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OTS DISSEMINATION BRANCH
2000 JUL -7 A 9:27

July 5, 2000

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Attn: Docket No. 2000-34

To the Office of Thrift Supervision:

I write regarding the ANPR put out by OTS on predatory lending. ACORN members would also like to thank Director Seidman for the leadership she has shown on working to address this critical problem.

Given the damage being done to individual borrowers and whole neighborhoods targeted by subprime lenders engaged in predatory practices, OTS and other government agencies with oversight responsibilities for lending institutions should favor consumer protection over concerns about parity. Banks and thrifts benefit substantially from federal regulation, both directly through federal insurance of deposits and other subsidies and indirectly through increased public confidence in the banking system. OTS, because of its unique authority under AMTPA, will have to decide where is the greater harm -- thrifts being subject to some restrictions on high-cost loans that they typically do not make or state-chartered housing creditors being allowed to avoid state consumer protection laws. There are also troubling issues that need to be addressed about the involvement of affiliates of thrifts in the subprime industry.

Over the past decade, the subprime industry has experienced tremendous growth. While the majority of predatory loans have been made by lenders that are only loosely, if at all, regulated at the state level, there have been a few cases of banks and thrifts themselves originating predatory loans. Without any strong action by the regulators or Congress, these cases can be expected to increase. Even more troubling, however, is the significant numbers of predatory loans being made by the subprime affiliates and subsidiaries of banks and thrifts. Racial steering into higher-cost loans and the lack of upstreaming of 'A' borrowers into 'A' loans is leading to a nation of two banking systems -- one of banks and thrifts in white, middle- and upper-income areas where credit is offered at relatively low cost and another in minority and low- and moderate-income communities where subprime lenders provide high-cost loans regardless of an applicant's actual characteristics.

While ACORN and a number of other groups have conducted studies showing the concentration of predatory lending in our neighborhoods and the damage that can be seen through increased numbers of foreclosures,[1] the relative lack of aggregate data on subprime lending should not be used to justify inaction on the part of regulators. To a large extent, the very reason for the shortage of data is industry opposition to more data collection under HMDA and other laws. There is no better example of this than the completely arbitrary exemption from HMDA for lenders whose home purchase loans and refinancings constitute less than 10% of their overall loan volume.[2] The lack of data could be easily addressed by the Federal Reserve requiring lenders to report information about the costs of the loans they originate in addition to other information currently required under HMDA. In the meantime, however, the agencies should move forward with their efforts to restrict predatory practices in the home mortgage market.

Reliance on Market Forces

In the background section, the ANPR indicates OTS's past preference for following a market-based approach. That assertion is followed by a recognition that the subprime market is not functioning properly and, as a result, borrowers are being substantially overcharged for their loans. Subprime lenders do not compete primarily on price but more often through aggressive marketing and the all-too-successful use of deceptive practices and pressure tactics.

Subprime lenders win customers primarily on the basis of their marketing efforts instead of on the pricing of their loans. In their marketing efforts, subprime lenders and mortgage brokers deluge potential borrowers from lower-income and minority communities with an endless series of mailings and phone calls. It is not surprising that residents of a neighborhood neglected by banks but heavily targeted by subprime lenders would believe that a subprime loan was their only option, regardless of their actual credit history. And with lenders and brokers' frequent phone calls, they attempt to build trust that will lead borrowers to believe they are receiving the most appropriate loan product, when that is not the case most of the time.

In practice, shopping for the least expensive subprime loan is virtually impossible, in large part because lenders' advertisements or initial offers do not provide consumers with accurate assessments of the real loan costs. Subprime lenders regularly engage in deliberate deceptions that result in applicants paying excessive rates and fees. They use consistent strategies of misleading borrowers about the costs of their loans, as well as about the borrowers' own credit-worthiness. As applicants sort through the barrage of

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[1] A recent ACORN study in Philadelphia showed that the number of foreclosures more than doubled from 1995 to 1998.

[2] To prevent lenders using the AMTPA bypass around state laws from also obtaining this exemption from HMDA, OTS could include HMDA requirements in list of regulations that are applicable to housing creditors under AMTPA.

advertisements from subprime lenders and mortgage brokers, they are not provided with accurate estimates of loan costs. Borrowers are frequently promised fixed rates when they are in fact being provided with adjustable rates. This practice is made more confusing by the presence of 'teaser' starting rates, in which borrowers are not told that their rates are sure to rise considerably after the teaser rate expires. Compounding all of these problems is the fact that it is impossible for borrowers to tell if any lenders are being honest about their loan terms. Applicants for subprime loans are also frequently victimized by a variety of tactics employed by lenders to place them under substantial financial pressure to accept the loan at closing, whatever its terms, including encouraging default on previous debt.

The pricing on subprime loans seems to be driven most often not by the credit risks of the borrowers, but by how much the lender or broker can get away with. This should come as no surprise when so many lenders pay their employees, or the brokers from whom they buy loans, large bonuses for charging higher rates and fees.

We need more protections especially for low- and moderate-income and minority families who have surmounted a whole range of obstacles to buying a home but live in areas neglected by banks and thrifts and targeted by subprime lenders. A home loan is the most complex transaction most families will ever make, and a home is the largest purchase -- for many families it represents their entire life savings. Simply providing accurate disclosures is not enough. We don't ask people to make decisions about buying medications based on reading fifty pages of disclosures; we make rules about what standards drugs need to meet in order to be sold. Home loans are similar. Borrowers are never going to know as much as lenders, and experience shows that too many subprime lenders are taking outrageous advantage of this fact.

OTS Regulation of High-Cost Loans

The OTS's unique regulatory authority makes it especially appropriate for the agency to establish much-needed consumer protections against predatory loans. The thrifts that it most directly regulates do not originate predatory loans to any great extent and should not be affected by any consumer protections on high-cost loans. They do, however, benefit substantially from consumer confidence in the banking system and would benefit from consumers knowing that there were federal regulations providing extra assurance that people applying for loans from thrifts were not receiving predatory loans. And with the trend toward larger financial conglomerates, thrifts are likely to develop more affiliates and subsidiaries, leading to greater involvement in the subprime market where predatory practices are common. Basic consumer safeguards would help prevent affiliates from becoming involved in predatory lending and help protect against a disturbing but increasingly common division of labor -- the thrift (or bank) portion of the conglomerate focusing on middle- and upper-income and predominantly white neighborhoods while the

subprime affiliate targets lower-income and heavily minority neighborhoods with more costly loans.

Occasionally, industry groups have urged the federal banking regulators to refrain from acting against predatory loans because banks and thrifts themselves are not heavily engaged in originating abusive loans (although their other activities may be supporting such loans). In this case, however, the OTS's unique regulatory authority over state-chartered housing creditors, which are heavily involved in originating predatory loans, brushes aside that argument. As these housing creditors may sidestep state consumer protection laws against prepayment penalties and other terms through AMTPA, a lack of action on the part of OTS would continue to allow this loophole, and thus place a tremendous obstacle in the way of all attempts to curb predatory lending

In setting these safeguards, OTS should consider the following recommendations:

• High-cost loan thresholds. Greater protections are obviously needed for consumers entering into high-cost loans, and one of the most critical issues is where to set the threshold for high-cost loans. The primary weakness of HOEPA is that its consumer protections extend to a tiny fraction of all loans in the subprime market. Lenders are able to charge excessive fees and interest rates while still staying below HOEPA's fee and APR thresholds. To address this problem, ACORN recommends that OTS use the following high-cost loan thresholds:

> The points and fee threshold, assuming OTS does not alter the current definition to include third-party fees, should be adjusted to 3%. Banks and thrifts charge origination fees of between 1% to 2% for providing the same services as subprime lenders, and 3% is an appropriate reflection of where high-cost home loans begin, especially as subprime lenders so commonly take advantage of applicants' lack of knowledge to tack on junk fees. In addition, the definition of points and fees should be expanded to include yield-spread premiums, and financed credit insurance policies or other similar products. The APR threshold should be lowered from Treasury +10% to Treasury +6%. At current rates, this would cover loans with APRs above about 11.5%, a much more appropriate definition of high-cost home loans than exists under HOEPA.

There is widespread agreement that borrowers entering into high-cost loans need additional protections. On high-cost loans, ACORN believes OTS should prohibit the following predatory practices:

• Financing of Fees beyond 3% of the loan value. The financial damage caused to borrowers by excessive fees increases substantially when those fees are financed into the loan. Rather than using their monthly payments to reduce their loan principal, such

borrowers are trapped into paying down their loan fees for several months or even years. The financing of fees on high-cost loans is often used by lenders to generate easy profits by stripping borrowers of the equity they have built up in their homes.

• All Balloon Payments. Balloon payments have a limited place in the prime market for certain borrowers with rising incomes who have already demonstrated the ability to manage credit extremely well. In the subprime market, loans with teaser rates and balloon payments are harmful for borrowers. On high-cost loans with balloon payments, borrowers often are misled into believing that their monthly payments are paying down the principal, but that is not the case as the lender hides from the borrower the true costs of the fees, interest rate, and other loan provisions through a balloon payment that the borrower does not know about or understand how it works.

• Mandatory Arbitration Clauses. Current federal and state laws are already heavily stacked against borrowers seeking just redress for falling victim to illegal lending practices. Apparently not satisfied with those circumstances, many lenders who also lie about loan terms push borrowers into signing mandatory arbitration clauses that prevent them from asserting any of their legal rights. Lenders should not be allowed to curtail borrowers' access to legal remedies when the lender breaks the law.

• Suitability of product for individual borrower. There are significant problems with applicants for subprime loans being provided with products that are not appropriate to their needs. In addition to loan flipping (which is discussed below), a whole range of different practices pervade the subprime industry that prevent borrowers from receiving the terms they want or believe are in their loans. For any entity that contains a thrift and a subprime affiliate, OTS should take steps to ensure that 'A' borrowers applying for a loan at the affiliate are upstreamed into 'A' loans while lower-income and minority applicants are not unfairly steered from the thrift into higher-cost loans with the affiliate. For housing creditors that choose to sidestep state law under AMTPA, OTS should also establish guidelines that help ensure 'A' borrowers receive 'A' loans.

• Required notice of availability of housing counseling. Most victims of predatory lending practices signed their loans without adequately understanding the terms or the costs of their loans. Many of these tragic situations could be avoided if the applicant had had the opportunity to talk with a certified housing counselor who can explain the impact of the loan's fine print on their financial situation. We would recommend that housing counseling be required before the signing of high-cost loans. Short of that, applicants should be notified of its availability and of counseling agencies convenient to their location.

Other loan items are almost universally harmful for borrowers and have no place among the business practices of responsible thrifts. In recognition of this fact, ACORN recommends that OTS prohibit the following loan provisions on all home loans:

• Single-Premium Credit Insurance. Credit life, disability, unemployment, and health insurance policies range from overpriced at best to a complete rip-off at worst. While we would advise borrowers to avoid all such policies, there is absolutely no justification for charging such policies as a lump-sum premium at the outset of a loan, rather than having borrowers pay them monthly like any other insurance policy. Financing credit insurance policies into home loans is another way subprime lenders strip equity from borrowers. Any credit insurance policies that are paid off monthly should also be conducted as separate transactions from home loans.

• Yield-Spread Premiums. These kickbacks explicitly reward mortgage brokers for jacking up interest rates, a practice which is copied by some lenders in directly rewarding employees for increasing the costs of subprime loans. The higher the interest rate, the higher the kickback. Brokers often go to great lengths to build trust in their clients but then abuse that trust by convincing them to take out loans at higher interest rates. OTS should take strong action against yield-spread premiums.

• Refinancing Without Benefit (or Loan Flipping). Loan flipping is the refinancing of home loans when the lender's only motive is to profit from fees or other charges while the borrower does not receive any benefit. We have seen cases where lenders have convinced borrowers to refinance 0% Habitat for Humanity loans into high-interest rate loans. Lenders engaged in loan flipping aggressively target homeowners who have built up substantial equity in their homes with repeated phone calls, mailings, and personal visits. The refinancings strip the equity and result in higher monthly payments, even though the only reason the borrower agreed to refinance was because they were promised lower monthly payments.

• Prepayment Penalties. While only around 1% to 2% of 'A' loans contain these penalties (in exchange for a slight reduction on standardized interest rates), industry analysts estimate that around 70% of subprime loans contain prepayment penalties. These penalties are used in the subprime market to trap borrowers in rates above what is appropriate for their risk by preventing them from refinancing. Prepayment penalties are profoundly anti-competitive measures which prevent the market from working for the benefit of borrowers.

• Encouragement of Non-Payment. An all-too-common practice in refinancings is to encourage borrowers to fall behind on an existing home loan with the promise of refinancing them down the road at a lower rate. When the borrower does not pay off their existing loan, their credit record is damaged, and then the lender tells them they are no

longer eligible for the lower rate. The ruse serves no purpose but to trap the borrower into signing a loan at unfavorable terms.

• Asset-Based Lending. The extension of loans based on the value of a dwelling and not on the borrower's ability to repay, also known as asset-based lending, produces huge windfalls for lenders under certain circumstances. On such loans, lenders profit from the origination fees and other charges – draining whatever savings the borrower may have – and then more than cover any losses due to the foreclosure process on the re-sale of the house. While the lender realizes substantial profits, the family is forced out of their home by a loan the lender knew they could never afford. OTS should move beyond HOEPA to prohibit this practice on an individual basis.

• Negative Amortization. Borrowers should be protected from loans with interest rates and fees so high that the monthly payments do not even cover the accumulating interest.

• Post-default interest rates. There is no justification for lenders to increase the interest rate on a loan simply because the borrower has defaulted on it.

Any consumer protections that OTS provides to consumers taking out loans from thrifts or their affiliates or subsidiaries should also be extended to consumers taking out loans from housing creditors that choose to opt out of state law under AMTPA.

Incentives to Encourage Responsible Lending

It is no secret that subprime lenders have targeted low- and moderate-income and heavily minority communities that have been abandoned, or at least neglected, by most banks and thrifts. A large portion of subprime lenders' profits has been due to providing high-cost loans to 'A' borrowers who either did not have banks or thrifts in their neighborhoods or were not marketed to by those institutions. From our outreach efforts and negotiating sessions with subprime lenders, we estimated that around 30% of borrowers in subprime loans should be qualifying for A loans.

Given this context and banks and thrifts' obligations to serve all neighborhoods under the Community Reinvestment Act, we believe it is inappropriate to talk about incentives for banks. Instead, we should be talking about their legal responsibilities. Banks and thrifts bear a substantial amount of responsibility for the extra costs subprime loans impose upon the families and neighborhoods they have abandoned. While subprime lenders have filled the vacuum left by banks and thrifts, over 98% of those same banks and thrifts receive 'satisfactory' or above CRA ratings. We need OTS and the other banking regulators to do more than merely recognize the link between banks' withdrawal from the neighborhoods that subprime lenders have targeted and provide for the stronger enforcement of banks' CRA responsibilities. Until that happens, borrowers in the

subprime market will continue to pay tens of thousands of dollars more on their home loans, simply because of the color of their skin or where they live.

In addition to holding thrifts to a higher standard under CRA, ACORN recommends that OTS should take the following steps:

• The agencies should penalize banks under their CRA evaluations for the purchase and origination of loans with predatory characteristics.

• On new charters and mergers, the agencies should consider whether the bank engaged in, or supported, predatory practices and not approve applications that are inconsistent with the principles of responsible lending.

• Thrifts should not be allowed to pick and choose among which categories of business done by their affiliates count toward their performance under CRA.

• The failure of banks and thrifts to upstream applicants with 'A' credit who apply for a loan with subprime affiliates into 'A' loans is a fair lending violation. OTS should pusue those violations and regularly inspect thrifts with affiliates and thrifts that engage in subprime lending for their patterns of providing 'A' and subprime loans.

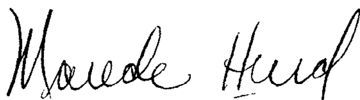
Overall Approach to AMTPA

ACORN believes OTS should reverse the position of its 1996 letter to a Wisconsin thrift that AMTPA's pre-emption of state laws applies beyond alternative mortgages to other mortgages as well.

Beyond that, OTS should recommend to Congress that AMTPA be repealed. It has significantly contributed to the rise of predatory lending practices by allowing unregulated lenders to to circumvent important consumer protections under state law. In addition, serious questions are being raised about whether its original rationale, weak as it is, still exists because of advances in the secondary market and other changes that provide lenders with greater flexibility.

On behalf of ACORN's 100,000-plus low- and moderate-income member families, thank you for your consideration.

Sincerely,



Maude Hurd
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