Madams:

This letter conveys our comments on the joint revisions to the Community Reinvestment Act (CRA) regulation recently proposed by the four federal banking regulators. Our comments relate to the section of the proposed rule that addresses the effect of abusive lending practices on an institution's CRA rating.

At the outset, we wish to applaud the agencies for taking this landmark step to recognize and curb the devastating effects of predatory lending. CRA is not neutral in its incentive effects. CRA can inadvertently work to condone lending abuses where abuses receive neutral treatment in CRA examinations. And, it can actually support abusive lending if banks receive CRA credit

for abusive loans. Conversely, CRA can actively discourage predatory lending by giving adverse treatment to lending abuses in the CRA ratings process.

The proposed rule takes four important steps in that direction. First, it strengthens current law by providing concrete examples of legal violations that would adversely affect CRA ratings. Second, under the proposed rule, evidence of a pattern or practice of asset-based lending in home mortgage and consumer loans, where the borrower cannot be expected to make the loan payments, would also merit adverse treatment. Third, illegal practices and proscribed asset-based lending would adversely affect an institution's CRA evaluation whether the practices occur in or outside the institution's CRA assessment areas. Finally, where an institution designates any loans by an affiliate for CRA treatment, evidence of prohibited lending practices by that affiliate within any assessment area would garner adverse CRA treatment.

Comments

1. Given the important progress made by the proposed rule, it is essential that the above four provisions of the proposed rule not be rolled back in any way.

2. In addition, in extending adverse treatment to asset-based loans that are structured with terms that borrowers cannot be expected to repay, the agencies invited comment "on whether it is feasible to define any other specific abuses by regulation in a way that both shields consumers from the costs of the abuse and avoids inadvertently curtailing the availability of credit to consumers."

In that respect, we are concerned that the proposed rule overlooks certain other abusive loan practices that do not benefit borrowers under any circumstances. In our view, these loan practices are harmful *per se* to borrowers. Nevertheless, in many jurisdictions, there is no across-the-board legal prohibition against these practices. Unless these loan practices receive adverse CRA treatment, effectively these practices will be condoned under CRA.

Accordingly, in the final rule, we urge the agencies to expand the list of practices triggering adverse treatment under CRA to include the following practices that are harmful *per se*:

> (a) *Negative Amortization* – Individual consumers gain no discernable benefit from home mortgages or consumer loans with negative amortization, except in the limited case of reverse mortgages for senior citizens or the terminally ill, which are heavily regulated.[1] In loans with negative amortization, scheduled payments are not enough to cover the interest due. Unpaid interest is tacked onto the principal, causing the principal to mount. With every payment, the borrower goes deeper into debt and loses more and more equity

1. Reverse mortgages are regulated under the Home Equity Conversion Mortgage program administered by the Department of Housing and Urban Development and specifically require mandatory counseling before closing.

in his or her home. Reverse mortgages deplete equity in what is often the borrowers' largest asset, prolonging loan repayment for years at added expense to borrowers and increasing the likelihood of foreclosure.

The Home Ownership and Equity Protection Act (HOEPA) prohibits negative amortization clauses in high-cost home loans.[2] The concerns underlying the negative amortization provision of HOEPA are equally valid for all home mortgage and consumer loans. Accordingly, we would mandate adverse CRA treatment for negative amortization clauses in all home mortgage and consumer loans except for reverse mortgages regulated by the Home Equity Conversion Mortgage program of the Department of Housing and Urban Development.

(b) *Single-Premium Credit Insurance Policies* -- Single-premium policies for credit life insurance and other types of credit insurance or single-premium debt suspension or cancellation contracts that are marketed in tandem with subprime mortgages are a common abuse. Under single-premium policies, borrowers pay the same lump sum premium for insurance or debt cancellation coverage, whether they make their loan payments through to maturity or prepay their mortgages. Moreover, single-premium policies are often financed as part of the loan. In some cases, borrowers have been sold single-premium credit insurance products even though they were too old to qualify for such insurance. As the end result, borrowers often pay for needless insurance and assume more onerous debt obligations. If borrowers want credit life insurance or lenders require it, lenders could simply charge monthly insurance premiums. Hence, there is no economic justification for credit insurance policies or debt suspension or cancellation policies that are marketed on a captive, single-premium basis. In recognition of the abusive nature of this practice, a number of major subprime mortgage lenders have publicly disavowed the use of single-premium policies.[3] We urge regulators to amend the final rule to provide that the use of single-premium credit insurance or single-premium debt suspension or cancellation contracts in home mortgage and consumer loans will receive adverse treatment under CRA.

(c) *Steering* -- Steering occurs when subprime lenders persuade unsuspecting borrowers, who are actually eligible for prime loans, to agree to loans at higher subprime rates. Steering is exacerbated by the use of yield-spread premiums, which reward mortgage brokers for convincing borrowers to pay higher interest rates than the lenders are willing to take. The Mortgage Bankers Association of America has recognized the pernicious effects of steering in its best practices guide by counseling mortgage lenders

2. *See* 15 U.S.C. § 1639(f); 12 C.F.R. § 226.32(d)(2).

3. *See, e.g.*, Patrick McGeehan, *Household Announces Changes in Lending Practices*, N.Y. TIMES, July 24, 2001; Patrick McGeehan, *Third Insurer to Stop Selling Single-Premium Credit Life Policies*, N.Y. TIMES, July 21, 2001; Adam Wasch & R. Christian Bruce, *CitiFinancial Announces It Will End Single-Premium Credit Insurance Sales*, BNA BANKING REP., July 2, 2001, at 9–10; Patrick McGeehan, *Citibank Set To End Tactic On Mortgages*, N.Y. TIMES, June 29, 2001, at C1.

that "[b]orrowers should be offered loan options commensurate with their qualifications, and such options and their costs should be clearly explained."[4]

We strongly recommend adverse CRA treatment for steering prime-eligible customers to subprime home mortgage or consumer loans. To satisfy this standard, a lender who makes a subprime loan would have to demonstrate, under underwriting guidelines in effect at the time of the loan application, that the lender had evaluated whether an applicant who received a subprime home mortgage or consumer loan qualified for a prime rate and, if so, had been offered a prime rate.[5] Under this standard, lenders would be allowed a choice of underwriting guidelines for determining prime eligibility, including Fannie Mae, Freddie Mac, or private secondary-market models.

(d) *Payments by lenders to home-improvement contractors from mortgage proceeds other than by instruments payable to the borrower or jointly to the borrower and the contractor, or according to a written escrow agreement* -- Checks made solely payable to home-improvement contractors can be major inducements to home-improvement scams. Such checks are already prohibited by HOEPA.[6] Making the check payable to the borrower or jointly to the borrower and the contractor, or disbursing the loan payments according to a written escrow agreement, are simple measures that can avoid this needless harm to borrowers. Accordingly, we recommend that in home mortgage or consumer loans, checks or other loan disbursements made solely payable to home-improvement contractors trigger adverse CRA treatment.

(e) *Loan with escalating interest rates upon default*—Loans with escalating interest rates upon default reduce borrowers' ability to rectify their financial situations, thus increasing the likelihood that they will lose their homes to foreclosure. Even when borrowers can cure and resume their payments, they may find that the increased interest rate and correspondingly larger monthly payments may be unaffordable. Refinancing, the only avenue through which borrowers can avoid the increase in monthly payments, may be impossible because, having defaulted, the borrowers may not be able to secure alternative, less-costly financing. Loans with interest rate increases triggered by default do not benefit borrowers and actually increase the likelihood that borrowers will move from default to foreclosure. In HOEPA, Congress prohibited higher interest rates upon default in home loans covered by that statute.[7] We believe that *all* home mortgage and consumer loans with these terms should receive adverse treatment under CRA.

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4. *See* Mortgage Bankers Association of America, Best Practices/Legislative Guidelines: Subprime Lending, Legislative Guidelines Best Practices ¶ 3 (2000), *available at* http://www.mbaa.org/resources/predlend/.

5. The new rate spread reporting thresholds under the Home Mortgage Disclosure Act (HMDA) could be used to define subprime home mortgage loans for purposes of CRA. First lien subprime home mortgage loans could be defined, for example, as any home mortgage loan whose rate spread between the annual percentage rate (APR) on the loan and the yield on Treasury securities of comparable maturity equals or exceeds three percentage points. *See, e.g.*, *Home Mortgage Disclosure*, 67 Fed. Reg. 43218 (June 27, 2002); 12 C.F.R. § 203.4(a)(12).

6. *See* 15 U.S.C. § 1639(i); 12 C.F.R. § 226.34(a)(1).

7. *See* 15 U.S.C. § 1639(d); 12 C.F.R. § 226.32(d)(4).

In addition to the *per se* harmful practices described above, we continue to have serious concerns about other abusive practices in the subprime home mortgage market that also inflict grave harm on vulnerable individuals, including but not limited to, loan flipping, equity stripping, excessive prepayment penalties, yield spread premia, and onerous balloon clause terms. We urge the agencies to further consider amending the CRA regulations to discourage such abuses by insured depository institutions and their subsidiaries and affiliates.

3. Although insured depository institutions have been responsible for some past subprime lending abuses, the bulk of the problem consists of predatory lending by nonbank mortgage lenders or consumer finance companies. Increasingly, such lending is being done by nonbank subsidiaries and affiliates under the bank holding company or financial holding company umbrella. Indeed, insured banks and thrifts and/or their parent companies can profit from subprime activities, while avoiding reputational risks and safety and soundness concerns, by pushing subprime operations out to nonbank operating subsidiaries and affiliates.

Insured banks and thrifts have a choice whether to locate their subprime lending activities within the depository institution or outside in a nonbank subsidiary or thrift. Given that choice, a bank or thrift should not be permitted to evade CRA scrutiny by pushing out its subprime activities to a nonbank subsidiary or affiliate and then refusing to designate loans by that subsidiary or affiliate for CRA evaluation. In the case of operating subsidiaries of national banks, such evasion would be especially pernicious due to the Comptroller's recent preemption ruling, which further privileges subprime operating subsidiary operations by stating that such operations by national bank operating subsidiaries are exempt from regulation by and visitorial powers of the states. For this reason, it is imperative that evidence of discriminatory, other illegal, and abusive credit practices by any subsidiary or affiliate automatically merit adverse CRA treatment, *whether or not* any loans by that affiliate have been designated for consideration in a CRA evaluation.

4. Finally, when considering evidence of discriminatory, other illegal, and abusive credit practices by any nonbank subsidiary or affiliate, we urge the agencies to consider such evidence with respect to all geographic locations, not just CRA assessment areas. The concept of a CRA assessment area is foreign to the business plans of most nonbank affiliated lenders. To the contrary, the geographic operations of many nonbank subsidiaries and affiliates with subprime operations are often nationwide in scope, are not driven by branch locations, and are generally more far-ranging geographically than the CRA assessment areas of their bank and/or thrift affiliates.

We appreciate your consideration of our comments.

Sincerely,

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cc: Adrienne Hurt, Esq.
Board of Governors of the Federal Reserve System