

**From:** Reinhart, Mary Ann on behalf of Public Info  
**Sent:** Wednesday, July 05, 2000 2:57 PM  
**To:** Gottlieb, Mary H  
**Subject:** FW: Predatory Lending ANPR comments



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-----Original Message-----

**From:** Dan Immergluck [mailto:[danimmer@woodstockinst.org](mailto:danimmer@woodstockinst.org)]  
**Sent:** Wednesday, July 05, 2000 2:03 PM  
**To:** [public.info@ots.treas.gov](mailto:public.info@ots.treas.gov)  
**Subject:** Predatory Lending ANPR comments

Please accept our comments on the ANPR, which are attached. We will fax separately.

Sincerely,

Dan Immergluck  
Senior Vice President  
Woodstock Institute  
407 S. Dearborn, Suite 550  
Chicago, IL 60605  
312-427-8070 / 312-427-4007 fax

July 5, 2000

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

To Whom It May Concern:

I am writing on behalf of the Woodstock Institute to comment on the Advanced Notice of Proposed Rulemaking (ANPR) recently issued by the Office of Thrift Supervision (OTS) on the topic of responsible alternative mortgage lending. The Institute has been extremely active in the arena of abusive and predatory mortgage lending and commends the OTS and Director Seidman for their leadership in issuing this notice.

The Woodstock Institute has studied the problem of predatory and abusive high-cost home lending extensively and has been heavily involved in policy debates on the issue at the federal, state and local levels. While the Institute recognizes the need for lenders to offer credit to individuals with imperfect credit, it has found that the home equity market in particular has become hypersegmented, with prime lenders focusing on nonminority communities and subprime specialists, many of which have exhibited abusive lending practices, targeting minority neighborhoods. Some of the abuses in the subprime industry are driven by the ability to extract excessive profits from less-sophisticated borrowers and by the very high returns sought by lenders and related brokers.

The Institute's recent report, *Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development*, documents the racial hypersegmentation of subprime lending and served as a model for later analyses by the U.S. Department of Housing and Urban Development and other groups. It also identified a number of approaches to reducing the predatory lending problem.

One of the problems identified in the report is the ability under certain federal laws for lenders to essentially preempt state consumer protection regulations. One of these laws is a principal subject of this notice – the Alternative Mortgage Transaction Parity Act. AMTPA gives state-regulated mortgage lenders the ability to opt-out of state regulations governing certain "alternative mortgage transactions," including adjustable rate mortgages, balloon payments, and prepayment penalties. However, the "alternative" label is quite deceiving and inappropriate for today's

subprime lending market, because these features are commonplace, and are often key tools used to deceive and trap vulnerable homeowners in expensive and sometimes unaffordable mortgage debt. The Institute agrees with Director Seidman's comment that the Parity Act is "no longer a recipe for effective supervision" (American Banker, April 5, 2000).

The Institute supports the repeal of AMTPA. However, given the improbability of such an action in the near term, we wholeheartedly welcome OTS's steps to make sure that if a state-regulated lender opts for OTS rules on alternative transactions that these rules not provide an effective preemption of state consumer protection laws.

We applaud the OTS for not only addressing the AMTPA problem, but also suggesting the need for additional regulatory action on predatory lending. *Two Steps Back* pointed to the involvement of banks and thrifts, either directly or indirectly, in the predatory mortgage problem. The U.S. Department of Housing and Development identifies a large number of depositories as directly involved in the subprime lending. Yet there are few if any signs that examiners have seriously scrutinized the activity of these lenders for evidence of predatory activity. Other depositories are investing in mortgage-backed securities, sometimes with the intent to earn CRA investment test credit, that may be funding predatory loan activity. Some banks and thrifts may be purchasing whole loans that may be predatory. And finally, many of the largest banks and thrifts are affiliated either through a subsidiary relationship or through affiliation via a holding company with a subprime mortgage company. One example is Bank of America FSB, whose parent corporation owns Equicredit, the largest subprime lender in African-American communities in the Chicago area. Equicredit's market share of conventional refinance loans in black tracts in the region is more than 36 times its market share in white tracts.

The Conference of State Bank Supervisors (CSBS) has reported that the Parity Act has made it difficult for states to offer the protection that consumers demand and often stands in the way of states enforcing their own laws and cracking down on predatory lenders. Research done by both the General Accounting Office and the CSBS documents that state housing creditors have used the Parity Act to bypass an assortment of state mortgage lending laws across the country including: prohibitions on prepayment penalties; limitations on up-front fees for home equity loans; limitations on late charges; prohibitions on negative amortization, disclosures for high-rate, high-point mortgage loans; limitations on appraisal fees for home mortgages; and prohibitions on balloon mortgages.

### **Direct Involvement of OTS-Regulated Institutions in the Subprime Market**

It is not just state housing creditors operating under AMPTA that have been increasingly involved in subprime and potentially predatory activity. According to the recently released HUD/Treasury report on predatory lending, between 1993 and 1998, the number of subprime mortgage loans (home purchase and refinance)

originated by subprime-lending banks and thrifts increased by 551 percent while the number of such loans originated by affiliates of banks and thrifts increased nearly 70-fold. In total, subprime depository institutions and their affiliates made about 25 percent of all subprime mortgages in 1998. And this does not include the subprime activity of depositories not classified as specialized subprime lenders, or those who are able to report subprime unit activity together with their prime affiliates' HMDA data.

As described in the comments of the National Community Reinvestment Coalition on this notice, black borrowers were four times more likely to receive subprime rather than prime refinance loans, and about three times more likely to receive subprime rather than prime home purchase loans from OTS-regulated institutions. While African Americans received about 2.5 percent of all prime refinance loans in 1998 from OTS-regulated institutions, they received nearly 10 percent of all subprime refinance loans from these institutions. Similarly, while blacks received 3.5 percent of all prime home purchase loans in 1998 from OTS-regulated institutions, they received about 9 percent of all subprime home purchase loans made by these institutions. For white borrowers, these patterns reversed themselves, with whites more likely to receive prime rather than subprime loans from OTS-regulated institutions in 1998.

Predatory lending practices often translate into quick profits in the short-term, making predatory lending a tempting line of business. While these practices were once limited to a few unscrupulous lenders, mainstream lending institutions, such as banks, thrifts, and their affiliates, are feeling increasing pressure to engage in these practices in order to compete in the fiercely-competitive financial services sector. Thrifts have already become active in the subprime lending market; for instance, Downey Savings and Loan Association, a major thrift lender, has been involved in the subprime market since 1996. Washington Mutual, the nation's largest thrift, has acquired Long Beach Financial, a large subprime lender. In the Chicago area, Superior Bank FSB, a major subprime lender, ranks 12<sup>th</sup> in terms of refinance applications in African-American neighborhoods, while ranking only 73<sup>rd</sup> in white communities.

In addition, many finance companies engaged in subprime lending have applied to the OTS to obtain thrift charters. For example, GMAC Mortgage, which has a large subprime affiliate, recently received a thrift charter. First Tennessee National recently secured a thrift charter (First Horizon) to house its subprime lending activities. The Travelers Group, which received a thrift charter in 1997, has been actively engaged in subprime lending activities through Commercial Credit (now CitiFinancial). Both Commercial Credit and Travelers Bank and Trust refinanced Habitat for Humanity borrowers in North Carolina. American General Finance, which received its charter in 1999 and has been active in the subprime lending market, also refinanced a Habitat borrower in North Carolina. (See comments of the Coalition for Responsible Lending, North Carolina). Consecro, a financial

conglomerate that owns Green Tree, has applied for a thrift charter from OTS. North Carolina's Coalition for Responsible Lending has identified several loans originated by Green Tree that contain practices we believe are predatory. For instance, Green Tree originated a loan in North Carolina that contained financed, up-front credit insurance equal to 20% of the amount of the loan. In addition, it is our understanding that the Associates has applied to the OTS for a thrift charter. The Associates has been the subject of numerous news reports accusing it of egregious predatory lending practices. The U.S. Department of Justice has also recently initiated fair lending action against the Associates.

### **Recommendations for Anti-Predatory Lending Regulations and Increased Scrutiny of Subprime Lenders**

OTS should use its authority not only to adopt comprehensive anti-predatory lending regulations governing all OTS-regulated thrifts, but also to apply this regulatory framework to state housing creditors that wish to utilize the Parity Act's preemption of state law for alternative mortgage transactions. In addition, the OTS needs to step up its scrutiny of subprime lending during CRA exams and accompanying fair lending reviews.

The OTS should use its authority to define high-cost loans as those with an annual percentage rate of 5 percentage points above comparable-term Treasury rates for first mortgages and 6 percentage points above Treasuries for second mortgages, or with points and fees greater than 5 percent of the loan amount. The definition of points and fees should include all of the costs the borrower is required to pay in order to get the loan, including prepayment penalties, credit life or disability insurance, broker fees including yield spread premiums, and closing costs other than primary mortgage insurance or escrows. Financing of more than 3 percent in points and fees should be prohibited.

In addition, for high-cost loans, OTS should prohibit prepayment penalties, balloon payments, frequent refinancing or "flipping" of loans with no benefit to the borrower, encouragement of default by the lender, negative amortization, and arbitrary call provisions in all high-cost loan transactions. The OTS should also prevent the financing of single-premium credit life or disability insurance and mandatory arbitration.

Finally, OTS should require thrifts and all affiliates to "upstream" potential borrowers to the lowest-cost products offered by their related entities. This requirement is necessary to prevent lenders from "steering" borrowers into higher fee and interest rate loans than they qualify for. According to Fannie Mae, about half of all subprime borrowers could qualify for lower-cost conventional financing.

These regulations should apply to all thrifts the OTS oversees, and state housing creditors wishing to utilize the Parity Act to preempt state laws.

### **Using CRA and Fair Lending Law as a Tool Against Predatory Lending**

As suggested in *Two Steps Back*, the OTS also needs to increase its scrutiny of subprime lending during CRA exams and accompanying consumer compliance and fair lending reviews. CRA has been instrumental in leveraging a tremendous increase in safe and sound lending to traditionally underserved communities. It is one of the most important means by which to stimulate conventional lending institutions to compete against predatory lenders in lower-income and minority communities. But for CRA to be useful in this endeavor, it must be enforced rigorously, and institutions must perceive a credible threat of receiving a less-than-satisfactory rating if caught engaging in predatory activity.

Another important way the OTS has jurisdiction over the portion of the subprime market that is abusive and/or predatory is through its supervision of institutions which purchase, invest in, act as trustee for, indirectly finance, and/or service subprime loans originated by other lenders. Clearly, the OTS can and should promulgate standards, as a matter of fair lending and CRA compliance, but also as a safety and soundness matter, for savings and loan holding company involvement with these subprime and predatory lenders. Until regulators expect them to be aware of the nature of the loans with which they become involved, banks and thrifts will continue to play a role in predatory lending.

As part of these standards, the OTS should require that institutions purchasing or investing in subprime loans obtain sufficient documentation on fees, rates, terms and conditions of the underlying loans to ensure that the loans are not predatory as described by the practices listed above.

In order for CRA and fair lending law to provide a powerful tool against predatory lending, the regulations must be applied throughout the entire parent-affiliate relationship. Fair lending regulations already permit this, but it is very unclear whether prime and subprime units are being vigorously examined for racial disparities or that egregious patterns of racial disparity are being addressed by regulators. CRA regulations may require some minor modification to require examiners to look at all affiliates' activities when examining an institution, rather than giving the bank the no-lose option of including an affiliate at its discretion.

Again, we are pleased with the leadership the OTS has taken by issuing this Advance Notice. We very much encourage the agency to adopt the actions recommended above and to do so as quickly as possible to provide lower-income communities with valuable tools in fighting predatory lending.

Sincerely,

Malcolm Bush  
President