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Remarks by John Taylor, President and CEO of the
National Community Reinvestment Coalition before the
U.S. House of Representatives
Financial Services Committee, Oversight and Investigations Subcommittee

Congressional Review of OCC Preemption: The Impact on Housing and Community Development

Introduction

Good morning Representatives Kelly and Gutierrez and distinguished Members of the Committee. My name is John Taylor and I am the President and CEO of the National Community Reinvestment Coalition in Washington, D.C. I would like to thank you for the opportunity to speak to you today regarding the OCC's preemption of state anti-predatory lending law.

Background

NCRC is a national trade association representing more than 600 community-based organizations and local public agencies who work daily to promote economic justice and increase fair and equal access to credit, capital and banking services to traditionally underserved populations in both urban and rural areas.

NCRC supports long-term solutions that provide resources, knowledge, and skills to build community and individual wealth. NCRC has represented our nation's communities on the Federal Reserve Board's Consumer Advisory Council, Community Development Financial Institutions Advisory Board, Freddie Mac's Housing Advisory Council, Fannie Mae's Housing Impact Council and before the United States Congress.

NCRC works directly with the community through our services including the Consumer Rescue Fund, and Financial Education and Outreach initiatives. Our Consumer Rescue Fund initiative has assisted more than 500 consumers who were victims of predatory lending. We also provide financial education to help low- and moderate-income people achieve homeownership and access to wealth.

Predatory Lending and Discrimination

Predatory lending has surged in recent years. Now, more than ever, we need strong and comprehensive anti-predatory laws at the state and federal level. We need more consumer protections, not less. Yet the OCC has just boldly preempted state anti-predatory law.

NCRC recently issued a report we called the *Broken Credit System* (available via http://www.ncrc.org). We find that African-American and elderly communities receive a considerably higher level of high cost loans than is justified based on the credit risk of neighborhood residents.[1] President Bush has declared an Administration's goal of 5.5 million new minority homeowners by the end of the decade. The widespread evidence of price discrimination threatens the possibility of creating sustainable and affordable homeownership opportunities for residents of traditionally underserved neighborhoods.[2]

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[1] NCRC used 2001 HMDA data and 1999 data on creditworthiness obtained from one of the three major credit bureaus. For more information about the report's methodology, please visit our web site, http://www.ncrc.org.

[2] A subprime loan has an interest rate higher than prevailing and competitive rates in order to compensate for the added risk of lending to a borrower with impaired credit. NCRC defines a predatory loan as an unsuitable loan designed to exploit vulnerable and unsophisticated borrowers. Predatory loans are a subset of subprime loans. A predatory loan has one or more of the following features: 1) charges more in interest and fees than is required to cover the added risk of lending to borrowers with credit imperfections, 2) contains abusive terms and conditions that trap borrowers and lead to increased indebtedness, 3) does not take into account the borrower's ability to repay the loan, and 4) violates fair lending laws by targeting women, minorities and communities of color. Using the best available industry data on credit worthiness, NCRC uncovered a substantial amount of predatory lending involving rampant pricing discrimination and the targeting of minority and elderly communities.

Sadly, it is still the case in America that the lending marketplace is a dual marketplace, segmented by race and age. If a consumer lives in a predominantly minority community, he or she is much more likely to receive a high cost and discriminatory loan than a similarly qualified borrower in a white community. At the same time, the elderly, who have often built up substantial amounts of equity and wealth in their homes, are much more likely to receive a high cost refinance loan than a similarly qualified younger borrower. The disproportionate amount of subprime refinance lending in elderly neighborhoods imperils the stability of long-term wealth in communities and the possibilities of the elderly passing their wealth to the next generation.

Lending discrimination in the form of steering high cost loans to minorities and elderly borrowers qualified for market rate loans results in equity stripping and has contributed to inequalities in wealth. According to the Federal Reserve Survey of Consumer Finances, the median value of financial assets was $38,500 for whites, but only $7,200 for minorities in 2001. Whites have more than five times the dollar amount of financial assets than minorities. Likewise the median home value for whites was $130,000 and only $92,000 for minorities in 2001.[3]

NCRC selected ten large metropolitan areas for our analysis: Atlanta, Baltimore, Cleveland, Detroit, Houston, Los Angeles, Milwaukee, New York, St. Louis, and Washington DC. As expected, the amount of subprime loans increased as the amount of neighborhood residents in higher credit risk categories increased. After controlling for risk and housing market conditions, however, the race and age composition of the neighborhood had an independent and strong effect, increasing the amount of high cost subprime lending.

For example:

[3] Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, *Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances*, Federal Reserve Bulletin, January 2003.

- The level of refinance subprime lending increased as the portion of African-Americans in a neighborhood increased in nine of the ten metropolitan areas. In the case of home purchase subprime lending, the African-American composition of a neighborhood boosted lending in six metropolitan areas.

- The percent of African-Americans in a census tract had the strongest impact on subprime refinance lending in Houston, Milwaukee, and Detroit. Even after holding income, creditworthiness, and housing market factors constant, going from an all white to an all African-American neighborhood (100 percent of the census tract residents are African-American) increased the portion of subprime loans by 41 percentage points in Houston.

- Solely because the percentage of the African-American population increased, the amount of subprime home purchase lending surged in Cleveland, Milwaukee, and Detroit. From an all white to an all African-American neighborhood in Cleveland, the portion of subprime home purchase loans climbed 24 percentage points.

- The impact of the age of borrowers was strong in refinance lending. In seven metropolitan areas, the portion of subprime refinance lending increased solely when the number of residents over 65 increased in a neighborhood.

- Elderly neighborhoods experienced the greatest increases in subprime refinance lending in St. Louis, Atlanta, and Houston. Even after holding income, creditworthiness, and housing market factors constant, the portion of subprime refinance lending would surge 31 percentage points in St. Louis from a neighborhood with none of its residents over 65 to all of its residents over 65.

NCRC's findings are consistent with a body of research on subprime lending. A recent survey study conducted by Freddie Mac analysts finds that two-thirds of subprime borrowers were not satisfied with their loans, while three-quarters of prime borrowers believed they received fair rates and terms.[4] In previous years, Freddie Mac and Fannie Mae have often been quoted as stating that about a third to a half of borrowers who receive subprime loans actually qualify for lower cost loans.[5] Dan Immergluck, a professor at Grand Valley State University, was one of the first researchers to document the "hypersegmentation" of lending by race of neighborhood.[6] Like Immergluck's work, the Department of Housing and Urban Development found that after controlling for housing stock characteristics and the income level of the census tract, subprime lending increases as the minority level of the tract increases.[7] The Research Institute for Housing America, an offshoot of the Mortgage Bankers Association, released a controversial study in 2000 that concluded that minorities were more likely to receive loans from subprime institutions, even after controlling for the creditworthiness of the borrowers.[8]

NCRC's study is quite similar and builds upon important research conducted by a Federal Reserve economist and two researchers from the Wharton School at the University of Pennsylvania. Paul Calem of the Federal Reserve, and Kevin Gillen and Susan Wachter of the Wharton School also use credit scoring data to conduct econometric analysis scrutinizing the influence of credit scores, demographic characteristics, and economic conditions on the level of subprime lending. Their study found that after controlling for creditworthiness and housing market conditions, the level of subprime refinance and home purchase loans increased in a statistically significant fashion as the portion of African-Americans increased on a census tract level in Philadelphia and Chicago.[9]

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[4] Freddie Mac analysts Marsha J. Courchane, Brian J. Surette, Peter M. Zorn, *Subprime Borrowers: Mortgage Transitions and Outcomes*, September 2002, prepared for Credit Research Center, Subprime Lending Symposium in McLean, VA.
[5] "Fannie Mae Vows More Minority Lending," in the Washington Post, March 16, 2000, page E01. Freddie Mac web page, http://www.freddiemac.com/corporate/reports/moseley/chap5.htm.
[6] Dan Immergluck, *Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development*, the Woodstock Institute, November 1999.
[7] Randall M. Scheessele, *Black and White Disparities in Subprime Mortgage Refinance Lending*, April 2002, published by the Office of Policy Development and Research, the U.S. Department of Housing and Urban Development.
[8] Anthony Pennington-Cross, Anthony Yezer, and Joseph Nichols, *Credit Risk and Mortgage Lending: Who Uses Subprime and Why*? Working Paper No. 00-03, published by the Research Institute for Housing America, September 2000.
[9] Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. Available via pcalem@frb.gov.

Equity Stripping and Foreclosure

While price discrimination is insidious, it is often combined with abusive terms and conditions that compound the evils of predatory lending. Overpriced loans with abusive terms and conditions strip equity out of borrowers' homes and often lead to foreclosure. Major abuses associated with predatory lending include packing loans with usurious fees and unnecessary products, steep prepayment penalties, repeated refinancing or flipping, single premium credit insurance, and mandatory arbitration.

The abusive terms and conditions on predatory loans can be so harmful that after several years of paying on time, the borrower still owes almost the entire principal on the loan. This is systematic equity stripping. NCRC's Consumer Rescue Fund initiative has uncovered numerous examples of predatory lending in its purest and most vicious form.

NCRC developed the Consumer Rescue Fund (CRF) initiative, designed to get borrowers out of abusive loans and helps borrowers at risk of foreclosure get a fresh start. Under the CRF initiative, NCRC arranges affordable refinance loans for victims of predatory lenders. All CRF loans are conventional home mortgage loans with prime-like interest rates, no fees, no points, no prepayment penalties, and no insurance or ancillary product sales or offerings. The CRF initiative has also created a national predatory lending referral network in cooperation with other consumer rights groups, legal service organizations, and the pro-bono Bar. The purpose of the collaboration is to maximize our collective ability to bring fair lending cases and complaints for matters that were previously perceived as consumer issues.

The following are examples from our CRF Initiative of predatory lending:

- NCRC recently represented an elderly minority couple who had owned their home in the District of Columbia for nearly 40 years. In order to pay medical expenses, a predatory lender convinced the couple to take out an adjustable rate mortgage with a prepayment penalty of over $13,000 and a loan payment that exceeded the couple's monthly income. Faced with imminent foreclosure, the couple attempted a "short sale" of their home, but was almost unable to complete the sale due to the prepayment provision. After NCRC's intervention, the sale took place.

- NCRC intervened in the case of a borrower saddled with an 11% interest rate home purchase loan. Although the usurious loan had settlement charges of 15 percent, it still had no escrow for taxes and insurance. NCRC staff estimated that the property's appraisal was inflated by about $ 20,000. When the borrower tried to obtain the original appraisal from the lender, he was told it was deleted from the computer. The borrower was also hurried through the closing; he did not understand the loan terms and he did not understand why the closing costs were significantly different from the Good Faith Estimate (GFE). A prepayment penalty equal to six months of interest payments was applied for a period of three years after loan origination.

- NCRC aided a borrower with a balloon loan that had an APR of 11.16 percent. The borrower spoke only Spanish, but the broker conducted the closing in English. Needless to say, the broker did not explain loan terms adequately. When the borrower approached our CRF program, the monthly housing payment to income ratio was an incredible 86 percent. Despite consuming almost her entire monthly income, the loan did not contain an escrow for taxes and insurance payments.

- NCRC's CRF initiative assisted a borrower who originally obtained a home improvement loan. Different lenders convinced the borrower to refinance his loan twice within six months. One lender charged more than $5,600 in fees. After the second flip, the borrower was paying almost 60 percent of his monthly income on mortgage payments

- NCRC assisted a borrower with a balloon loan over $41,000 that had an APR of more than 13 percent. When the balloon payment must be made at the end of 15 years, the borrower will owe $35,000, or almost the entire loan amount.

- NCRC rescued a borrower that had an adjustable rate mortgage of $105,000 with an initial APR of 13.99 percent. The fees and points on this loan amounted to 4.7 percent of the loan amount, due in large part to a broker fee of $4,725. The loan was unaffordable from inception since the broker exaggerated the borrower income by adding the income of a minor, teenage daughter who had worked part time. At time of CRF intake, the total debt to monthly income was an incredible 67 percent. Yet, the loan did not have an escrow for taxes or insurance payments. To escape this predatory loan, the borrower confronted a prepayment penalty of 5 percent for a period of three years after loan origination. Consequently, the foreclosure process had commenced by time the borrower had contacted NCRC.

Predatory Lending Destroys Housing and Community Development

Predatory lending destroys housing and community development in minority and low- and moderate-income neighborhoods across America. When predatory lenders besiege a neighborhood, the initial impact is a reduction in economic activity. Receiving discriminatory and over-priced loans, families lose equity and confront unaffordable mortgage payments. They spend less on products and services. Local businesses lose customers and revenues. After a while, the process is accelerated as more and more neighborhood residents reduce expenditures and businesses stop paying their landlords. Still later, when families lose their homes to foreclosure, property values plummet, houses become abandoned, businesses close, and people move out of the neighborhood. The only party benefiting from this economic devastation is the predatory lender, who profits by sucking wealth from the neighborhood.

It may be tempting to assert that NCRC exaggerates the impact of predatory lending on neighborhoods. But consider that in one Consumer Rescue Fund case, NCRC represented 400 families from an entire neighborhood that had been victimized by predatory developers, appraisers, brokers and lenders. Also consider that lawsuits such as the New York Attorney General’s lawsuit against Delta Funding are based on lenders targeting entire neighborhoods with high levels of minority residents and/or the greatest number of people without high school educations.[10]

The cruel irony is that the Community Reinvestment Act (CRA) and community group activism over the last several years motivated traditional lenders to make more prime and affordable mortgage loans to minority and low- and moderate-income communities. Federal Reserve economists, using NCRC's database on CRA agreements, document that traditional banks make more loans in communities in which they have established partnerships with community groups and negotiated CRA commitments with them.[11] Now, however, all of this noble work is threatened by the surge in predatory lending.

The OCC Anti-Predatory Standard Will Not Protect Communities

The cruel irony is compounded when one of the federal agencies charged with enforcing CRA preempts all state anti-predatory law with one grand stroke of its pen. States lose their ability to protect their citizens from massive foreclosures and loss of wealth.

The OCC boasts that it enacted the strongest regulation ever against predatory lending. In fact, the OCC preempts comprehensive state anti-predatory law with an inadequate regulation. The OCC's regulation states that a national bank shall not make a loan based "predominantly on the foreclosure value of the borrower's collateral, without regard to the borrower's repayment ability." The rule further prohibits national banks from engaging in practices that are unfair and deceptive under the FTC (Federal Trade Commission) Act.

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[10] Complaint by New York State Attorney General against Delta Funding, in the United States District Court Eastern District of New York, August 19, 1999.

11 *Do CRA Agreements Influence Lending Patterns*? Paper presented at Federal Reserve Community Development conference by Raphael W. Bostic (Board of Governors of the Federal Reserve System and University of Southern California bostic@usc.edu), and Breck L. Robinson (University of Delaware robinsob@be.udel.edu).

The OCC's asset-based standard falls short because it will not cover many instances of predatory lending. For example, an abusive loan can escape OCC scrutiny because it can still strip equity without leading to delinquency or foreclosure. In other words, a borrower can have the necessary income to afford monthly payments, but he or she is still losing wealth as a result of a lender's excessive fees or unnecessary products.

Unlike state law, the OCC regulation does not explicitly prohibit numerous abuses such as flipping, single premium credit insurance, steep prepayment penalties, fee packing, high balloon payments, and mandatory arbitration. The OCC claims that the FTC Act can cover some of these abuses, but many other predatory practices are not addressed by the FTC Act or the OCC's interpretation of the FTC Act.[12]

The OCC's new regulation does not begin to compensate for the roll back in state protections. State law is much more comprehensive and specific than the OCC regulation in its prohibitions against abusive lending, and is thus a much more rigorous legal tool in lawsuits and other enforcement actions. Under state law, state agencies and private citizens were able to sue predatory lenders using a national charter. Now, under OCC preemption, they cannot. It is true that the OCC has used the FTC Act to stop a few national banks in their predatory tracks. But it is unconsciousable to handcuff the ability of states and their citizens to go after the predators using strong state laws.

State Anti-Predatory Lending Laws Combat Abusive Practices Without Decreasing the Availability of Credit

The benefits of state anti-predatory law are clear: prevention of widespread foreclosures, wealth stripping and the preservation of housing and community development. The costs

[12] The OCC issued an Advisory Letter (AL 2003-2) in February of 2003 in which they discuss how the FTC Act could be applied to abusive lending practices. The agency's discussion of applying the FTC Act includes only three abusive practices – flipping, equity stripping, and fee packing. Furthermore, the OCC says that these practices may or may not violate the FTC Act, depending on the "totality of the circumstances" associated with the loan. This Advisory Letter suggests that the OCC's enforcement of its new standard is likely to be more tentative and hesitant than state Attorney Generals and bank commissioners using state law that is much more specific and detailed about how and when abusive practices are illegal.

of state laws are undocumented and illusory. The financial industry claims that state anti-predatory laws increase lending costs and thus causes them to curtail responsible subprime lending. The OCC agrees with these assertions.

In a speech over the summer, Comptroller Hawke said that state anti-predatory laws have "overbroad and unintended adverse effects...effects that, as we've seen, can be almost as harmful as the problem those laws were designed to address."[13]

But the studies to date present inconclusive and contradictory evidence about the possibilities of anti-predatory laws restricting access to credit. On the other hand, the damage caused by predatory lenders is real and severe.

In a paper entitled "Do Predatory Lending Laws Influence Mortgage Lending," Peter Nigro of the OCC and Keith Harvey of Boise State University conclude that North Carolina's anti-predatory law did not affect the subprime market share of loans made to low- and moderate-income borrowers in North Carolina relative to five other Southeastern states. While the authors find a small decrease in the subprime market share to minorities, the change is "significant at the 10 percent level only." In other words, the change for minorities is barely statistically significant. Moreover, Nigro and Harvey find that non-bank mortgage companies decreased their lending to a much greater extent than banks after passage of North Carolina law. This study suggests that national banks have not faced significant constraints nor has their lending been "materially" impacted by passage of state anti-predatory law.[14]

In a more recent study, Professor Michael Stegman and his colleagues at the University of North Carolina concluded that the North Carolina anti-predatory law did not restrict overall access to credit, but did decrease loans with abusive features such as loans with

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[13] Remarks by John D. Hawke, Jr., Comptroller of the Currency, before the Federalist Society, Washington DC, July 24, 2003.

[14] Keith D. Harvey, Boise State University, and Peter J. Nigro, OCC, *Do Predatory Lending Laws Influence Mortgage Lending? An Analysis of the North Carolina Predatory Lending Law*, September 2002, see pg. 14 and 25

prepayment penalties beyond three years.[15] Ironically, the OCC misinterpreted Stegman's work when the OCC asserted a sharp decline in loans in the wake of North Carolina law. The trade publication, *Inside B& C Lending*, reports that the OCC later issued a clarification acknowledging its mischaracterization of the Stegman study.[16]

NCRC is aware that other studies come to opposite conclusions regarding the impact of anti-predatory laws. Professor Staten of Georgetown University asserts that anti-predatory law reduces the number of subprime loans to traditionally underserved borrowers.[17] Nigro and Harvey conducted another study documenting declines in subprime lending after enactment of anti-predatory law by the cities of Philadelphia and Chicago.[18] These studies, however, suffer significant data and interpretative shortcomings. Staten's study relies on data supplied by a trade association of subprime lenders. Nigro's and Harvey's study does not adequately consider that lenders stopped lending in the two cities for a very short time period in order to pressure the cities and their state governments to nullify the laws.

Regardless of whose studies are viewed with more credibility, it is beyond doubt that an impartial observer would conclude that the current level of academic research does not support the bold assertions and actions of the OCC. For each study that asserts impairment of national bank lending, another study discounts that possibility. Moreover, only one study, Stegman's, examines the types of loans affected by anti-predatory law.

Finally, the OCC stretches the bounds of credulity by asserting that state anti-predatory law interferes with the safe and sound operations of banks. In their Question and Answer

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[15] Roberto G. Quercia, Michael A. Stegman, and Walter R. Davis, *The Impact of North Carolina's Anti-Predatory Lending Law: A Descriptive Assessment*, June 25, 2003, the Center for Community Capitalism, University of North Carolina at Chapel Hill.

[16] "OCC Admits NC Slip-Up, but Did Anyone Notice," Inside B&C Lending, August 18, 2003.

[17] Gregory Elliehausen and Michael Staten, *Regulation of Subprime Mortgage Products: An Analysis of North Carolina's Predatory Lending Law*, October 2002, McDonough School of Business, Georgetown University.

[18] Keith D. Harvey and Peter J. Nigro, *How Do Predatory Lending Laws Influence Mortgage Lending in Urban Areas? A Tale of Two Cities*, March 2002.

document on their preemption order, the OCC states, "When national banks are unable to operate under uniform, consistent and predictable standards, their business suffers, which negatively impacts their safety and soundness."[19]

Anti-predatory law prohibits abusive practices, not the provision of basic banking products. Moreover, anti-predatory law is not any more interruptive of uniform national standards than state law applying to many other aspects of banking and lending. Federal statutes including the Real Estate Settlement Procedures Act (RESPA) and the Home Ownership and Equity Protection Act (HOEPA) allow stronger state consumer protection laws to co-exist with federal laws. Lenders have adapted to this regime for decades.

It is predatory lending, not the multiplicity of state law that threatens safety and soundness. Indeed, the FDIC has found that although subprime lenders constitute about 1 percent of all insured financial institutions, they account for 20 percent of depository institutions that have safety and soundness problems.[20] The spectacular failures of Superior Bank and Conseco are testimony that predatory lending devastates financial institutions as well as their borrowers. State anti-predatory law helps lenders save themselves from their own abusive practices instead of presenting a barrier to mainstream lending.

Preemption of State Law Results in Too Few Consumer Protections and Regulators

Any prudent lawmaker would agree that it is dangerous to designate just one agency as the enforcer of consumer protection law in an industry as large and complex as banking. Yet, the OCC's aggressive preemption has done just that. It has replaced anti-predatory law and enforcement in about half of the states with only one federal regulator.[21]

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[19] OCC January 7, 2004 press release and accompanying documents, see http://www.occ.treas.gov.
[20] Department of Treasury, Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, Proposed Agency Information Collection Activities (Collecting subprime lending information on call reports), Federal Register, May 31, 2000, pages 34801-34819.

[21] States with anti-predatory laws include AR, CA, CO, CT, District of Columbia, FL, GA, KY, IL, MD, ME, MN, NE, NC, NJ, NM, NY, OH, PA, SC, TX, VA, WV

Using CRA Wiz software produced by PCI Services, Inc., NCRC calculates that OCC-regulated institutions made 4,479,087 single-family loans or about 28 percent of all single family loans reported under HMDA in 2002. The OCC preemption will thus have profound impacts on the market and on the scope of protection against abusive lending.

While the OCC boasts that national banks are not involved in predatory lending to any discernible degree, NCRC finds it implausible that a group of lenders representing nearly one third of the marketplace are involved, purposefully or unwittingly, in only a marginal amount of abusive activity. To take just one example, NCRC provided assistance to Maxine Wilson, who spearheaded a lawsuit involving more than 400 families in New York state against a number of financial institutions and real estate developers. The lawsuit also involves national banks. In this case, the national banks did not make the predatory loans, but they purchased them.

Conclusion

To start the new year, the OCC acted in a manner directly contradictory with their responsibilities of enforcing CRA, anti-discrimination laws, and safety and soundness statutes. The OCC's audacious preemption order is a dire threat to housing and community development. It is a direct threat to the ability of thousands of hard-working families to hold onto to their American Dream of homeownership. Congress must act quickly to undo the OCC's action before the scourge of predatory lending accelerates. Congress must repeal the OCC's order as well as the preemption actions of the Office of Thrift Supervision and the National Credit Union Administration. Congress must also enact a comprehensive anti-predatory law that does not preempt state law along the lines of Senator Sarbanes and Representative Schakowsky's bills.

NCRC stands ready to work with you in these vital endeavors.