52

July 5, 2000

Manager, Dissemination Branch
Information Management and Services Division
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552
Attn: Docket No. 2000-34

RE: Responsible Alternative Mortgage Lending; Advance Notice of Proposed Rulemaking (65 FR 17811)

Dear Sir or Madam:

The Conference of State Bank Supervisors (CSBS) is pleased to have the opportunity to comment on the Office of Thrift Supervision's (OTS) advance notice of proposed rulemaking (ANPR) regarding responsible alternative mortgage lending. As part of the ANPR, the OTS has decided to review its mortgage lending regulations to determine their effect not only on federal savings associations and their customers but also on state-licensed housing creditors who may be making alternative mortgage transactions under the Alternative Mortgage Transaction Parity Act (AMTPA) and their customers.[1] CSBS is the national organization of state officials responsible for chartering, regulating and supervising the nation's 6,868 state-chartered commercial and savings banks and 419 state-licensed branches and agencies of foreign banks.

General

CSBS is concerned that regulatory conditions exist that allow unprincipled lenders to target financially unsophisticated borrowers for loans characterized by grossly unfavorable terms. These loans are often made with no consideration of the borrower's ability to repay the loan with the result that borrowers lose their homes and other assets that serve as collateral. We are also guided by the strong

[1] 65 Fed. Reg. 17811 (April 5, 2000).

conviction that efforts to extinguish predatory lending must not constrain the flow of credit to families with low-to-moderate incomes, the elderly, or immigrants, the same populations that too frequently have been the targets of predatory lenders. We further recognize that responsible lenders must extend credit profitably within the parameters of safety and soundness.

We thank the OTS for addressing the complex issues identified in the ANPR and for seeking perspectives on ways to thwart abusive lending practices. Our comments are focused on unscrupulous practices that give rise to the term, "predatory lending." Examples of such fraudulent and deceptive practices include: extending credit without regard for the borrower's ability to repay in an apparent effort to seize collateral; structuring loans that feature substantial negative amortization, high prepayment penalties that often prevent the borrower from terminating the loan; interest rates significantly higher than the risk profile of the borrower justifies and financing fees for potentially unnecessary products such as credit insurance. In and of themselves, some of these provisions may not constitute predatory lending behavior, but in combination with high-pressure deceptive sales practices or fraud, the results can be devastating to financially unsophisticated consumers.

The ANPR requests information on initiatives state authorities have undertaken to eliminate such practices. We are pleased to provide the OTS with examples of state efforts to identify and deter predatory lending in the attached appendix. CSBS is concerned that aggressive activity at the federal level, such as OTS interpretations of the Home Owners Loan Act (HOLA), AMTPA and its general preemption authority, has had the apparent unintended consequence of limiting the effectiveness of state efforts to root out predatory lending abuses. Therefore, we suggest that, as a preliminary matter, the OTS carefully review the impact of its current broad preemption practices. We also recommend that the OTS consider how existing laws and regulations can be used to thwart predatory lending, and if necessary, develop additional supervisory and policy initiatives.

Background

At the heart of the ANPR is a fundamental question. What is the impact of OTS interpretive opinions, regulations, legal actions and preemption in administering HOLA, AMTPA, and related federal law under OTS administration relative to predatory lending? For example, the OTS explains that "the limited role the Parity Act plays in the overall regulation of housing creditors has not always been clearly understood."[2] Potentially serious public policy implications emerge when preemption occurs without an understanding of possible unintended

[2] Id. at 17815.

consequences. CSBS suggests that preemption is a multifaceted issue that requires a deeper level of communication between federal and state regulators than has occurred in the past.

CSBS also acknowledges that preemption may, at times, be necessary to facilitate a modern banking system. We point, for example, to the ability that state banks and state savings associations have to export interest rates and fees on consumer loans as they operate in multiple states. However, such preemption should benefit both businesses and consumers and should be undertaken in a manner that clearly spells out its necessity and benefits. As the OTS seeks solutions to discourage predatory lending practices, we suggest that the OTS enhance its efforts in seeking public comment before preempting state laws such as consumer protection statutes. Such an inclusive process should provide valuable information regarding whether and/or how similar existing federal protections adequately protect consumers and when no federal regulation exists, whether the state law should be preempted.

According to the OTS's explanation in its ANPR, AMTPA enables state-licensed housing creditors to make alternative mortgage transactions that comply with designated federal regulations as an alternative to state law. Housing creditors, other than state-chartered banks and state-chartered credit unions that wish to make an alternative mortgage transaction under AMTPA must comply with OTS's alternative mortgage transaction regulations.[3] According to the OTS's current regulations, its alternative mortgage transaction regulations govern prepayments,[4] late charges,[5] adjustments to interest rates and amortization schedules on home loans,[6] and disclosure.[7] We are concerned that the consumer protection provisions of the OTS's alternative mortgage transaction regulations are not as robust as comparable state regulations to combat predatory lending abuses.

Ideally, every mortgage transaction should take place between a willing creditor and a well-informed consumer. However, this is not always the case when the lender engages in fraud or deception. As a result, two key issues combine to potentially foster an environment that facilitates abusive lending practices. First, the fact that AMTPA preempts state measures that discourage predatory lending practices like unreasonable prepayment penalties and late charges, and second, the fact that the OTS's regulatory framework in this area lacks substantive provisions that discourage predatory lending practices.

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[3] State-chartered banks and state-chartered credit unions must comply respectively with regulations of the Office of the Comptroller of the Currency and the National Credit Union Administration.
[4] 12 CFR 560.33.
[5] 12 CFR 560.34.
[6] 12 CFR 560.35.
[7] 12 CFR 560.210.

The Alternative Mortgage Transaction Parity Act

Congress passed AMTPA to provide a nationwide platform in which state-chartered depository institutions, federal thrifts, national banks, and state-licensed housing creditors could offer alternative mortgage loans such as adjustable rate mortgages. AMTPA was enacted during a time when several states prohibited adjustable rate mortgages and when the majority of mortgage lending was originated by thrift institutions. However, the mortgage marketplace has changed significantly since 1980. No longer are adjustable rate mortgages an untested product and no longer are thrifts the primary originators of mortgage loans in this country. In fact, according to a recent study published by the U.S. Department of Housing and Urban Development, in 1980 thrifts made 49.7% of all mortgages and mortgage companies made 22%. The percentages were more than reversed by 1997. In that year, thrifts made just 18.3% of mortgage loans and mortgage companies made 56.3%. Commercial banks have been more consistent, accounting for 22% of mortgage loans in 1980, and 24.8% in 1997.

Thus, the mortgage-lending landscape has changed considerably since AMTPA's enactment. In recent years mortgage companies have dominated originations. However, CSBS is not aware of trends suggesting one segment of the industry is more likely than another to engage in predatory lending practices.

Despite changes in the mortgage lending market, CSBS is not suggesting a repeal of AMTPA's preemptive authority. However, to create an environment that discourages predatory lending practices, there should be a thoughtful, deliberative process applied to preemption decisions, including coordination with state authorities.

Subsidiaries of Federal Thrifts & the Changing Nature of Federal Thrift Charters

As indicated above, AMTPA provides that the OTS's authorized regulations preempt conflicting state laws in states that did not opt out of AMTPA by October 1985. Generally, state-chartered thrifts and non-depository housing creditors remain subject to state laws and supervision.[8] However, it should be noted that through HOLA, legal opinions and otherwise, the OTS has largely exempted consumer finance companies that are operating subsidiaries of federal thrifts from complying with state supervision, state licensing laws and most other

[8] See 12 U.S.C. § 3802(2); S. Rep. No. 463, 97th Cong., 2d Sess. 54 (1982).

state regulations.[9] In effect, the OTS has claimed exclusive supervisory responsibility for consumer finance companies if they are wholly owned or majority-owned subsidiaries of federal thrifts. CSBS suggests that the OTS clarify what examination and supervisory procedures the OTS applies to such subsidiaries.

CSBS is also mindful of changes in the types of entities seeking OTS approval for a federal thrift charter such as securities firms and insurance companies. While many recent thrift charter applications are from community-based institutions with traditional business plans, others are from organizations with aggressive marketing plans for distributing financial products and services through an established, national sales staff who may not be familiar with banking laws and regulations. CSBS suggests that OTS consider the adequacy of its regulatory and examination mechanisms for supervising this new variety of sales-oriented thrift institution. With many, newly chartered, financial conglomerates deploying thousands of sales agents into the consumer lending market, the OTS may wish to review whether the free-market approach is effective for deterring predatory lending practices.

Preemption of State Consumer Protection Initiatives

CSBS recommends that the OTS expand its review of the impact that preemption has had on predatory lending beyond an evaluation of AMTPA. For example, the OTS, in interpreting the HOLA, AMTPA, and similar federal statutes, has consistently preempted state lending laws designed to protect consumers from predatory lending practices. A decidedly rare number of state laws have not been preempted, including (until recently) measures to prevent fraud and deceptive practices.[10]

However, it is extremely challenging to combat predatory lending based solely upon the grounds of deceptive practices or fraud. State authorities can present a much more compelling case to thwart predatory lending abuses by demonstrating that lenders have violated specific state laws such as charging unlawful and unreasonable prepayment penalties. Through a history of aggressive preemption, the OTS has removed such legal tools from the state authorities' arsenal.

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[9] The OTS claims that state licensing laws and other regulations (including disclosure requirements, net worth standards and fee restrictions) are preempted insofar as they apply to the lending activities of operating subsidiaries of federal thrifts. The OTS asserts that these operating subsidiaries are entitled to the same shield of federal preemption as that enjoyed by their parent thrifts. See 61 Fed. Reg. 66,561, 66,563 (1996); OTS Op. Chief Counsel, Aug. 19, 1997, 1997 OTS LEXIS 9. The OTS' position was upheld by a federal district court in *WFS Financial, Inc. v. Dean,* 79 F. Supp. 2d 1024 (W.D. Wis. 1999).

[10] OTS Op. Chief Counsel, March 10, 1999.

Recently, 45 State Banking Departments indicated that the OTS has preempted state consumer protection measures including the following either through HOLA, AMTPA or otherwise:

(i) Prepayment penalty bans or limits
(ii) Limitations on "up front" fees for home equity loans
(iii) Limitations on excessive "up front" fees on home mortgages
(iv) Notice requirements regarding late fees on mortgages
(v) Licensing requirements for mortgage brokers and lenders
(vi) Bonding requirements for mortgage brokers and lenders
(vii) Net worth requirements for mortgage brokers and lenders
(viii) Limitations on discount points for residential mortgages
(ix) Limits on prepayment penalties for second mortgages
(x) Limits on late fees
(xi) Limitations on fees for home equity lines
(xii) Prohibitions on balloon mortgages
(xiii) California's Unfair Business Practices Statute and the California Deceptive, False and Misleading Advertising Statute to the extent that such statutes interfered with a thrift's lending activities in the areas of:
    a. Advertising
    b. Forced placement of hazard insurance
    c. Imposition of certain loan-related fees

CSBS is not advocating a ban on prepayment penalties, balloon payments, late charges or related provisions. Mortgages, at times, include such features as some lenders seek to extend credit profitably to a broader range of consumers. As we have indicated earlier, CSBS recognizes the need for creditors to lend profitably and within the parameters of safety and soundness. However, we suggest that the OTS consider basic guidelines that reflect measures many states have taken in this area. If creditors offer products that incorporate features such as balloon payments, up front financing of fees, and prepayment penalties, they should do so responsibly. This standard includes the responsibility to ensure that consumers understand the features of the transaction and can reasonably be expected to repay the loan.

CSBS applauds the OTS for exploring the impact of preemption under HOLA, AMTPA, and otherwise. Nevertheless, we suggest that in order to determine whether such preemption facilitated a predatory lending environment, the OTS should have sought comment on the issues enumerated in the ANPR, before state laws were preempted. A preferable procedure for implementing AMTPA, HOLA and other federal laws administered by the OTS, would be to seek comment before, not after, preempting state laws.

The sheer magnitude of the number of questions raised in the ANPR suggests that the OTS does not clearly understand the impact of the preemption of state law in this area. Your efforts to study this issue more thoroughly through this ANPR are commendable. We further suggest that the OTS carefully consider and evaluate this impact before preempting additional state laws such as North Carolina's anti-predatory lending statute, discussed in the appendix. In light of the fact that a growing number of states are acting to protect their citizens from predatory lending abuses, CSBS believes it is imperative for the OTS to implement procedures so that the deterrent effect of the North Carolina statute or other state anti-predatory lending laws are not neutralized by AMTPA. Accordingly, the OTS should affirmatively provide an opinion regarding the applicability of North Carolina's statute by the end of the year.

During testimony before the House Banking and Financial Services Committee, OTS Director Ellen Seidman stated that rather than establishing regulatory requirements, the OTS has generally allowed lenders and borrowers to determine the agreed upon terms as stated in the contract governing the lending transaction. The OTS has largely relied upon consumer disclosures to govern that free-market process in lieu of requiring substantive measures designed to protect consumers.

We suggest that state consumer protection laws, such as limits on prepayment penalties that have the effect of preventing a borrower from refinancing a predatory loan, and others listed previously are crafted not to impose an undue regulatory burden, but rather, to protect consumers from abusive lending practices. These consumer protection provisions were deliberated and enacted by elected officials. Similarly, many elected officials believe that bonding requirements provide a filter to allow only qualified, reputable lenders and mortgage brokers to operate in their states. Also, net worth requirements provide a safety net should State authorities be forced to take enforcement action in order to protect consumers. The OTS should more fully understand the public policy implications of preemption in these areas.

Coordination with State Banking Authorities

During testimony before the House Banking and Financial Services Committee, OTS Director, Ellen Seidman, suggested that the role the states play in supervising state-licensed housing creditors is similar to the role the OTS plays in supervising federal thrifts' compliance with Federal Reserve regulations such as the Truth in Lending Act. We strongly disagree with Director Seidman's analogy.

The Federal Reserve has promulgated detailed regulations regarding compliance with the Truth in Lending Act and other regulations they administer.

In contrast, the OTS's guidance for state-licensed housing creditors to follow when they choose to comply with OTS regulations in lieu of state law provides few specific details. For example, the OTS regulation governing alternative mortgage transaction prepayments is a mere two sentences in length.[11]

The OTS should consider substantive standards designed to discourage predatory lending practices in concert with recommendations outlined in a report recently issued by the Department of Treasury (Treasury) and Department of Housing and Urban Development (HUD).[12] We also encourage the OTS to adopt one of the specific recommendations in the report by working with the State Banking authorities and CSBS to address the issue of predatory lending. For example, the Treasury/HUD report suggests that cooperative efforts between federal and state authorities to deter predatory lending will have more of an impact than individual efforts at the state or federal level.[13] CSBS agrees with this recommendation, and would gladly participate in a state/federal initiative in this area.

Furthermore, the OTS should incorporate the principles of Executive Order 13132 (Order), signed by President Clinton on August 4, 1999. The Order directs all executive offices/agencies and encourages all independent federal regulatory agencies to recognize and respect the authority and jurisdiction of states to govern activities within their borders. The Order also directs federal agencies that propose to preempt state law to provide all affected state and local officials notice and an opportunity for appropriate participation in the proceedings. Greater coordination between federal and State banking authorities on the subject of predatory lending is extremely important.

State Initiatives to Discourage Predatory Lending

The ANPR requests information about efforts by State authorities to limit predatory lending practices. State authority over non-depository lenders has been severely limited by AMTPA and other federal laws with preemptive effect. In spite of the very real limitations on their authority previously discussed, many states have made efforts to control predatory financial practices within their borders. For the most part, they have centered on educating consumers, conducting targeted examinations including interviewing borrowers, enforcing state laws that have not been preempted, and finding other ways to test whether non preempted consumer protection laws are being observed by the industry.

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[11] 12 CFR 560.34.

[12] Curbing Predatory Home Mortgage Lending. U.S. Dept. of Housing and Urban Development and U.S. Dept. of Treasury Joint Report, (June 20, 2000).

[13] Id. at 83 (June 20, 2000).

In the attached appendix, we have summarized initiatives taken by various states in response to predatory lending practices they have observed. They are a testament to the ongoing interest of the states in protecting their citizens against such practices.

Conclusion

CSBS believes that it will take a concerted effort among all chartering authorities to regulate, monitor and examine housing creditors under their purview to develop an atmosphere of enhanced vigilance against abusive practices. In that regard we thank Director Seidman for seeking opportunities to meet and discuss a variety of policy issues with CSBS. We urge the OTS to expand those efforts and to develop an approach that complements rather than conflicts with state-based initiatives such as those described in this letter to prevent abusive lending practices. One way to enhance the success of the regulatory community in preventing predatory lending is for the OTS to provide states with an opportunity to participate in future OTS preemption determinations, as directed by Executive Order 13132.

Thank you for the opportunity to comment and please feel free to call on us if we can provide assistance in this extremely important area.

Best Personal Regards,

Neil Milner, CAE
President and CEO

Appendix

Examples of State Initiatives To Discourage Predatory Lending

The following examples demonstrate how the states have traditionally served as models in which best practices have evolved, not only in expanding the nature of financial services products and delivery systems, but also as laboratories for development of sound supervisory practices. We submit them for your review and consideration.

California

The California legislature is currently reviewing new legislation to deter predatory lending practices. The proposed law establishes a category of loans that trigger consumer protections. The category includes "restricted" home loans with APRs that are 6 points or higher than the Treasury rate, or which have total points that are 4% over the loan amount.

The proposed law also prevents equity stripping, which means that lenders cannot advance a home loan if the loan pays off an existing home loan and the loan's terms do not provide a benefit to the borrower. The proposal also requires counseling for the borrower and written proof of the counseling. A lender also must reasonably believe that the borrower can repay the loan. In addition, the financing of life, disability or unemployment insurance must occur as a transaction that is separate from the home loan.

Illinois

The Illinois Office of Banks and Real Estate (OBRE) recently issued proposed rules designed to target lenders responsible for the surge in predatory lending. The proposed rules provide added consumer protection in the area of high-risk consumer lending. Key features of the proposed rules are summarized below:

- Housing creditors licensed by the OBRE who service Illinois loans must file semi-annual reports on their default and foreclosure rates on conventional loans. The agencies will use this data to monitor more closely the practices of certain lenders and focus resources on consumers facing the greatest need.
- A "high-risk home loan" is defined as a loan that is considered a mortgage under Section 152 of the Home Ownership and Equity Protection Act of 1994.

- Certain "high risk loans" cannot be made without verifying the borrower's ability to repay.
- Lenders must fully disclose if prepaid insurance and warranty products are added to the financing costs of certain "high risk loans."
- Refinancing a mortgage within a 12-month period may be prohibited unless it results in a permanently lower mortgage payment for the borrower.
- Licensees must advise borrowers to consider seeking consumer counseling when certain "high risk loans" are 30 days past due. Licensees would also delay foreclosure proceedings for 30 days so that a mutually agreeable debt re-payment schedule can be established.
- The proposal would establish a Mortgage Awareness Program to provide enhanced consumer education in the area of real estate lending.

Additionally, the Illinois legislature appropriated an additional $400,000 to the Agency's FY 2001 budget for increased supervision and enforcement efforts related to the problem.

Indiana

The Indiana Department of Financial Institutions, Division of Consumer Credit, has developed a study program for High School Government and Economics teachers to help them inform their students about consumer credit. The Department of Financial Institutions' objective is to encourage curriculum enrichment to insure that basic personal financial management skills are attained during the High School educational experience.

Curriculum topics include budgeting, choosing a credit card, purchasing an automobile and guarding against fraud. The study program also includes specific details on various consumer protection statutes such as the Equal Credit Opportunity Act and the Fair Credit Reporting Act.

Massachusetts

The Commonwealth of Massachusetts has aggressively reviewed the actions of subprime lenders and moved against those entities deemed to be engaged in predatory lending. The Division of Banks has worked closely with the Attorney General's Office on two egregious cases arising from the Division's licensed examination program. In one case, a lender charged 17 points to a borrower having a debt-to-income ratio of 109%. In another case, a non-bank lender was charging 10 points to consumers – a violation of state regulations that prohibit charging unconscionable rates or terms.

In the latter case, the federal court determined that the company was engaging in unfair and deceptive trade practices and that the company could not charge more than five points. Since that case, five points has been an important threshold when reviewing the practices of lenders in Massachusetts. Lenders that charge more than five points face stricter regulatory scrutiny during examinations.

The Division of Banks also issued an industry letter in 1997 on subprime and predatory lending issues warning Massachusetts banks, credit unions and non-bank lenders about the unique financial, legal and compliance risks associated with subprime lending. It also unequivocally states that predatory practices will not be tolerated.

Massachusetts is also proposing changes to the Commonwealth's HOEPA regulations (Massachusetts has an exemption from Regulation Z) that address abusive practices. These changes, a vigorous on-site compliance examination program, along with a new, statewide, toll free consumer mortgage hotline and referral service, will further deter predatory lending abuses in Massachusetts.

Minnesota

Minnesota, like other states, has not attempted to differentiate between subprime and predatory lending. But mortgage lenders in the state must follow standards of conduct that include prohibitions: (1) on fees when no product or service is provided; (2) on false, deceptive or misleading statements; (3) on making residential loans with the intent that the loan will not be repaid and the lender will obtain title to the property via foreclosure, and; (4) on making a higher cost loan than underwriting or credit scoring data would indicate the borrower is entitled to unless the borrower consents in writing. Regarding usury, Minnesota law was recently amended to require out-of-state lenders to comply with limits on real estate loan rates and charges.

New Jersey

The New Jersey Department of Banking and Insurance has focused on enforcing un-preempted state laws that provide some protection to consumers against predatory practices, on conducting thorough examinations to uncover abuses, and on educational initiatives to create a more informed public.

For example, the New Jersey Department has worked successfully with the New Jersey Department of Education and others to highlight financial education as an important way to fulfill the State's core curriculum standards. The goal of the program is to provide every New Jersey public school student a grounding in basic banking, including an understanding of credit management, the types of

loans available, how to critically assess the true cost and other relevant features of various credit instruments, and how to manage successfully one's finances. The Department has also promoted financial education through public appearances, distribution of materials, and participation in various groups that encourage financial education.

New York

The New York State Banking Department has presented a proposed regulation for final adoption to the New York Banking Board. Adoption of the proposal should be complete within several days and the regulation will be effective approximately sixty days thereafter. The regulation requires that a lender must have due regard for a borrower's ability to repay the loan. In addition, the proposal lowers the thresholds that are set forth in HOEPA, prohibits "flipping" and "packing" and provides an "unconscionability" standard. The regulation includes a provision creating a presumption that if the total monthly obligations of the borrower do not exceed 50% of his or her verified monthly income, then the borrower can afford to repay the loan. A lender making a loan to a borrower with a higher debt-to-income ratio is required to justify that the borrower could afford to repay the loan.

Additionally, if insurance premiums are being financed as part of the loan, the 50% debt-to-income ratio is a cap rather than a safe harbor. A lender may charge points and fees but only if two years have passed since the borrower's last refinancing (or at any time on the new money advanced to the borrower). Moreover, financed points and fees (other than certain enumerated third party fees such as an appraisal) may not exceed five percent of the loan amount. Balloon payments are permitted, provided the term of the loan is at least seven years. Lenders will be required to provide a disclosure recommending counseling to borrowers as well as a list of counselors approved by the Banking Department. Lenders are also required to provide an annual report of the credit history of their borrowers to a national credit agency.

The New York State Banking Department is also writing guidelines related to the securitization of subprime loans. The guidelines will focus on ensuring that all loans that are packaged by lenders and sold to investors meet sound underwriting and appraisal rules and comply with applicable federal and state consumer protection laws. Superintendent McCaul, while acknowledging that securitization has resulted in increased capital availability benefiting subprime borrowers, has also noted that the securitizations have provided funds for abusive lenders.

New York's experience, indeed the experience of all of the States with predatory lending protection initiatives, has provided important information about how enhanced due diligence will serve to ensure that securitizations do not fund abusive loans. Securitizations have provided depth and breadth to a critical market and have increased lending to low and moderate-income borrowers. But they have also funded the explosion in predatory lending we are now observing. The securitizations are structured with representations and warranties that protect the underwriters and the investors. There is no harm, no foul to either of these parties—only to the recipient of an abusive loan.

Underwriters traditionally look to simple characteristics such as volume, financial condition and default rates when making underwriting decisions for securitizations. As an example, a low default rate may hide a high refinance rate that is an indicator of abusive lending. New York would also encourage underwriters to ensure that the underlying loans are made with an eye toward ability to repay on the part of the borrower, not based on the value of the collateral. Both examples illustrate how an enhanced due diligence standard will remove abusive loans from securitizations.

The New York Banking Department has also been instrumental in developing and distributing educational materials regarding predatory lending abuses to NY consumers. The Department has developed brochures and has distributed them throughout the community, including non-English speaking communities. The Department has also worked with community groups and has held educational outreach programs in the evenings and on weekends.

North Carolina

North Carolina's Predatory Lending Law is the only one in the country that specifically addresses the issue of predatory lending. Specifically, the new law targets "high cost" home loans under $300,000. The definition of a high cost loan under the law is a loan that includes:

(1) An APR that exceeds the Treasury rate by more than 10 points;
(2) Points and fees that exceed 5% of the total loan amount if the loan is $20,000 or higher;
(3) Points and fees of either 8% of the total loan, or $1,000, whichever is less, if the loan is under $20,000;
(4) Prepayment penalties of more than 2% of the amount a borrower had prepaid on their home loan, and;
(5) Prepayment penalty if the borrower pays off the mortgage later than 30 months after closing.

It's important to note how North Carolina lawmakers addressed this issue as they drafted the legislation. The rates, points and prepayment provisions are not prohibited. The drafters did not want to limit access to credit. But under the North Carolina statute, loans that fall within the definition of a high cost loan trigger a series of protections designed to prevent predatory practices. For example, the statute limits or bans practices that can have the effect of making timely repayment impossible. Some argue that such practices "set up" borrowers to default and thus lose their home. The statute specifically:

1. Bans call provisions, preventing the lender from accelerating indebtedness;
2. Limits balloon payments by preventing a payment that is more than twice the amount of the regular payment;
3. Limits negative amortization, prohibiting a payment schedule that causes the principal to increase;
4. Bans increased interest rates after the borrower defaults;
5. Limits advance payments, preventing requirements that more than two payments be consolidated and paid in advance;
6. Bans modification or deferral fees, preventing a lender from charging any fees to modify, renew, extend or amend a high-cost loan or to defer any payment that is due, and;
7. Limits "packing," preventing lenders from adding single premium credit life, disability or unemployment insurance to the loan amount.

The North Carolina statute goes further by preventing "flipping," the practice of refinancing a mortgage even though the new loan has no reasonable net benefit to the borrower. The law also prohibits recommending or encouraging default on an existing loan or other debt in connection with a proposed refinancing.

Like many other states, the leaders in North Carolina also recognize that one of the most important remedies for predatory lending is consumer education and counseling. When individuals understand the lending process and their rights and responsibilities, they are less likely to sign agreements that are not in their best interests. In an attempt to address this issue, the North Carolina law prohibits high-cost home loans unless the borrower receives financial counseling. The lender must also reasonably believe that the borrower will be able to repay the loan. The law also bans the refinancing of prepayment fees or penalties payable by the borrower in a refinancing transaction.

The statute also prohibits loans that would allow unscrupulous home improvement contractors and lenders from collaborating to provide loans with rates and fees that were beyond the ability of the borrower to repay. Violations under the North Carolina statute trigger usury penalties, forfeiture of interest and

return of twice the interest paid. Treble damages may also be awarded to the borrower.

Virginia

Virginia's legislature passed the Commonwealth's Mortgage Lender and Broker Act in 1987. The statute supplements Virginia's "Money and Interest" laws, and recognizes differences between first mortgages, where more latitude is allowed in rates, closing fees and loan-associated costs, as compared to loans secured by subordinate liens on homes, which require stricter controls on rates and fees.

The Act requires mortgage companies and lenders not affiliated with state or federal depository institutions to be licensed and supervised by the state, and it prohibits certain abusive practices and provides enforcement mechanisms against violators. Commissioner of Financial Institutions E.J. Face, Jr. explained that his agency uses three components for preventing predatory lending practices. The first is the regulator's ability to assess a lender's qualifications to enter the business. The second is thorough monitoring, and the third is effective action to penalize violations, deter offenses, and remove repeat offenders, if necessary.

According to Commissioner Face, Virginia's laws worked well until recently, when a trade association of alternative mortgage lenders in Virginia utilized a 1996 Office of Thrift Supervision opinion that preempted state law under AMTPA. A federal court has since enjoined Virginia from enforcing its laws limiting prepayment penalties, thus preventing the state from acting against a number of lenders under its supervision. The case is set for hearing before the U.S. Court of Appeals for the Fourth Circuit. Commissioner Face contends that OTS's preemption was unwarranted and has prevented his agency from protecting Virginia consumers.

Washington

Washington State Director of Financial Institutions John Bley believes that no amount of new laws addressing predatory lending can replace the need for aggressive enforcement. Washington's Department of Financial Institutions has brought charges against Nationscapital Mortgage Corporation for alleged predatory lending practices and against First Alliance Mortgage Corporation (FAMCO) for alleged records and licensing violations. FAMCO is also under investigation by the U.S. Department of Justice, and is being sued by a number of other states. While FAMCO filed for bankruptcy in March, Washington's DFI and the state's Attorney General are pressing forward with their charges against the company.

Director Bley notes that regulators should evaluate not only loan files but must also investigate lending practices including following-up on consumer complaints by individuals who understand predatory practices. Director Bley adds that criminal sanctions against deceptive practices are the most effective deterrent to abusive lending.

The Washington DFI distributed an interagency memorandum intended to help Washington state examiners identify deceptive and predatory mortgage practices. For example, some predatory lending schemes involve deception about the type of loan being transacted for. Loan type deception is generally related to the sale or delivery of an adjustable rate mortgage (ARM) instead of a fixed rate mortgage, that the borrower desired. In some cases, the borrower is unaware that they received an ARM at closing because the ARM's initial rate approximates that of a comparable fixed rate mortgage. The memorandum also provides examples of practices involving deception regarding loan cost and monthly payments.