

**OCC ADVISORIES TO NATIONAL BANKS REGARDING
PREDATORY AND ABUSIVE LENDING PRACTICES AND
NOTICE OF REQUEST FOR PREEMPTION DETERMINATION OR ORDER**

--Questions and Answers--

General

What actions is the OCC taking today?

The OCC is issuing two advisory letters containing guidelines to assist national bank efforts to prevent predatory and abusive lending practices in connection with direct loan originations and with broker and third-party originations. It is also publishing a request for preemption determination of a state anti-predatory lending law.

- **Description of the advisory letters**

Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices
(OCC Advisory Letter 2003-2)

This advisory letter sets forth the OCC's supervisory guidance on lending practices that have been called "predatory" or "abusive." Any lending practices that take unfair advantage of borrowers or that have a detrimental impact on communities conflict with the high standards of conduct the OCC expects national banks to observe. Engaging in lending practices that are predatory also subjects banks to legal and supervisory risks.

The advisory letter advises national banks and their operating subsidiaries to take appropriate steps to ensure that they do not become involved in predatory lending. These steps include adopting policies and procedures to ensure that an appropriate determination has been made that a borrower has the capacity to make scheduled payments to service and repay the loan. A loan to a consumer that has been based on the foreclosure value of the collateral rather than on the borrower's ability to repay the loan without resort to the collateral, is fundamentally a predatory loan, and is inconsistent with safe and sound banking practices.

National banks also are advised to adopt policies and procedures to specify whether and under what circumstances they will make loans involving features that have been associated with abusive lending practices, such as frequent, sequential loan refinancings; refinancings of special subsidized mortgages that contain terms favorable to the borrower; balloon payments; prepayment penalties that are not limited to the early years of the loan; interest rate increases upon default; the financing of points and fees; single premium credit life insurance; and mandatory arbitration clauses. Such policies should be adequate to avoid the risk that a transaction could be deemed to involve unfair or deceptive practices. The advisory notes that the OCC has authority to enforce the Federal Trade Commission Act's (FTC Act) prohibition against unfair and deceptive practices, and explains that many predatory practices, such as "loan

flipping” and “equity stripping,” may be unfair or deceptive. The OCC will take supervisory action as appropriate to address such violations of law.

The OCC’s guidance also advises national banks to adopt policies and procedures that reflect the degree of care that is appropriate to the risk of a transaction. In some circumstances, this could include consideration of how the loan meets the borrower’s particular financial circumstances and needs. In addition, to promote credit access, national banks are encouraged to adopt procedures that provide for reporting of good credit histories to the major credit reporting agencies. Finally, the advisory notes that national banks should perform loan documentation reviews to ensure that loans comply with applicable laws and the bank’s policies in this area.

Significantly, the advisory notes that engaging in predatory lending practices also may adversely affect the OCC’s evaluation of a national bank’s CRA performance. For example, if a bank engages in “loan flipping” or “equity stripping” that violates the FTC Act, such practices have an adverse effect on the bank’s CRA evaluation. In addition, if a national bank makes loans without regard to the borrower’s ability to repay the loan, it has engaged in a practice that is inconsistent with helping to meet the credit needs of the community and has not complied with the OCC’s safety and soundness regulatory guidelines. Such a practice also may have an adverse effect on the bank’s CRA evaluation.

Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans
(Advisory Letter 2003-3)

National banks and their operating subsidiaries also can face significant risks when they make loans using brokers or purchase loans from third parties and such loans contain abusive features or reflect predatory lending practices.

This advisory letter states that national banks should take affirmative steps to address the risk that they may acquire predatory loans through broker and loan purchase transactions. Among other things, the advisory states that national banks should have clear procedures for entering into broker and third party originator relationships that delineate any unacceptable characteristics for loans the bank will acquire. As with loan origination policies, national banks should have policies for brokered and purchased loans that address such matters as: loans that are the result of frequent, sequential refinancings; loans that refinance special subsidized mortgages that contain terms favorable to the borrower; loans involving negative amortization, balloon payments and prepayment penalties that are not limited to the early years of the loan; loans that provide for interest rate increases upon default; loans that finance points and fees, including single premium credit life insurance; and loans with mandatory arbitration clauses.

The advisory states that national banks should perform appropriate due diligence before entering into a business arrangement with a broker or third-party loan originator, including conducting background checks on compliance with applicable licensing and consumer protection laws and reviewing litigation, enforcement actions, and consumer complaints against the third party. Based on this due diligence, the advisory recommends that national banks develop approved lists of brokers and originators with whom it will do business.

In addition, the advisory states that national banks should have written agreements with third parties that require brokers to abide by bank policies in this area, applicable law, and to make best efforts to ensure that loans offered to borrowers are consistent with the borrower's needs, objectives, and financial situation. The advisory also notes that Fannie Mae and Freddie Mac have adopted screening procedures to prevent predatory loans from being included in loan pools they purchase for securitization. If national banks obtain mortgage-backed securities from other sources, such as "private label" issuers, they should make reasonable efforts to review the issuer's reputation and the actions taken by the issuer to prevent predatory loans from being included in its pools.

To address another significant risk of consumer abuse involving fraud, national banks are advised to obtain and review written agreements between the borrower and the broker to ensure that the agreement clearly discloses the services the broker will provide and the fees to be paid to the broker, contains a specific request by the borrower for the specified services at that fee, and includes a signed and dated acknowledgement of receipt by the borrower of such agreement prior to performance of the broker's services.

National banks should monitor broker and third-party loan originators for compliance with these policies. When brokers or originators are found to have violated bank policies or applicable laws, banks should take appropriate corrective action, including modification of loan terms and termination of the business arrangement with the third party.

- **Description of the request for preemption determination**

We also expect to publish shortly in the *Federal Register* notice of a request we have received from National City Bank, N.A., National City Bank of Indiana, N.A., and their operating subsidiaries, National City Mortgage Company and First Franklin Mortgage Company, for a determination or order that the Georgia Fair Lending Act (GFLA) does not apply to the banks or their operating subsidiaries. Our *Federal Register* notice describes the statute that governs national banks' real estate lending activities, 12 U.S.C. § 371, the OCC's implementing regulations at 12 C.F.R. Part 34, and, in general, the Constitutional standards that govern our preemption analysis. We will also publish, as an appendix to the notice, the text of National City's request, which discusses in detail why the bank believes that the GFLA is preempted. Our notice will solicit public comment for a period of 30 days after publication.

Why are you releasing your supervisory guidance to national banks about predatory lending on the same day that you publish notice of the preemption request you have received from National City?

We think that it is important to state our views on predatory lending and the receipt of the preemption request provides a timely opportunity to do that. We also recognize that the question of whether or not State anti-predatory lending laws apply to national banks raises related questions about the standards that will apply to national banks if those laws do not apply to national banks. The comprehensive supervisory guidance we have issued today is responsive to such questions. The supervisory guidance contained in the OCC's advisory letters is the strongest statement by any Federal banking regulator to date that predatory and abusive lending

practices are unacceptable in the banks we supervise. Our release of the advisory letters now, as we take up National City's preemption request with respect to the Georgia Fair Lending Act (GFLA), confirms that – whatever our conclusion on the preemption question – the OCC will apply uniform standards nationwide to deter and, if appropriate, to remedy practices that are unsafe or unsound or that take unfair advantage of national banks' borrowers or have a detrimental effect upon their communities.

About the Advisory Letters

Will the OCC examine national banks and their operating subsidiaries to ensure that they have adopted the policies and procedures described in the Advisory Letters?

We expect that national banks and their operating subsidiaries will adopt such policies and procedures as are appropriate to the nature and scope of their operations. As a general matter, if we determine that an institution does not have adequate procedures in place suitable to address the risks it may face, we will advise the bank to take corrective action to address the matter. For example, if an examiner determines that a bank does not have procedures to ensure that loans it originates or purchases will be made based on a determination of the borrower's ability to repay the loan without resort to the collateral the bank will be directed to adopt such procedures. The examiner may further review whether the absence of those procedures has caused the bank to engage in any unsafe and unsound or abusive lending practices for which supervisory action will be necessary.

National banks and their operating subsidiaries are subject to regular examination as part of our comprehensive supervision of those entities. As the advisory letters note, a number of federal laws such as the Home Ownership and Equity Protection Act (HOEPA) and the Fair Housing Act may be implicated by predatory or abusive lending practices and our supervision includes a review for compliance with these laws. In addition, the OCC has a separate department whose function is to receive, review, and respond to consumer complaints against national banks or their subsidiaries.

If the OCC learns -- through its supervision of a bank or through its review of consumer complaints against a bank -- that the bank has engaged in practices that may be abusive, the OCC will appropriate supervisory action if it concludes that the practices are unfair or deceptive under the FTC Act, otherwise unlawful, or inconsistent with safety and soundness standards. Such supervisory action can include enforcement actions that require the bank to provide compensation to affected borrowers. A bank that has strong and effective policies and controls to prevent these practices will mitigate the risks of engaging in unsafe and unsound or unlawful conduct.

Why did you issue supervisory guidance rather than a regulation?

Supervisory guidance is a flexible way to address the number, variety, and complexity of issues that fall under the general category of "predatory lending," without cutting off fair access to

credit to low- and moderate-income borrowers. The advisory letters set out uniform and comprehensive standards to assist national banks in avoiding practices that are predatory or abusive, or from acquiring loans that contain reflect such practices. The advisory letters also state the OCC's intention to review evidence that a national bank or its operating subsidiary has engaged in an abusive lending practice under the unfair and deceptive practices standards of the FTC Act. The OCC believes that broad supervisory guidance and application of the FTC Act standards is a particularly appropriate way to ensure that abusive lending practices are not occurring in the national banking system because such determinations are inherently fact specific. The OCC does not have evidence to suggest that national banks are originating predatory loans or that proscriptive regulations are needed at this time to address such conduct. The advisory letters make sufficiently clear that predatory lending practices will not be tolerated within the national banking system.

About the Preemption Notice

How does National City's preemption request differ from other, similar requests that the OCC has received and published for comment?

The National City covers a different subject matter than other preemption questions that national banks have raised over the last several years. National City's request pertains primarily to the effect of the GFLA on the bank's exercise of its real estate lending powers. These powers are governed by the Federal statute that authorizes national banks to engage in real estate lending, 12 U.S.C. § 371, and by Part 34 of the OCC's regulations. Other recent preemption requests have included, for example, requests for opinions with respect to the applicability, under certain provisions of the Gramm-Leach-Bliley Act (GLBA), of State insurance sales laws to national banks insurance sales, solicitation, and cross-marketing activities. National banks and the OCC have also been involved in litigation over the applicability of State restrictions on fees (such as ATM convenience fees, and so-called "on us" check cashing fees) to national banks.

The National City request also differs procedurally from others that we have seen recently. National City is asking the OCC for a "determination or order" that provisions of the GFLA are preempted. The national bank real estate lending statute – 12 U.S.C. § 371 – specifically authorizes the OCC to issue an order with respect to the conditions that apply to national bank real estate lending. Unlike our legal opinions, which simply express the OCC's views about whether a Federal court is likely to find that a particular State law is preempted, an order would have the binding force and effect of law.

Given that 12 U.S.C. § 371 authorizes the OCC to set conditions on national banks' real estate lending activities, will the determination or order you issue to National City contain conditions on that bank's ability to engage in real estate lending? Will the conditions include the standards set forth in the advisories you've issued today?

The authority expressly granted to the OCC by section 371 enables us to address the conditions

that do apply to national bank real estate lending activities, as well as the conditions that do not apply. Our determination or order in the National City matter will address whether various provisions of the GFLA apply to condition the bank's real estate lending activities because that is the issue the bank has presented to us. Whether it is appropriate, or necessary, to specify affirmative conditions that apply as a matter Federal law will depend on our evaluation of the merits of this matter, which will not conclude until after the public comment period has closed.

Why are you reviewing the Georgia Fair Lending Act now when the Georgia legislature is considering amendments that would substantially revise that law?

In its letter to us, which is published as an appendix to our *Federal Register* notice, National City has represented that the proposed amendments to the Georgia statute would not affect many of the provisions that it argues are preempted. We will, of course, conduct our own review of the Georgia law, including any amendments that may be enacted, as part of our preemption analysis.

If you conclude that the GFLA is preempted, will that same conclusion apply to anti-predatory lending statutes in other states, such as New York?

Whatever conclusions the OCC reaches with respect to the Georgia law will apply only to the Georgia law. The provisions of other States' laws would need to be analyzed and evaluated separately.

National City's request asserts that 12 U.S.C. § 371 "occupies the field" of real estate lending. If that's true, doesn't this mean that all state and local anti-predatory lending laws would be preempted?

As is described in our *Federal Register* notice, National City has argued that § 371, together with the relevant provisions of Part 34 of the OCC's regulations, evidence a presumption that State law does not apply to the real estate lending activities of national banks and their operating subsidiaries unless the OCC determines, pursuant to its regulations, that a particular State law is not preempted. National City argues, in effect, that the statute and regulations leave no room for State regulation of real estate lending by national banks or their operating subsidiaries – that the statute and regulations together occupy that field.

Even if we conclude that National City's analysis in this respect is correct, our regulations require us to review the specifics of any State law that a bank may argue is preempted. Our regulations, at 12 C.F.R. § 34.4(a), contain a list of five types of State law limitations that do not apply to real estate loans made by national banks or their operating subsidiaries. The same rules, at § 34.4(b), say that the OCC will apply "recognized principles of Federal preemption" in considering whether other types of State laws – those not enumerated in the list at § 34.4(a) – apply. For purposes of issuing a determination or order under § 371, we will analyze whether a particular provision of the GFLA falls within the list of types of laws already expressly preempted under our regulation. If a provision of the GFLA does not fall within that list, we will apply "recognized principles of Federal preemption" to determine whether the provision applies. In either case, our conclusion will depend on the content of the particular State law, so that broad

generalizations about the applicability of all State anti-predatory lending laws would not be appropriate.

National City's request pertains to the bank itself and to two mortgage banking operating subsidiaries of the bank. If the Georgia law is preempted, what sorts of protections will consumers have who borrow from the mortgage banking subsidiaries?

Unless Federal law requires otherwise, the mortgage banking subsidiaries are subject to the same laws that apply to their parent bank. Thus, the consumer protections that apply in the case of the parent bank -- including the anti-predatory lending standards in the Home Ownership and Equity Protection Act and the OCC's advisories -- apply to all loans made by the mortgage banking subsidiaries. Moreover, these subsidiaries are subject to the OCC's supervision and regulation. As a result, their lending operations are examined by the OCC, and the OCC has the same broad range of enforcement tools available to address violations of law by the subsidiaries as we have in dealing with the parent bank.

The OTS has recently issued an opinion indicating that provisions of the GFLA are preempted with respect to Federal savings associations. How will your analysis differ from the OTS's?

National banks and Federal thrifts are Federal instrumentalities with comparable charters. In many cases, both types of entities are governed by similar Federal laws. There are, however, differences between the statutory powers given to the two types of entities. We will, of course, be looking specifically at the powers granted to national banks under the national banking laws and regulations, whereas OTS's analysis was based on provisions of the Home Owners' Loan Act and Federal thrift regulations.