Analysis of OCC Guidelines Establishing Standards for Residential Mortgage Lending Practices

CRL Policy Analysis February 3, 2005

While we are heartened that the OCC has recognized many of the issues raised by state anti-predatory lending efforts in recent years, the OCC's guidance for national banks is no substitute for meaningful and effective legislative efforts at the state and federal level. Further, we are disappointed that the OCC does not identify some practices as clearly predatory and take a stronger stance on enforcing rules that prohibit banks from engaging in predatory lending.

The Guidelines demonstrate recognition of some predatory lending issues, but are insufficient to protect homeowners from abusive lending practices compared to state and federal legislation.

The guidelines *do* identify abusive practices with general language and do establish the need for banks to heighten scrutiny when certain terms and practices are used. It is clear that the OCC has taken a serious look at these critical issues and has made a positive move to provide guidance on abusive practices. To date, the OCC has not demonstrated its willingness to resolve claims of abusive mortgage lending comparable to efforts by state officials or homeowners themselves.

If they take a stronger approach to enforcement of the standards established in these guidelines, the OCC will be making a significant contribution towards helping to protect homeowners from abusive practices.

<u>We believe the OCC's guidance would be stronger and more meaningful by affirming the following</u>:

- Single premium credit insurance and mandatory arbitration are patently unfair to borrowers and should not be permitted.
- Prepayment penalties on subprime loans should be used sparingly, if at all, and with significant limitations on the length and size of the penalty.
- Assignee liability is necessary to allow homeowners who have received predatory loans to protect their homes from foreclosure.
- Any loan with points and fees over 5 percent of the loan amount, including prepayment penalties and yield spread premiums, are particularly subject to abuse, and should be extremely rare.

Below is a more detailed discussion of the strengths and weaknesses of the OCC's new guidelines.

1. The OCC identifies certain inherently abusive practices as potentially appropriate for borrowers.

While the OCC identifies certain practices that *may* be abusive, such as financed single premium credit insurance, prepayment penalties on subprime loans, and mandatory arbitration clauses, the guidelines state that these loan terms, conditions and features "may, under particular circumstances, be susceptible to abusive, predatory, unfair or deceptive practices*, yet may be acceptable and may benefit customers under other circumstances."*

In contrast, many states and reputable lenders have recognized that single premium credit insurance and mandatory arbitration are unfair to borrowers and cannot be present in home mortgage loans. North Carolina banned financed single premium credit insurance over five years ago. In addition, most lenders have abandoned single premium credit insurance in favor of other products, so the OCC's hortatory guidance lags far behind other regulators and the market.

Similarly, numerous states have banned or established specific limits on subprime prepayment penalties, and recent research has demonstrated the harmful impact of prepayment penalties on homeowners. Instead, the OCC adopts an ambiguous recommendation that lenders consider avoiding originating loans with "prepayment penalties that are not limited to the early years of the loan."

Like state anti-predatory lending laws that have successfully curbed abusive loans, the OCC should clarify that any limit on total points and fees should count prepayment penalties towards the threshold amount. In addition, the OCC should adopt specific and strict limits on subprime prepayment penalties themselves. There are numerous models for this approach. For example, at least nine states ban prepayment penalties outright, and approximately 35 limit the term or size of permissible penalties. Further, Fannie Mae and Freddie Mac have both announced they will not purchase loans with prepayment penalties exceeding three years, and several lenders have adopted similar best practices. Household has limited prepayment penalties to the first two years of the loan and 2% of the loan amount, and several other subprime lenders have limited prepayment penalties to 3% in the first year, 2% in the second, and 1% in the third year of the loan.

2. The OCC's standards for purchased loans are too general and are no substitute for meaningful assignee liability protection against abusive loans at the state level.

While the OCC provides that banks should use heightened scrutiny in purchasing loans from brokers and other third parties, we do not believe the guidelines provide a meaningful incentive or sufficient guidance for Banks to oversee third-party relationships. Echoing state efforts to address high-cost loans through a comprehensive treatment of all of the points and fees on a loan, the OCC recommends that national banks adopt standards regarding total loan compensation in purchasing loans, including terms such as yield-spread premiums that can "provide an incentive to originate loans with predatory or abusive characteristics."

Again, the OCC does not require that standards be in place, nor does it provide any indication regarding the appropriate level of total compensation. In addition, the OCC standards are no substitute for remedies provided in state law. Without the complementary enforcement mechanism of meaningful remedies and assignee liability provisions in state and federal laws, such standards do not assist homeowners who have received a predatory loan but cannot raise a claim in foreclosure because their loan has been sold.

3. The OCC should provide additional clarity in defining prohibited predatory practices.

The OCC recognizes many of the core concerns with predatory lending by stating that a bank should not become involved in predatory practices such as "equity stripping" and "loan flipping." It is a positive step forward that the OCC has acknowledged that such practices put both a bank and its borrowers at risk.

Unfortunately, the OCC guidance does not provide the clarity and certainty found in many state predatory lending laws. For example, while the guidelines prohibit financing excessive fees, they offer no standard for determining what might be considered excessive. In contrast, many states, and many lender best practices have suggested that any loan with points and fees over 5% of the loan amount are particularly subject to abuse. State laws have also specified that a comprehensive approach is needed in addressing fees, for example clearly designating prepayment penalties and yield spread premiums as fees that strip equity and impose costs on borrowers.

In addition, the OCC prohibition against loan flipping is not as robust as that adopted by several states. For example, North Carolina has had success in reducing loan flipping by requiring that the new loan provide a "net tangible benefit," rather than the OCC standard, which seems to accept any economic benefit. Under the OCC standard, abusive lenders will continue to be able to provide some cash or minimal change in terms on refinances, even when such loans provide no real net benefit to the borrower. As such, the effectiveness of the OCC flipping standard will depend on the quality of the OCC's diligence in enforcing its rule.

4. The OCC has recognized some of the valuable protections put forth in some state laws (like North Carolina) and is mirroring some of the state efforts, but could go farther.

Even while the OCC guidelines recognize the effectiveness of state anti-predatory lending laws, their guidelines are weaker and vaguer than the protections provided by many of those laws. Given that the OCC has taken an aggressive stance in preempting the application of state laws to national banks, the OCC should implement similarly clear regulations that recognize certain practices or loan terms are abusive on their face and cannot be done properly. The positive effect of the OCC guidelines is particularly compromised by statements that suggest that some abusive practices could "benefit some borrowers."

5. The OCC has not previously taken a strong enforcement stance, and the effectiveness of the new guidelines will depend on a more decisive approach to preventing and remedying abusive mortgage practices, particularly in light of the discretion it has afforded itself by promulgating guidelines rather than regulations.

To date, the OCC has not demonstrated a commitment to protecting borrowers from abusive mortgage practices. The only case involving home mortgage abuses the OCC has pursued is one in which it obtained $100,000 in restitution for 30 homeowners. In contrast, according to Helen P. Howell, the Director of the Department of Financial Institutions in the State of Washington, "[I]n 2002 alone, the states recovered over $500 million in restitution and fines for predatory lending and other consumer protection violations, compared to only $7 million collected by the OCC." Unlike other regulators, including the Department of Housing and Urban Development, the Department of the Treasury, and the Federal Reserve Board, the OCC has never even held a public hearing on predatory lending concerns, despite repeated requests from consumer advocates.

These are guidelines, not regulations, and as such they afford the OCC maximum discretion in how it responds to a bank's activities. While the guidelines are enforceable pursuant to the safety and soundness rules of the FDIA, the OCC can choose how aggressively it responds to purported violations. The guidelines also supplement, rather than replace, previous OCC advisory letters. For this reason, the OCC will need to increase its commitment to enforcement if the guidelines are to have any positive impact on homeowners.

Finally, the guidelines do not provide any mechanism for aggrieved borrowers to raise claims and protect against the loss of their home or allow any enforcement by state agencies. The absence of such enforcement only serves to demonstrate the need for meaningful legislation at the state and federal level to provide real protection for borrowers against the loss of equity and their home.

About the Center for Responsible Lending

The Center for Responsible Lending (CRL) is a national nonprofit, nonpartisan research and policy organization dedicated to protecting home ownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

For more information, please visit our website at **www.responsiblelending.org**.