



SUPPORT H.R. 3974

The Prohibit Predatory Lending Act

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MILLER, WATT, AND OTHERS SPONSOR ANTI-PREDATORY LENDING LEGISLATION BASED ON LANDMARK NORTH CAROLINA SOLUTION

H.R. 3974 draws on North Carolina's landmark 1999 law to amend existing federal law, the Home Ownership and Equity Protection Act. The bill:

- Improves upon existing **protections for high-cost home loans**.
 - Prohibits equity-stripping practices such as the financing of exorbitant fees, prepayment penalties (on high-cost loans below local FHA loan limits), and excessive fees for payoff information, modification, or late payments;
 - Prohibits practices that increase the risk of foreclosure, such as lending without regard for whether the borrower is able to repay, encouraging a borrower to default, balloon loans, and call provisions;
 - Requires that a borrower receive counseling before entering into a high-cost loan; and
 - Prohibits mandatory arbitration clauses on high-cost loans.
- **Tightens existing loopholes** in the scope of HOEPA protections.
 - Expands the scope of the Act to cover purchase money loans and open-end loans;
 - Defines high-cost loans as loans with points and fees above 5% of the loan amount (HOEPA currently says 8%), and includes yield-spread premiums and prepayment penalties in the definition of points and fees;
 - Codifies the Federal Reserve regulations on the existing rate threshold for high-cost loans and the inclusion of single premium credit insurance in points and fees; and
 - Clarifies that HOEPA applies to broker abuses.
- Addresses equity-stripping below high-cost thresholds by **adopting the North Carolina prohibition against flipping** a home loan without any reasonable, tangible benefit to the borrower.

North Carolina's Landmark Anti-Predatory Lending Law a Success

In 1999, North Carolina enacted a landmark anti-predatory lending law that addressed abusive mortgage lending practices. Research regarding the North Carolina law has shown that the state's reform is having its intended effect. Without question, North Carolina has reduced predatory lending. At the same time, evidence shows borrowers in North Carolina continue to have access to a wide variety of competitively priced loans from a wide variety of lenders.

An analysis by a leading industry trade journal, *Inside B&C Lending*, found that top North Carolina subprime lenders "continue to offer a full array of products for borrowers in North Carolina – with little or no variation in rate" compared to other states. In addition, a recent

Morgan Stanley & Co. survey of 280 subprime branch managers and brokers found that tougher predatory lending laws have not reduced subprime residential lending volumes.

The Center for Responsible Lending's analysis of home loans made in the nation and reported to federal regulators as originated under the Home Mortgage Disclosure Act (HMDA) shows that subprime lending continues to thrive in North Carolina. For instance:

- North Carolina had 15% more subprime home loans per capita than the rest of the nation as a whole in 2000.
- Measuring access to subprime home loans as the ratio of subprime to prime loans, North Carolina ranked 6th out of the 50 states and the District of Columbia in 2000.
- North Carolina had the highest proportion of subprime to prime loans to low-income borrowers in the nation. One of every three loans to low-income North Carolina borrowers (annual incomes of less than \$25,000) were subprime.
- Every subprime lender with significant business in the state in 1999 (greater than 1% market share) that reported originating any loans nationally also continued making North Carolina home loans in 2000. The only lender to announce its intention to withdraw from the North Carolina market, Countrywide's subprime affiliate, originated only an average of 121 loans per year from 1998 to 2000. The lenders who have remained in the state, including Countrywide's prime lender, continue to find North Carolina a profitable place to do business.

Some erroneously point to an industry-sponsored study (published by the Credit Research Center) as evidence that the North Carolina law decreased access to subprime credit for low-income borrowers. However, the study has been widely criticized. Significantly, the study was based on loans originated between 1997 and June 30, 2000; however, the N.C. law did not take full effect until July 1, 2000.

Estimates from the Center for Responsible Lending show that the new law saved consumers at least \$100 million by preventing predatory loan terms that would have been expected to occur in the law's absence.

Most recently, a 2003 University of North Carolina study concluded that the NC law succeeded in reducing the incidence of loans with predatory terms (perhaps most notably leading to a 72% drop in subprime prepayment penalties with terms of three years or longer while giving rise to a 43% increase in subprime home purchase loans). The study is available on the CRL website, www.responsiblelending.org.

Background on Predatory Lending

Predatory lending, a term used to describe an abusive set of home lending practices that deprive homeowners of hard-earned equity, has been estimated to cost U.S. consumers \$9.1 billion each year. Over the last decade, predatory lending emerged in the subprime home loan market primarily among finance companies and mortgage brokers (both of whom lack safety and soundness regulators). Subprime lending generally describes loans made to individuals that do not meet the criteria for mainstream (also called "prime") loans. It is important to note that while all subprime loans are not predatory, almost all predatory loans are subprime.

While many abusive practices have emerged in this sector, the single largest abuse is equity-stripping. Not satisfied with higher interest rates, abusive lenders strip equity by charging exorbitant fees, often equal to 5% or more of the loan amount (five times the typical fee on a competitive, prime loan). The problem for borrowers is that while they may refinance out from an interest rate that does not properly reflect their risk, they cannot recover fees. Instead, in almost every instance those fees are financed into the loan amount and are repaid from the borrower's equity when they refinance.