

**Testimony of Martin Eakes,
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Before the Senate Committee on Banking, Housing and Urban Affairs
Hearing On
The Office of the Comptroller of the Currency's Rules on
National Bank Preemption and Visitorial Powers
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Chairman Shelby, Ranking Member Sarbanes, and members of the Committee, thank you for holding this important hearing and for inviting me to testify before you today. I am CEO of Self-Help and the Center for Responsible Lending (CRL). Self-Help is a non-profit community development lender that creates ownership opportunities for low-income and minority families through homeownership and small business financing. Since 1980, Self-Help has provided over \$3 billion in financing in 47 states, enabling more than 37,000 families to become homeowners. CRL, an affiliate of Self-Help, is a nonprofit, nonpartisan research and policy organization that promotes responsible lending practices and access to fair terms of credit for low-wealth families. CRL is dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices.

For the first 20 years of my professional life, I worked to make subprime home loans to low-wealth families unable to get a loan from a bank. In 1998, my perspective on Self-Help's mission expanded when a middle-aged African American home loan borrower broke into tears in my office. He told me his wife had died three years before, leaving him to care for their six-year old daughter. He desperately wanted to hold onto his house, telling me, "This house is more than a home. It is also the physical memory of my daughter's mother." For ten years, he said, he had tried to refinance a home loan he had taken at 14% interest; he insisted that the lender would not let him pay off the loan. The loan documents showed that this man's loan of \$29,000 had been inflated with \$15,000 in fees. The lender would not tell him—or me -- the pay-off balance.

We soon discovered that the problem was larger than one loan. This same lender was making 18,000 mortgage loans per year in North Carolina alone. As I attempted to help this man refinance his loan with Self-Help—and to help others who followed him -- I learned how an unscrupulous lender can steal a lifetime's accumulation of wealth in the few seconds it takes a homeowner to sign his name. We realized all our efforts to build wealth through homeownership are unlikely to result in lasting changes for the communities we work in unless we also work to protect wealth from predatory practices and unscrupulous lenders.

States have acted to build on federal protections against abusive lending; however, the OCC's final regulation represents a major step backwards in the fight against predatory lending. We cannot afford to have our collective efforts to protect borrowers from losing their homes and the lifetime of savings built up in home equity to be diminished by a renegade federal agency. To preserve homeownership, a competitive

dual banking system, and the right of states to protect their citizens, Congress should rescind the OCC's regulation.

In my testimony, I will emphasize four main points:

- First, the OCC's final regulation rolls back state legislation that has curbed abusive lending practices while preserving access to credit. The OCC's action will undermine creative efforts by states to protect their citizens from evolving financial abuses.
- Second, the OCC's final regulation has all but eliminated the essential role that States have played in enforcing state laws against abusive lending by national banks, and particularly, by their operating subsidiaries. Instead of complementing a state's efforts, the OCC seeks to replace them, at a catastrophic cost to American homeowners.
- Third, the OCC has blatantly ignored Congressional directives to refrain from interfering with state efforts to protect its citizens from abusive lending unless the Federal policy interest is clear and the legal basis is compelling.
- Finally, the OCC's actions will make the national bank charter a safe haven for predatory lenders, an outcome that is bad for borrowers and bad for banks.

I. State laws have effectively curbed abusive lending without drying up access to credit.

Predatory lending practices, such as exorbitant and anti-competitive fees, strip families of the home equity wealth that could otherwise be used to send children to college, start small businesses, weather crises such as unanticipated medical expenses,

and ensure a measure of economic security in old age. We estimate that predatory lending costs American families approximately \$9.1 billion each year in lost homeowner equity, unfair back-end penalties, and excess interest paid.¹

A. State legislatures have devised successful approaches to the problems of predatory lending.

Five years ago, we helped form the Coalition for Responsible Lending to respond to predatory lending in North Carolina. The group began with the CEOs of 120 financial institutions. Eighty-eight organizations joined this coalition, representing three million North Carolina voters. Coalition members included the NAACP, Habitat for Humanity chapters, and the Council of Churches. Ultimately, the Coalition worked with associations representing realtors, mortgage brokers, mortgage bankers, credit unions, community banks, and the state's large banks to support a moderate bill that passed both legislative chambers nearly unanimously.

Significantly, national banks – and North Carolina has some of the largest and best -- helped draft North Carolina's landmark law and publicly supported it. Their participation in the state effort reinforced what we already knew from our lending partnerships: The vast majority of national banks are responsible lenders and they abhor predatory lending, both for creating a negative perception of financial institutions and as an illegitimate and anti-competitive banking practice. Consequently, I was surprised to hear the OCC's Chief Counsel assert in January that some national banks had stopped making subprime home loans in North Carolina because of the law. To my knowledge, not a single national bank has complained about North Carolina's law or has ever

¹ Stein, Eric. "Quantifying the Economic Cost of Predatory Lending," Coalition for Responsible Lending

requested that the OCC issue a ruling to preempt the law's application. In fact, no major prime or subprime lender has pulled out of the North Carolina mortgage market in response to the law that has been in full effect since 2000.

North Carolina's predatory lending law was built on the foundation of the federal Home Ownership and Equity Protection Act of 1994. We did not ban specific loans. Rather, building on the HOEPA model established by Congress, the North Carolina predatory lending law established special protections for borrowers entering into "high-cost" loans. North Carolina did not alter the federal HOEPA standard on interest rates in any way because we felt the major abuses were exorbitant fees and other equity-stripping loan terms. Once charged, fees are forever; excessive interest rates, on the other hand, can be temporary, as responsible lenders compete to offer better rates. Thus, the North Carolina law supplemented federal protections by reducing the threshold for up-front fees that trigger high-cost loan protections. The law therefore encourages – but does not require -- lenders to shift some compensation from upfront fees to interest rates, so that the risk of a loan is captured in the rate, the term most apparent to borrowers shopping for a loan.

Reflecting the broad consensus we developed in North Carolina, the law lowered the threshold for additional borrower protections to five percent of the loan amount—five times the fees typically charged in the conventional market.² This threshold is still generous, and the law does not apply protections to the vast majority of prime or even subprime loans. Rather, it adds important protections for the worst and most risky loans

(2001) (available at <http://www.predatory.lending.org/pdfs/Quant10-01.PDF>).

² According to Freddie Mac, conventional borrowers pay, on average, a 1.1% origination fee. Fannie Mae conference, "The Role of Automated Underwriting in Expanding Minority Home Ownership," Airlie

in the marketplace, loans that should be rare. The vast majority of national banks do not even make loans in this range. In fact, Fannie Mae and Freddie Mac, as well as many other lenders' and investors' best practices, currently provide that they will not make or purchase loans with points and fees above five percent of the loan amount.³ The OCC itself has cautioned national banks against the liquidity risk of investing in mortgages with more than 5% points and fees given the adverse reaction from the secondary market to those loans.⁴

In addition to providing protections for borrowers in high-cost home loans,⁵ the North Carolina law also prohibits a few blatantly abusive practices for all home loans. In particular, the law bans the financing of single premium credit insurance, insurance purchased by the borrower to repay the lender in the event the borrower dies. The practice of financing credit insurance into a home mortgage has been almost completely eliminated since the passage of the North Carolina law, through the combined efforts of

Center, Warrenton, Virginia, (June 8, 2000). Peter Mahoney, Associate General Counsel of Freddie Mac, reported that total points and fees for conventional loans has decreased from 1.6% in 1993 to 1.1% in 1999.

³ Freddie Mac and Fannie Mae, the two largest purchasers of home loans in the nation, will not purchase home loans with points and fees in excess of 5%. <http://www.freddiemac.com/sell/selbuln/1228indltr.html>; http://www.efanniemae.com/singlefamily/forms_guidelines/lender_letters/db_lender_letters.jhtml?role=ou#03-00). In addition, the best practices of the nation's three largest subprime home lenders, accounting for more than 25% of the market, limit fees on loans to 5% or less: Household International, the nation's largest subprime home lender, caps origination fees at 3%. *See* http://www.household.com/corp/hiau_best_practice.jsp#5. Citifinancial, the nation's second largest subprime home lender, caps fees on loans made at Citi branches at 3%. *See* 9/19/2002 announcement at <http://www.citigroup.com/citigroup/press/data/020919a.htm>. Washington Mutual, the nation's third largest subprime lender, caps points and fees at 5% (including yield spread premiums paid by lender to brokers). *See* http://www.wamunewsroom.com/images/pressreleases/Responsible_lending_principles.pdf.

⁴ OCC Advisory Letter 2003-3 (<http://www.occ.treas.gov/ftp/advisory/2003-3.doc>).

⁵ Because financed fees are often invisible to the borrower, who does not actually see cash paid out for these costs, lenders may not finance fees in high-cost loans. The law also prohibits balloon payments and negative amortization on such loans, loan structures that can be used to obscure the cost of equity-stripping fees. Furthermore, high-cost home lenders must look beyond the value of the collateral used to secure a loan when assessing borrowers' ability to repay. Finally, given the high likelihood of abuse in high-cost home loan transaction, the law requires counseling before a high-cost loan is closed. This mandate is similar to the Congressional requirement of counseling in conjunction with reverse mortgage transactions.

federal regulators,⁶ the GSEs,⁷ and disavowal of the practice by major lenders.⁸ The Act also bans “flipping,” refinancing a loan primarily to generate fees for the lender without providing the borrower with a “reasonable tangible net benefit.” Prepayment penalties for early repayment of a first-lien home loan of less than \$150,000 -- deceptive fees pervasive in the subprime market⁹ -- are also not permitted. Again, these are practices that an increasing number of lenders have disavowed. By CRL’s estimate, the North Carolina anti-predatory lending law saves homeowners \$100 million each year.¹⁰

Fortunately, North Carolina has not been the only State to pass important legislation against predatory lending. Nearly half of the States have passed legislation to curb abusive lending. Much has been learned through these efforts. In Georgia, for instance, the legislature passed the strongest anti-predatory lending law in the country,

⁶ 66 Fed. Reg. 65604 (Dec. 20, 2001) (amending Regulation Z to include premiums for credit life insurance and similar products in the calculation of the HOEPA points and fees trigger).

⁷ See Freddie Mac, “News Release: Freddie Mac Announces Steps To Protect Borrowers From Predatory Lending Practices” (March 24, 2000) (available at <http://www.freddiemac.com/news/archives2000/predatory.htm>); Fannie Mae, “News Release: Fannie Mae Chairman Announces New Loan Guidelines to Combat Predatory Lending Practices” (April 11, 2000) (available at <http://www.fanniemae.com/newsreleases/2000/0710.jhtml>).

⁸ Bank of America, Chase, First Union, Wachovia, Ameriquest, Option One, Citigroup, Household and American General have all decided not to offer SPCI on their subprime loans. See “Equicredit to Stop Selling Single-Premium Credit Life”, *Inside B&C Lending* at p.3 (Bank of America, April 2, 2001); Erick Bergquist, “Gloom Turns to Optimism in the Subprime Business,” *American Banker* at p.10 (Chase, May 15, 2001); “First Union and Wachovia Announce Community Commitment for the New Wachovia,” (May 24, 2001); statements by officers of Ameriquest and Option One; Jathon Sapsford, “Citigroup Will Halt Home-Loan Product Criticized by Some as Predatory Lending,” *Wall Street Journal* (June 29, 2001); Anitha Reddy, “Household Alters Loan Policy,” *Washington Post* (July 12, 2001); Patrick McGeehan, “Third Insurer to Stop Selling Single-Premium Credit Life Policies”, *New York Times* (American General, July 21, 2001).

⁹ In contrast to an 80% prevalence of prepayment penalties in subprime loans, in the competitive, conventional conforming market, less than 2% of borrowers accept prepayment penalties. See Standard & Poor’s, *Legal Criteria Reaffirmed for the Securitization of Prepayment Penalties*, at <http://www.standardandpoors.com> (May 29, 2002); *Freddie offers a new A-, prepay-penalty program*, Mortgage Marketplace, at 1-2 (May 24, 1999); Joshua Brockman, *Fannie revamps prepayment-penalty bonds*, *American Banker* at 16 (July 20, 1999). For a discussion of prepayment penalties, see Goldstein and Son, *Why Prepayment Penalties are Abusive in Subprime Loans* (April 2, 2003) (available at http://www.responsiblelending.org/pdfs/PPP_Policy_Paper2.pdf).

¹⁰ Ernst, Keith, John Farris, and Eric Stein, “North Carolina’s Subprime Home Loan Market After Predatory Lending Reform”, Center for Responsible Lending (August 2002) (available at http://www.responsiblelending.org/predlend_nc/working.cfm).

only to realize that its strict liability for buyers of home loans unnecessarily restricted the willingness of secondary market participants to provide credit to Georgia homeowners. In a matter of days, secondary market players and Georgia policymakers were able to draft language to address this problem. Georgia taught us an important lesson: State legislatures can move with rapid speed to fine-tune the balance between protecting access to credit and protecting borrowers from abusive loan terms.

Furthermore, states can build on the successes of other states to fill in gaps left in earlier laws. In fact, after numerous other states applied their anti-predatory lending laws to open-end loans, North Carolina expanded its law to cover these loans under our Act. Most recently, legislatures in New Jersey and New Mexico have passed strong anti-predatory lending laws that have incorporated the successful parts of the “first generation” of predatory lending laws (such as New York and North Carolina), adopted the lessons of Georgia’s experience, and added new provisions to close loopholes that have emerged in these earlier laws.

All of the major secondary market participants, including Fannie Mae and Freddie Mac, have recently announced that they will continue to purchase or rate all mortgage transactions in New Jersey and New Mexico, with the exception of high-cost loans.¹¹ In

¹¹ See, e.g., Fannie Mae, *Purchase of New Jersey and New Mexico “High-Cost Home Loans,”* and Illinois “High-Cost Home Loans,” Announcement 3-12 (November 21, 2003); Freddie Mac, *Industry Letter* (November 26, 2003); Standard & Poors, *Standard & Poor’s Permits Additional New Jersey Mortgage Loans Into Rated SF Transactions* (November 25, 2003) (specifically citing NJ Department of Banking regulations and an opinion from the NJ Attorney General as reasons for their policy adjustment). While there have been some technical concerns raised with regard to the New Jersey and New Mexico laws, legislators and regulators in those states have again proven that they can readily resolve such issues. See, e.g. Bulletins 3-30 and 3-15 regarding the New Jersey Homeownership Security Act, *available at* <http://www.njdobi.org/PressReleases/pr111803.htm>. While there have been some claims that lenders are leaving the New Jersey market, this appears to be politically motivated, rather than based on substantive concerns with the law. The Department of Banking recently stated, Unfortunately, certain large lenders are trying to stop the new law by refusing to offer loans, refusing to fund smaller lenders, and arguing that the law will dry up available credit. It is not the law that is drying up

fact, there continues to be a thriving secondary market for the vast majority of subprime loans in states that have enacted anti-predatory lending legislation. Nationally, both subprime lending and the securitization of subprime loans increased by over 50 percent in 2003 over 2002 – volume increased to \$332 billion from \$213 billion, while subprime securities rose to \$203 billion from \$135 billion.¹² As reported by an industry publication, “Subprime lenders should continue to see strong demand for their product in the secondary market this year, analysts predict.”¹³ Furthermore, “Fitch anticipates few problems from ‘pending or existing’ predatory lending laws, as both sellers and issuers have significantly stepped up their due diligence efforts.”¹⁴

The adjustments by secondary market participants demonstrate that state laws successfully encourage the market to police itself and discourage loans with excessive fees. Because the secondary market is willing to purchase all loans except high-cost loans, lenders are more likely to charge for risk through rate in order to stay below high-cost thresholds. Further, these laws ensure that borrowers with high-cost loans are better protected if a loan turns out to be abusive, because the lender is more likely to have held the loan in portfolio.

In summary, state legislatures have acted as laboratories of democracy. These efforts are producing a convergence on many issues and have already had an effect at the federal level. State efforts have informed the Federal Reserve’s decision to include single

credit, it is these steps lenders are taking as part of their overall strategy to change the law. *Available at* <http://www.state.nj.us/dobi/hoa03alert.htm>.

¹² Inside B & C Lending. Jan. 12, 2004, p.3 and Feb. 9, p.1. The growth rate over ten years has been astounding: in 1994, subprime lending totaled just \$34 billion, while only \$11 billion of that was securitized.

¹³ Inside B & C Lending. Jan. 12, 2004, p.3.

¹⁴ Id. at 4.

premium credit insurance in the HOEPA calculation of points and fees,¹⁵ the OTS decision to address prepayment penalty abuses by state housing creditors,¹⁶ and even the OCC's own advisory guidance regarding unfair and deceptive trade practices.¹⁷

B. State laws are working as intended, notwithstanding the OCC's efforts to impugn them with rhetoric and flawed research.

Unfortunately, the OCC has attacked state anti-predatory lending laws in order to justify its preemption rules. We believe that, had it had been a bit more vigorous in its own empirical assessment of these laws, the OCC would have concluded that the North Carolina law has decreased predatory practices without diminishing access to legitimate credit and that other state laws were likely to have similar results.

When it promulgated its proposed rule and preempted application of Georgia's amended law to national banks, the OCC released a working paper entitled "Economic Issues in Predatory Lending" in July 2003. This outcome-driven working paper falls far short of the quality of research one would expect from a federal agency. The working paper shows an underlying failure to understand the real abuses addressed by the state anti-predatory lending laws. The best example of the OCC's blinders can be seen in the paper's focus on interest rates; the paper fails to consider excessive fees or equity-stripping practices like flipping. This oversight is astonishing since successful state anti-predatory lending laws all target excessive fees, not interest rates. Furthermore, as explained in CRL's comments to the OCC on this working paper, the OCC demonstrates

¹⁵ 66 Fed. Reg. 65604 (Dec. 20, 2001).

¹⁶ 67 Fed. Reg. 60542 (Sept. 26, 2002).

¹⁷ See OCC Advisory Letter 2003-2, "Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices," February 21, 2003; OCC Advisory Letter 2003-3, "Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans," February 21, 2003.

significant bias in its review of research conducted on the impact of anti-predatory lending laws.¹⁸

1. Research shows that the North Carolina law is working as intended to protect homeowners and preserve access to credit.

The best and most comprehensive research regarding the effects of the North Carolina law shows that the North Carolina approach has been successful in addressing the worst predatory lending abuses while preserving access to affordable credit for subprime borrowers. Using a database of 3.3 million loans made by more than twenty lenders in all fifty states, researchers at the Center for Community Capitalism at the Kenan-Flagler Business School of the University of North Carolina at Chapel Hill concluded that the law is working as intended.¹⁹ After analyzing the effects of North Carolina’s law on the home mortgage market, the researchers found that the data “are strongly suggestive that the North Carolina law is doing what it is supposed to do.”²⁰

While the number of subprime refinance originations decreased after the law’s implementation, “about ninety percent of the decline was in predatory loans.”²¹ More specifically, the UNC study noted a decline in the incidence of subprime home refinance loans containing prepayment penalty terms that exceed three years, subprime balloon payments, and loan-to-value ratios of 110 percent or more. The study appropriately viewed such loans as of little or no benefit to the borrower. In short, the study suggests

¹⁸ See Center for Responsible Lending, *Comments Addressing the OCC’s Proposal to Preempt Application of State Anti-Predatory Lending and Other Laws*, Docket No. 03-16, October 6, 2003, at Appendix A. CRL comments to the OCC are available on our website at <http://www.responsiblelending.org>.

¹⁹ The Loan Performance data set used for this study is the most comprehensive data available on the subprime mortgage market. R. Quercia, M. Stegman, & W. Davis, “An Assessment of the Impacts of North Carolina’s Predatory Lending Law” (forthcoming Fannie Mae Foundation Housing Policy Debate). Note: As acknowledged in the study, the Center for Responsible Lending provided financial support to enable the research.

²⁰ R. Quercia, et al. at 26.

that the reduction of subprime refinances is consistent with a "weeding out" of bad loans since passage of the law.

Results from the study also suggested that the fees being charged before the law's implementation were not genuinely priced to account for the risk of default, but rather were inflated to extract extra charges from North Carolina's most vulnerable populations. The aim of the North Carolina law was to encourage lenders to reflect price in interest rate rather than in fees. However, "the mean change in interest rate for all subprime originations in North Carolina after the law took effect is significantly lower than the national increase."²² This fact also suggests that there was no post-law reduction in the supply of capital to North Carolina.

In fact, on the crucial issue of credit availability, the report found that "Home purchase loans to North Carolina borrowers with credit scores below 580 more than doubled since the Act was fully implemented, compared with a 62 percent increase nationally."²³ In addition, "**there was a post-law growth of 72 percent in the number of subprime home purchase loans in North Carolina.**"²⁴

The University of North Carolina confirmed what earlier research already suggested. 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.²⁵ In addition, a Morgan Stanley & Co. survey of 280 subprime branch managers

²¹ R. Quercia, et al. at 26.

²² R. Quercia, et al. at 22.

²³ R. Quercia, et al. at 20.

²⁴ R. Quercia, et al. at 18.

²⁵ Inside B&C Lending. 2001. Lenders Will Try to Pin Down Effects of NC Mortgage Law. March 5.

and brokers found that tougher predatory lending laws have not reduced subprime residential lending volumes in any significant way.²⁶

Our own analysis of home loans reported to federal regulators as originated under the Home Mortgage Disclosure Act (HMDA) shows that subprime lending continues to thrive in North Carolina.²⁷ In 2000, North Carolina was still the sixth most active state for subprime lending, with North Carolina borrowers 20 percent more likely to receive a subprime loan than borrowers in the rest of the nation. One in every three loans to low-income North Carolina families (annual incomes of \$25,000 or less) was subprime, the highest such proportion in the country.

2. The OCC ignored this compelling research in favor of uncritical acceptance of flawed research that supported the OCC's position.

The OCC working paper, however, uncritically accepted the conclusions of an industry-sponsored Credit Research Center (CRC) study, which claimed that the North Carolina law decreased low-income borrowers' access to credit. The CRC's conclusions should be viewed with suspicion for several reasons. First, the CRC study contradicts other industry reports and the weight of available evidence. Second, the CRC study relies upon a limited data set from nine anonymous lenders that has not been made available for independent verification.²⁸ Third, the CRC study examines data from a period ending June 30, 2000, the day before most of the North Carolina law's provisions took effect.

²⁶ Morgan Stanley. 2002. Channel Check: Surprisingly Strong Subprime Growth. Diversified Financials. August 1.

²⁷ Ernst, Keith, John Farris, and Eric Stein, "North Carolina's Subprime Home Loan Market After Predatory Lending Reform", Center for Responsible Lending (August 2002) (available at http://www.responsiblelending.org/predlend_nc/working.cfm).

²⁸ The CRC study started with a pool of 1.4 million loans made by nine anonymous members of an industry trade group (that funds CRC) in four states chosen by the authors. The researchers then analyzed one-tenth of these loans. By contrast, the UNC study analyzed 3.3 million loans made by more than twenty lenders in

Moreover, the data omits all open-end home loans from those lenders and is unable to account for a possible shift in lending to other lenders from one of the anonymous nine lenders studied. Finally, the CRC study ignores the problem of “flipping” and consequently assumes that any reduction in subprime originations is evidence of harm. However, any successful anti-predatory lending law would curb the practice of flipping (refinancing loans with no benefit to the borrowers) and thus would tend to reduce the number of subprime refinance originations.

The loan I discussed at the beginning of my testimony illustrates the difference between the OCC’s perspective and that of researchers from the University of North Carolina. The OCC and Credit Research Center view any drop in the number of subprime loans originated as evidence of a problem in the law, ignoring the fact that the intention of the law was to prevent abusive loans from being made. In many of the cases of predatory lending we have seen, the borrowers would have been better off if they had not refinanced their existing loan, but had pursued other options, such as a second mortgage. In many other cases, the borrowers could have obtained a better-priced loan, one that did not strip hard-earned equity from their home.

Those who claim that North Carolina has a liquidity crisis because of our anti-predatory lending laws are far divorced from the North Carolina mortgage market. Those who live and work in the state know that loans remain widely available. Joseph Smith, North Carolina’s Commissioner of Banks, has commented that “[d]uring the last twelve months, over seventy-five percent of formal complaints to [his office] ... have involved mortgage lending activities [but] [n]ot one of these complaints has involved the

all fifty states. The Loan Performance data set used for the UNC study is the most comprehensive data available on the subprime mortgage market.

inability of a North Carolina citizen to obtain residential mortgage credit.”²⁹ In a recent report to our Governor Michael Easley, Commissioner Smith stated,

As you may know, it has been alleged that North Carolina’s predatory lending law and the Mortgage Lending Act have resulted in the denial of credit to sub-prime borrowers. I believe the facts do not support that allegation...Complaints I have received and recent trends in real estate foreclosures suggest, to the contrary, that our citizens have received all of the credit of this kind that they need – and more.³⁰

While the OCC may find it convenient to criticize state anti-predatory lending laws, the OCC lacks any factual foundation for its claims that the laws increase the cost of credit or that they interfere with the legitimate exercise of national banks’ powers. The laws that the OCC wants to displace are working to protect homeowners and to preserve access to credit.

3. The OCC’s actions interfere with state efforts to address abusive practices.

Unfortunately, the OCC’s actions have already interfered with state efforts to address abusive practices by forcing state officials to choose between protecting consumers and disadvantaging state financial institutions. While the state of Tennessee has been considering enactment of protections against abusive lending practices, state officials now are reluctant to take action, even as applied to state-regulated finance companies. The Commissioner of Tennessee’s Financial Institutions Department, for example, recently predicted that state-regulated entities such as mortgage lenders are now likely to affiliate with national banking institutions to take advantage of the OCC’s new

²⁹ North Carolina Office of the Commissioner of Banks, Joseph A. Smith, Jr. letter to Comptroller John D. Hawke, Jr. (October 2, 2003) (*available at* <http://www.banking.state.nc.us/reports/Hawke.pdf>).

preemption rules, and expressed discomfort with passing a law that the state could not enforce.³¹

State officials will rarely expend great effort to enact a law that cannot be enforced or that will put the state's financial institutions at a competitive disadvantage. The chilling effect that the OCC's final action is having on state legislatures is unfortunate, since states are the most appropriate entities to protect consumers within their borders. New financial services products are developed every day, and new scams and unfair practices are among them. The federal government is too far removed to keep up with unscrupulous lenders' new tactics to exploit the unwary, but state governments can act quickly as new predatory practices arise. Furthermore, predatory lending can affect whole neighborhoods, as foreclosures brought on by abusive loans diminish nearby property values and discourage the growth of local businesses. States need to have the ability to respond when waves of foreclosures threaten to destroy communities.

II. State enforcement efforts are crucial in protecting homeowners from predatory lending by national banks or, especially, by national banks' operating subsidiaries.

A law – or a regulation -- is only effective when enforced. The North Carolina law has been successful in part because it has been accompanied by strong enforcement by our state's officials. Both our Attorney General and Commissioner of Banks have been active in investigating and taking action against abusive practices in the state and have been outspoken in their support of the law as an effective protection for consumers.

³⁰ North Carolina Office of the Commissioner of Banks, Joseph A. Smith, Jr. *Mortgage Lending Act Report*, via letter to Gov. Michael Easley (September 23, 2003) (available at http://www.banking.state.nc.us/reports/mla_report.pdf).

North Carolina was the first state in the nation to pursue claims against the Associates, investigating allegations of the illegal packing of single premium credit insurance in mortgage loans as early as July 1999, and eventually recovering approximately \$20 million for over 11,000 North Carolina homeowners in 2001.³² This important action, like state legislative efforts, has helped to inform federal enforcement. The FTC soon followed the lead of the state Attorneys General and filed its own suit, winning \$215 million for consumers nationwide a year later.³³

North Carolina is not alone. In the largest predatory lending case in history, the state Attorneys General of the 50 States recovered \$484 million in restitution to homeowners subjected to abusive lending practices – as defined under state law -- by Household Finance. States have well-established consumer protection departments that have a proven track record in fighting to protect their citizens from predatory lending abuse.

Instead of complementing these efforts to protect homeowners, the OCC's final rule displaces them. In her January testimony, Chief Counsel Williams suggested that States should reallocate resources from enforcing laws against financial abuses to other areas of consumer protection. Based on this position, the OCC has a special obligation to produce compelling evidence that it is better equipped than states to protect homeowners across the country from abusive lending practices. While I appreciate any enforcement

³¹ Karin Miller, "Federal Rule Usurps State Effort to Regulate Predatory Lending," Associated Press Newswires, January 20, 2004.

³² Office of the Attorney General, State of North Carolina, News Release: *Associates \$20.2 million consumer settlement is largest in NC history* (Sept. 16, 2002) (available at <http://www.jus.state.nc.us/>).

³³ Federal Trade Commission, News Release, *Citigroup Settles FTC Charges Against the Associates Record-Setting \$215 Million for Subprime Lending Victims* (Sept. 19, 2002) (available at <http://www.ftc.gov/opa/2002/09/associates.htm>).

efforts to curb predatory lending by the OCC, or by anyone else for that matter, the OCC falls far short of the current state enforcement system.

First, in contrast to the mission of State officials, the OCC's primary mission is to serve banks rather than individual homeowners. The OCC defines its mission as "ensur[ing] a stable and competitive national banking system."³⁴ For the OCC, protecting the banking system comes first, and protecting homeowners from predatory lending is, at best, a result of the efforts to keep the national banking system operating well. In fact, as it points out in its own rule, the OCC does not even have the authority to devise rules under the primary consumer protection statute it can enforce, the FTC Act; rulemaking authority belongs to the Federal Reserve.³⁵ Congress did not create the OCC to protect borrowers.

Second, it is unclear that the OCC has proper incentives in place to aggressively protect homeowners from predatory lending abuse. The national banks fund the OCC through assessments and fees for special services. The OCC's proposed rule is widely viewed as designed to help the largest national banks, which conduct business in many states and also happen to pay the largest assessments to the OCC. In fact, for several years the OCC has aggressively pursued a strategy of making preemption of state laws a major benefit of the national bank charter. In a speech delivered on February 12, 2002,³⁶ Comptroller of the Currency John D. Hawke, Jr., argued, "There is no question that

³⁴ It's worth noting that in the hierarchy of the OCC's objectives, borrower protection merits, at best, a fourth place, behind: 1) To ensure the safety and soundness of the national banking system; 2) To foster competition by allowing banks to offer new products and services; and 3) To improve the efficiency and effectiveness of OCC supervision, including reducing regulatory burden. See <http://www.occ.treas.gov/aboutocc.htm>.

³⁵ 69 Fed. Reg. 1904, 1911 (Jan. 13, 2004).

³⁶ The speech was reprinted in OCC News Release 2002-10.

national banks' immunity from many state laws is a significant benefit of the national charter—a benefit that the OCC has fought hard over the years to preserve.”

The OCC's need to maintain the support of national banks creates an inherent conflict of interest with its ability to protect homeowners. In a case involving preemption of a Texas consumer protection statute, the Fifth Circuit Court of Appeals recognized this conflict, noting: “[T]he constituency positively affected by the OCC's position [of preemption] is concentrated, organized and well-funded, and also happens to be the regulated industry. In contrast, the constituency which is adversely affected by the decision, though vast, is diffuse, unorganized, and definitionally ill-funded.”³⁷

Third, beyond a question of mission or motive, the OCC simply has not demonstrated an ability to resolve claims of abusive mortgage lending comparable to state officials'. While the OCC trumpets its “pioneering actions using the FTC Act to address consumer abuses,”³⁸ the only case involving home mortgage abuses the OCC cites is one in which it obtained \$100,000 in restitution for 30 homeowners.³⁹ 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.⁴⁰ 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.

³⁷ Wells Fargo Bank of Texas v. James, 321 F.3d 488, 494 (5th Cir. 2003) (deferring to OCC's preemption of Texas consumer protection statute regarding charges on cashing paychecks)

³⁸ 69 Fed. Reg. 1904, 1913 (Jan. 13, 2004).

³⁹ *Id.* The vast majority of OCC enforcement actions have focused on credit card abuses.

The case involving Guaranty National Bank of Tallahassee (“Guaranty National Bank”) shows that championing the rights of consumers is not the OCC’s priority. Guaranty National Bank engaged in a rent-a-charter scheme that allowed other lenders to make abusive loans in its name. Thousands of borrowers were charged double-digit points, including bogus discount points that did not in fact result in a reduction in the interest rate.⁴¹ While an OCC examination agreement places tight restrictions on Guaranty National Bank’s lending activities and collected a \$25,000 penalty, the OCC apparently did not order any consumer restitution.⁴² While the bank was finally closed earlier this month,⁴³ redress for consumers came only through private enforcement of state consumer protection laws, where a recent settlement provided \$41 million to the bank’s borrowers.

The OCC’s staffing and structure also pale in comparison to the resources of state consumer protection divisions and state banking departments. The OCC simply does not have the staff to replace state enforcement personnel. To put it in perspective, Director Helen Howell pointed out that,

The OCC has indicated that it will rely on an otherwise fully engaged staff of national bank examiners and a limited staff of OCC employees (fewer than 50 in a Customer Assistance Group) to respond to complaints from consumers nationwide. By contrast, however, in just 3 of

⁴⁰ Letter from Helen P. Howell to John D. Hawke, Jr. (October 3, 2003).

⁴¹ See, e.g., First Amended Complaint, *Baxter v. Guaranty National Bank of Tallahassee and Chase Manhattan Bank*, 01-CVS-009168 (N.C.Sup. Sept. 4, 2001); see also Complaint in Class Action, *Ulrich v. Guaranty National Bank of Tallahassee and GMAC-Residential Funding Corporation*, 02-1616 (W.D. Penn. 2002).

⁴² See Agreement by and between Guaranty National Bank Tallahassee, Florida and the Office of the Comptroller of the Currency, Formal Agreement No. 2002-2 (January 25, 2002), available at <http://www.occ.treas.gov/FTP/eas/ea2002-2.pdf>. See also Consent Order, U.S. Dept. of Treasury, Office of the Comptroller of the Currency, In the Matter of Guaranty National Bank of Tallahassee, #2003-37 (May 2, 2003), available at <http://www.occ.treas.gov/FTP/eas/ea2003-37.pdf>.

⁴³ “OCC Closes Guaranty National Bank of Tallahassee and Appoints FDIC Receiver” (March 12, 2004) <http://www.occ.treas.gov/scripts/newsrelease.aspx?Doc=GWZSYG2.xml>.

the fifty states—California, New York and Washington State—there are the equivalent of 56 full-time professionals reviewing and investigating consumer complaints. Moreover, this does not even include the numerous other attorneys and paralegals devoted to consumer protection investigation and enforcement in the offices of state attorneys general in just these three states.⁴⁴

While a staff of 1,800 examiners cited by the OCC may sound impressive,⁴⁵ such personnel have duties other than policing the market for predatory loans. As stated by Joseph A. Smith, Jr., North Carolina’s Commissioner of Banks, “[U]se of bank examinations as an enforcement tool with regard to mortgage lending would be limited in effect. A matter that is significant at the state or local level may—and probably will—be considered immaterial when viewed in the context of the total business of a large national bank or its subsidiary.”⁴⁶ Current OCC staff are clearly inadequate to the task of reviewing the almost five million home loans—or 2,700 loans per examiner—reported under the Home Mortgage Disclosure Act to the OCC in 2002. According to its website, the OCC’s Consumer Assistance Group alone received 78,000 phone calls last year.⁴⁷

And what happened to those phone calls? The OCC opines in the Question and Answers accompanying its final rule that:

The OCC’s Customer Assistance Group...also plays an important role in helping to identify potential violations of consumer protection law and unfair or deceptive practices. CAG provides immediate assistance to consumers and also collates and disseminates complaint data that help direct OCC examination resources...

⁴⁴ Letter from Helen P. Howell to John D. Hawke, Jr. (10/3/03).

⁴⁵ See “Notice of Proposed Rule Making Regarding 12 C.F.R. Parts 7 and 34 Bank Activities and Operations: Real Estate Lending Activities Questions and Answers” at 2 (July 31, 2003).

⁴⁶ North Carolina Office of the Commissioner of Banks, Joseph A. Smith, Jr. letter to Comptroller John D. Hawke, Jr. (October 2, 2003) (*available at* <http://www.banking.state.nc.us/reports/Hawke.pdf>).

⁴⁷ See Office of the Comptroller of the Currency, The OCC Customer Assistance Group, *available at* <http://www.occ.treas.gov/customer1.htm>.

The “immediate assistance” available to consumers is best described by OCC’s own website for the CAG:

It is best to resolve a complaint directly with your bank before involving an outside agency.

When resolution seems impossible, you may file a formal complaint with the OCC.

When we receive your call about a complaint, a customer assistance specialist will request certain information from you about your complaint. Should the specialist not be able to resolve your complaint immediately . . . [t]he specialist will assign you a case number and tell you exactly what they require you to provide, so that your case research can continue.

Many complaints stem from factual or contract disputes between the bank and the customer. Only a court of law can resolve those disputes and award damages. If we find that your case involves such a dispute, we will suggest that you consult an attorney for assistance.⁴⁸

Of course, this all assumes that a borrower even figures out that the Customer Assistance Group exists. How are borrowers supposed to know that the OCC is their only source of recourse if a national bank, or its operating subsidiary, has taken advantage of them? As far as we know, the OCC has never advertised the existence of its Customer Assistance Group to the general public, and we are not aware of any plans it has to do so. Forcing borrowers to rely solely on the OCC for recourse is like shutting all the hospitals but one in the middle of an epidemic, and then telling patients where the hospital is located only if they manage to show up at the front door. Since the birth of our country, borrowers have looked to State officials to help resolve their disputes. Now, they must look only to a federal office located somewhere in Texas.

⁴⁸ Available at <http://www.occ.treas.gov/customer.htm>.

The OCC's enforcement resources are diluted further in light of the enormous reach of its preemption interpretation. Because preemption applies to operating subsidiaries, and potentially even joint ventures that are owned by national banks or their subsidiaries, we actually cannot quantify the number of institutions the OCC intends to monitor by itself. Given the ease of incorporating new subsidiaries and ample opportunities to "joint venture" with a multitude of other state-chartered lenders and brokers,⁴⁹ it is impossible to believe that the OCC alone can sufficiently address predatory lending on this scale.

III. The system proposed by the OCC in its final regulation – one that protects banks at the expense of borrowers – is contrary to Congressional intent.

When our Coalition worked together to craft the North Carolina law, we were mindful of the effects of existing preemption precedent, but we never imagined that the OCC would take the incredibly expansive approach it has chosen in its final rule. The OCC has no independent authority to preempt state laws. Rather, it must follow Congressional intent when carrying out its statutory responsibilities. In this matter, the OCC has ignored clear statements of Congressional intent. Moreover, the OCC's standard for preemption is a departure from generally accepted judicial standards.

In the Conference Report on the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, the Conferees identified two actions by the OCC that the Conferees thought were "inappropriately aggressive, resulting in preemption of State law

⁴⁹ Wells Fargo Home Mortgage, an operating subsidiary of Wells Fargo's National Bank, owns at least a 50-50.1% share in approximately 85 joint ventures. The joint ventures originate subprime mortgages and direct them through WFHM's subprime channel through contractual broker arrangements. See Wells Fargo

in situations where the federal interest did not warrant that result.”⁵⁰ The Riegle-Neal Act also reinforced Congress’ position on the preemption of state law in several specific areas, establishing that when a state statute is not expressly preempted by federal law and that statute does not discriminate against national banks, “[t]he laws of the host State regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches shall apply to any branch in the host State of an out-of-State national bank to the same extent as such State laws apply to a branch of a bank chartered by that State.”⁵¹ The Riegle-Neal Act further required the OCC to enforce state law in those areas, specifying that “[t]he provisions of any State [law pertaining to community reinvestment, consumer protection, fair lending, and establishment of intrastate branches] to which a national bank is subject . . . shall be enforced, with respect to such branch, by the Comptroller of the Currency.”⁵²

Finally, the Act established new procedures that the OCC must follow when it seeks to preempt state laws regarding community reinvestment, consumer protection, fair lending, and the establishment of intrastate branches. In this way, Congress acted to “ensure that an agency only makes a preemption determination when the legal basis is compelling and the Federal policy interest is clear.”⁵³ Especially with regard to the state-licensed operating subsidiaries of national banks, the federal policy interest in preempting consumer protection laws is far from clear.

Letter to Shawn McNulty, Board of Governors of the Federal Reserve System, *Response to Request for Information* at 24-25 and Question 4 - Exhibit 1 (August 11, 2003)

⁵⁰H.R. Rep. No. 103-651, at H6638 (1994).

⁵¹ 12 U.S.C. § 36(f)(1)(A) (indicating strong Congressional preference to preserve these types of state laws).

⁵² 12 U.S.C. § 36(f)(1)(B).

⁵³ H.R. CONF. REP. 103-651 at 55 (on the 1994 Riegle-Neal Interstate Banking and Branching Efficiency Act).

Congress affirmed its position that states have a legitimate interest in protecting consumers' rights and a corresponding interest in the activities and operations of all banks doing business within their jurisdictions. The conference report states:

States have a strong interest in the activities and operations of depository institutions doing business within their jurisdictions, regardless of the type of charter an institution holds. In particular, States have a legitimate interest in protecting the rights of their consumers, businesses, and communities. Federal banking agencies, through their opinion letters and interpretive rules on preemption issues, play an important role in maintaining [this] balance of Federal and State law under the dual banking systems.⁵⁴

In the Riegle-Neal Act, Congress was careful not to disrupt settled law on preemption: “[N]ational banks are subject to State law in many significant respects. . . . Courts generally use a rule of construction that avoids finding a conflict between the Federal and State law where possible. The [Riegle-Neal Act] does not change these judicially established principles.”⁵⁵ The OCC’s proposed rules completely ignore Congress’s finding that states have a strong legitimate interest in protecting consumers from being harmed by a bank’s activities—regardless of the type of charter the bank holds.

In passing the Gramm-Leach-Bliley Act of 1999,⁵⁶ Congress expressly endorsed the Supreme Court’s standard for preemption of laws affecting national banks: States may not act “to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted.”⁵⁷ The Barnett analysis referenced in Gramm-Leach-Bliley asks whether compliance with both state and federal law is a “physical impossibility” or

⁵⁴ H.R. Conf. Rep. No. 103-651 at 53 (on the 1994 Riegle-Neal Interstate Banking and Branching Efficiency Act).

⁵⁵ Id. at 53.

⁵⁶ 15 U.S.C. s. 6701(d)(2)(A).

⁵⁷ Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 33 (1966).

whether compliance with a state law would “stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”⁵⁸ As the Barnett court emphasizes, the fundamental test governing whether a state statute regulating national banks is preempted by federal law is whether there is an “irreconcilable conflict” between the laws.⁵⁹ State anti-predatory lending laws do not make compliance with the National Bank Act or with other federal consumer protection laws physically impossible. They do not stand in irreconcilable conflict with bank powers. Rather, state anti-predatory lending laws attach additional protections to a small segment of subprime mortgage loans that tend to be abusive.⁶⁰

The OCC has disregarded Congressional intent and invented its own standard for preemption: States may not “obstruct, impair, or condition, a national bank’s ability to fully exercise its Federally authorized real estate lending powers.” By lowering the threshold for preemption, the OCC has created a standard that allows it to preempt any law it doesn’t like. The only state laws that the OCC does not purport to preempt are those that “only incidentally affect” a bank’s activities. This approach is similar to statements made in the OCC’s original proposal for the preemption rule that, generally, “the types of laws that are not preempted are *those that promote a national bank’s ability to conduct business.*”⁶¹ In other words-- if a state law is seen by the OCC as beneficial to national banks, it will not be preempted, whereas any laws that the OCC supposes not to benefit national banks will be preempted. This shift to preempt any law that, in the view

⁵⁸ Barnett, 517 U.S. at 31.

⁵⁹ See Barnett at 31.

⁶⁰ In particular, state anti-predatory lending laws target many of the same kinds of loans identified as problematic by the report of a joint U.S. Department of Housing and Urban Development-U.S. Department of the Treasury Task Force. See “Curbing Predatory Home Lending” at 21-22 (June 2000) (finding consistent evidence of loan flipping, excessive fees, fraud, and lending without regard to the borrower's ability to repay the loan).

of the OCC, fails to affirmatively aid national banks ignores a history of legal precedent and reduces the role of states to mere instrumentalities of the OCC.⁶² This result was not intended by Congress (and is not permitted under the Constitution).

Applying a true conflict analysis would make it clear that, at most, the National Bank Act only preempts a narrow range of state laws, where such provisions are directly in conflict with and significantly impair activities authorized by federal law. Therefore, state restrictions on predatory lending practices are consistent with, rather than irreconcilable with, the National Bank Act, and thus, are not broadly preempted under recognized standards of federal preemption. At most, such laws require that national banks do not engage in abusive lending – a set of practices Congress did not intend to empower national banks to engage in when it enacted or subsequently amended the National Bank Act.

Given that state anti-predatory lending laws do not reduce the ability of banks to make loans to low-wealth borrowers, and that the OCC believes that few national banks directly participate in predatory lending, preemption of state consumer protection laws in this vein seems unnecessarily aggressive and likely to hurt the very consumers who need protection the most.⁶³ The vast majority of national banks exercise the full extent of their authorized powers under the National Bank Act without running afoul of any state consumer protection laws. Given the vibrancy of national banks and the subprime

⁶¹ 68 Fed. Reg. at 46128. (emphasis added).

⁶² This “instrumentalities” approach is most clearly evident in the rule’s assertions that the National Bank Act be construed to preempt application of state laws to state-chartered corporations.

⁶³ The OCC has itself stated that “Based on the dearth of [evidence the national banks are engaged in predatory lending practices] – from third parties, [OCC] consumer complaint database, and [OCC] supervisory activities – [OCC has] no reason to believe that national banks are engaged in such practices to any discernable degree.” 68 Fed. Reg. at 46125. *See also* “OCC Advisories to National Banks Regarding Predatory and Abusive Lending Practices and Notice of Request for Preemption Determination or Order;”

market, it is hard to see how state anti-predatory lending laws have frustrated or obstructed the purposes of the National Bank Act.⁶⁴

In its explanation of its new and weaker standard, the OCC essentially ridicules those who pointed out (during the rulemaking process) its novel interpretation.⁶⁵ While it claims to be distilling Supreme Court constructions (and seems to claim that a federal agency is better equipped to do this than Congress or the judiciary), the OCC is actually ignoring the substance of the underlying decisions—which are impossible to reconcile with the OCC’s view that any inconvenience to a bank in exercising even incidental powers is cause for preemption.⁶⁶

Typically, courts defer to an agency’s interpretation of the laws it is charged with implementing because of the agency’s special expertise. The Supreme Court has not resolved whether deference to such judgments is appropriate, however, with regard to preemption.⁶⁷ Preemption is a determination that rests on legal analysis rather than technical competence or even policy studies. Moreover, the incentives for a federal agency to preempt state laws and thus enlarge its own power make deference to agency preemption decisions inappropriate.

OCC Advisory Letter 2003-2, “Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices,” February 21, 2003 at 1.

⁶⁴ In fact, we believe these laws will facilitate a more transparent and competitive subprime market, which in all likelihood would benefit national banks.

⁶⁵ The OCC states, “The variation among formulations that carry different linguistic connotations does not produce different legal outcomes.”

⁶⁶ In fact, although the OCC asserts that state predatory lending laws increase costs for banks, the OCC provides no evidence to support this claim. National banks already comply with a panoply of different state property tax rates, insurance regulations, and foreclosure procedures regardless of the OCC’s rule. Thus, while the OCC argues that it must protect national banks from the administrative burdens presented by state anti-predatory lending laws, compliance with different state laws is a routine task.

⁶⁷ See, e.g., Medtronic, Inc. v. Lohr, 116 S.Ct. 2240, 2263 (1996) (O’Connor concurring in part, dissenting in part: “It is not certain that an agency regulation determining the pre-emptive effect of *any* federal statute

IV. The OCC's final regulation will make national banks a safe haven for predatory lending.

The OCC's efforts to make the national bank charter more attractive than other chartering options will have a pernicious effect on both borrowers and on national banks. We believe this rule will promote predatory lending by banks and their subsidiaries, not reduce it.

First, the OCC has not only obviated strong state law protections, but it has replaced them with vague and inadequate standards. The OCC relies on a prohibition of asset-based lending and a reference to the FTC Act's ban on unfair and deceptive practices. Rather than prevent practices by making clear to lenders what they may and may not do – as state anti-predatory lending laws have done -- the OCC is planning to rely on a post-hoc “we'll know it when we see it” approach to predatory lending. By putting forward such an inadequate proposal for protecting homeowners, the OCC has rendered hollow its pledge to halt unfair and deceptive acts by national banks.⁶⁸ Without clear standards, bank examiners are highly unlikely to determine that banking practices violate the FTC Act. In the absence of specific substantive standards, regulated institutions are unlikely to invest in the sorts of internal training and protocols that would steer employees away from abusive practices.

Second, the OCC ignores existing evidence of predatory lending within national banks and their affiliates and subsidiaries.⁶⁹ Despite some contradiction between this

is entitled to deference, cf. *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735, 743-744, 116 S.Ct. 1730, 1734-1735, 135 L.Ed.2d 25 (1996).”).

⁶⁸ See, e.g., OCC Advisory Letter 2002-3.

⁶⁹ See, e.g. comments by Comptroller Hawke stating that “while the OCC has *no reason to believe that any national bank is engaging in predatory lending*, the agency's guidance will help prevent problems from arising in the future by prescribing steps national banks should take to avoid abusive practices.” OCC News Release 2003-8: OCC Issues Guidelines to National Banks to Guard Against Abusive Lending Practices (Feb. 21, 2003); “We have no evidence that national banks (or their subsidiaries) are engaged in such

claim and the assertion that OCC has led pioneering efforts to shut down predatory lending, this claim is belied by allegations brought by consumer advocates and researchers regarding national banks, such as Wells Fargo. National advocates believe that Wells Fargo has engaged in numerous abusive lending practices, both through its affiliated subprime entity as well as directly through its operating subsidiary, Wells Fargo Home Mortgage. Allegations include charges that Wells Fargo charged subprime borrowers substantial amounts in prepayment penalties, dramatically under-reported subprime lending activities under HMDA, and used spurious open-end loans to evade consumer protection laws.⁷⁰ Wells Fargo has also been the subject of several additional complaints and lawsuits regarding the abusive use of live check solicitations by its subprime affiliate, racial steering, and lending discrimination.⁷¹ Despite specific requests to the OCC to hold hearings on these issues, the OCC – the primary regulator for Wells Fargo– has determined that hearings are not necessary and has failed to provide a substantive response to comments.

practices to any discernible degree.” Statement Of Comptroller Of The Currency John D. Hawke, Jr. Regarding The Issuance Of Regulations Concerning Preemption And Visitorial Powers (Jan. 7, 2004); “There is scant evidence that regulated banks are engaged in abusive or predatory practices,” OCC, News Release 2004-3: OCC Issues Final Rules on National Bank Preemption and Visitorial Powers; Includes Strong Standard to Keep Predatory Lending out of National Banks (Jan. 7, 2004). By issuing guidelines to help national banks guard against a range of predatory lending practices, the OCC has acknowledged that national banks are not immune from a whole range of abuses. However, the guidelines are not in any way binding. OCC Advisory Letter 2003-2, “Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices,” February 21, 2003; OCC Advisory Letter 2003-3, “Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans,” February 21, 2003.

⁷⁰ See, e.g., ACORN, “Stop the Stage Coach,” available at www.acorn.org/acorn10/predatory_lending/plreports/stopthestagecoach.pdf. See Letter to Federal Reserve Bank of San Francisco from CRL (July 25, 2003) (available at http://www.responsiblelending.org/fed_state_update/fed_law.cfm); Letter from CRL to John D. Hawke (August 26, 2003); Letter from CRL to Federal Reserve Bank of San Francisco (September 29, 2003).

⁷¹ See Christian Berthelsen, “State sues Wells Fargo; Bank accused of overcharging,” San Francisco Chronicle at B1 (January 11, 2003); E. Scott Reckard, “State Sues to Void ‘Instant Loans’ by Wells Fargo Unit,” Los Angeles Times (January 10, 2003); California Department of Corporations, Press Release, “Department of Corporations Files \$38 Million Suit Against Wells Fargo Financial” (January 10, 2003).

As explained by North Carolina’s Commissioner of Banks, the OCC’s proposed rule would “create opportunities for regulatory arbitrage.”⁷² The OCC’s proposed rule encourages banks to seek out the federal charter. It also encourages national banks to change their subprime lending affiliates into operating subsidiaries, increasing the OCC’s responsibility for policing the subprime market and decreasing the states’ ability to regulate subprime lenders.

Encouraging banks to evade state law by converting to national charters would undermine longstanding federal policy that supports the dual banking system. Congress has always worked to ensure that both components of the dual banking system remain strong. The potential impact of the OCC’s proposed rulemaking on the dual banking system has not even been studied. In North Carolina, we have the strongest national banks and the strongest state-chartered banks in the country. We would hate to see competition among these banking entities undermined by the OCC’s creation of a safe haven for abusive practices.

The OCC’s rush to judgment on state predatory lending laws plants the seeds for long-term trouble in the national banking system. Abusive practices may well be profitable in the short term, but are ticking time bombs⁷³ waiting to explode the safety and soundness of national banks in the years ahead. The OCC has not only done a tremendous disservice to hundreds of thousands of homeowners, but has also sown the seeds for future stress on the banking system.

⁷² Letter from Smith to Hawke (10/2/03).

⁷³ The OCC’s closure last month of Guaranty National Bank after long-running concerns about its predatory lending practices is a small reminder of the danger to taxpayers of unchecked predatory lending. *See also*, E. Scott Reckard, “Pritzkers in Record Thrift Settlement Banking: The family and its partner agree to pay FDIC \$460 million for losses at Superior,” L.A. Times at C-1 (Dec. 11, 2001) (discussing the collapse of Superior Bank after “losing millions of dollars on high-risk loans”).

Congress has traditionally applied its own consumer protection laws to all financial institutions, maintaining a level playing field for state and federal institutions. In addition to the National Bank Act and the Riegle-Neal Act, other federal laws such as the Home Ownership and Equity Protection Act (HOEPA)⁷⁴ and the Real Estate Settlement Procedures Act (RESPA)⁷⁵ all anticipate the application of state law to national banks' real estate finance activities. In fact, HOEPA and RESPA have allowed states to enact comparable or stronger state legislation while avoiding preemption under the federal statutes.⁷⁶ Additionally, the Fair Housing Act,⁷⁷ the Equal Credit Opportunity Act,⁷⁸ and the Federal Trade Commission Act,⁷⁹ all regulate the real estate finance market without broadly preempting comparable state regulations. We would encourage Congress to confirm that it intends the same principle to apply here—federal law should be a floor, not a ceiling, and federal regulators should be required to support state efforts to protect their consumers from predatory lending abuses.

Conclusion

Unfortunately, the practical effect of the OCC's new rules as a whole will be to increase predatory lending, not reduce it. The few bad apples among national banks will be able to ignore state consumer protection laws with impunity, and borrowers will have no effective remedy when they face losing their homes to foreclosure. Further, the new rule will have the effect of encouraging lenders to shelter questionable practices under a national bank charter. Even worse, the OCC's expansive interpretation of the standard

⁷⁴ Pub. L. No. 108-68, 108 Stat. 2190 (1994).

⁷⁵ 12 U.S.C.A. § 2601 et. seq. (as amended).

⁷⁶ See 15 U.S.C. § 1610(b), 12 U.S.C. § 2616.

⁷⁷ 42 U.S.C.A. § 3601 et. seq. (as amended).

⁷⁸ 15 U.S.C.A. § 1691 et. seq. (as amended).

for federal preemption dramatically alters the current partnership between the federal government and the states in promoting a dual-banking system and in protecting the nation's consumers. Rather than help to support the fight against predatory lending, the OCC has used strong rhetoric, biased research, and contorted legal analysis to undermine effective state efforts to combat predatory lending without cutting off access to credit.

We respectfully ask that Congress act to overturn the OCC's rules preempting state consumer protections, and encourage the OCC to partner with the states in establishing meaningful consumer protections against predatory lending where federal standards serve as a floor, and not a ceiling, for homeowner protections.

⁷⁹ 15 U.S.C.A. § 41 et. seq. (as amended).