



Loans of Prey

States' efforts to stop predatory lending could be blocked by federal pre-emption

Congress is considering two very different bills addressing predatory mortgage lending—one that would allow states to adopt more stringent regulations, and another that would pre-empt every state and local law dealing with deceptive lending practices.

By Mary Branham Dusenberry

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Rhode Island officials spent nine months traveling around the state, hearing stories from people hurt by predatory lending practices in the mortgage industry. They’re now considering legislation, which could be rendered moot depending on what action, if any, Congress takes to address predatory lending practices.

Rhode Island’s Predatory Lending Commission released a report in February outlining the abusive practices the state’s residents have experienced. The panel is pushing for legislation to protect Rhode Island home buyers in the legislative session that ends June 30. Sen. Juan Pichardo, co-chairman of the commission, said a bill he has proposed in his chamber and a similar one in the House will meet that goal.

“The mortgage industry is against it,” Pichardo said. “They say there’s no need for legislation ... that predatory lending is not as bad in Rhode Island, and what Rhode Island needs is more education.”

While Pichardo agrees education will help those buying or refinancing a home, he also sees the need for a predatory lending law in Rhode Island like many other states have.

The mortgage industry recognizes predatory lending terms can cause problems, says Kurt Pfothenauer, senior vice president for government affairs for the Mortgage Bankers Association. But the industry believes the patchwork of laws across states and local communities does more harm than good. The Mortgage Bankers Association is backing a blanket federal law that pre-empts the many predatory lending laws in states and local communities.

“Having a multitude of state and local lending laws, all of which differ in important ways, increases and complicates compliance and increases the cost of compliance if one (lenders) operates in multiple jurisdictions,” said Pfothenauer. “Anytime you’ve got a lot of different cooks in the kitchen whipping up a different recipe to feed the same consumers, you’ve got increased cost and you’ve got increased regulatory risks, both from a client standpoint and a liability standpoint if you’re a lender.”

A federal law proposed by Rep. Bob Ney of Ohio and Rep. Paul Kanjorski of Pennsylvania would pre-empt the various state and local laws addressing the issue. The Mortgage Bankers Association supports that legislation.

“We believe if we got a uniform national standard that we could do a better job of creating a clear standard, and that could be a standard everyone in the country could then learn and enforce,” Pfothenhauer said. “Obviously we wouldn’t want to make enforcement national. Enforcement belongs to states and localities.”

Pfothenhauer believes a national standard “would leave fewer places for predators to hide.”

But Pichardo and others believe states should have jurisdiction in these types of issues. “I think the states know better than just a blanket federal bill that would affect all the states,” Pichardo said.

North Carolina Congressman Brad Miller agrees. He is co-sponsoring a bill with Massachusetts Rep. Barney Frank and North Carolina Rep. Melvin Watt that Miller says is “a floor, not a ceiling, and it provides the flexibility for the states to address problems we may not have anticipated.”

Proposals in Congress

Congress first addressed predatory lending in 1994 with the passage of the Home Ownership and Equity Protection Act (HOEPA) in response to evidence of abusive practices in the mortgage lending market. Most abusive lending takes place in the subprime market, which is typically where borrowers with tarnished or limited credit histories obtain mortgage financing. The subprime market has increased fifteenfold in 10 years after HOEPA was adopted.

In 1999, North Carolina passed the first comprehensive state law aimed at preventing predatory lending in the subprime mortgage market. It’s one of the strongest laws in the country, and one on which the Miller-Watt-Frank “Prohibit Predatory Lending Act” is based. Miller said the North Carolina law is widely considered the model state statute for preventing abusive lending while preserving access to credit.

The Ney-Kanjorski bill—the Responsible Lending Act—would set a national standard on predatory lending practices and would render the various state and local predatory lending laws moot.

Massachusetts Rep. John Quinn supports the Miller-Watt-Frank bill. “It’s a good bill that will create a strong federal standard and would let states go further if they think that’s necessary,” Quinn said. “It allows states to deal with their own local conditions.”

Iowa Attorney General Tom Miller says pre-emption—as proposed in the Ney-Kanjorski bill—is unnecessary. “Pre-emption is going in exactly the wrong direction because it eliminates important protections that do not in any way undermine credit for people in the subprime market.”

The Ney-Kanjorski bill, Quinn said, “would undo all of our hard work by erasing state laws that are getting the job done. The weak national standard that takes away our ability to protect our citizens won’t help anyone.”

The mortgage industry disagrees. Pfothenhauer points out that 19 states currently don’t have predatory lending laws on the books. “We could pass a standard tomorrow and have 50 states covered with a law that further protects consumers,” he said.

He says a single national standard will help consumers because lenders will face less confusion. “It’s puzzling to us that others would as an end goal want to create the confusion that’s being created now by having states and localities run in multiple and often varying and conflicting directions,” Pfothenhauer said.

Those laws, he says, have the potential to affect credit availability as a practical matter. That’s long been an argument from the mortgage industry—that some laws go too far, and companies withdraw from a locality or state, drying up credit in the subprime market.

Lending Study

A recent study by the Center for Responsible Lending (CRL) found just the opposite—that tough mortgage lending laws don’t dry up credit in states that crack down on predatory lending practices.

CRL examined reform efforts in 28 states. Keith Ernst, CRL senior policy counsel, said the market stayed even, or outpaced states without protections, in 26 of those states. “Twenty of the 28 states we examined showed markedly less predatory lending than states without reform,” he said.

The report—*The Best Value in the Subprime Market: State Predatory Lending Reforms*—is the most comprehensive study of predatory lending reform efforts to date, according to Ernst. Researchers analyzed more than 6 million subprime home loans made across the country over a seven-year period, and looked at such things as prepayment penalties, the date and loan amount, borrowers’ credit scores, down payments, the loan to valuation negotiated with the loan, and whether the borrower was able to document income on the loan application.

Ernst and others believe the study supports their contention that states which enact strict lending reforms to protect their citizens haven’t harmed the mortgage industry or the subprime market, where most borrowers with tarnished credit obtain home financing. They hope it will prompt other states to enact such laws or strengthen the ones they have.

“These findings suggest that state reforms force lenders to reign in unnecessary charges,” Ernst said. “At the end of the

Predatory Lending Topic of Spring Meeting Session

Predatory lending is the topic of one session during the CSG spring meeting at The Greenbrier in White Sulphur Springs, W.Va. The Financial Services Working Group will discuss, among other topics, subprime mortgage loans as well as moves to eliminate state and local government lending regulation by establishing uniform federal standards. The speakers for the session—from 1 to 3 p.m. Sunday in the Taft Room at the Conference Center—include Tim Doyle, senior director of government affairs for the Mortgage Bankers Association; Christopher Kukla, director of state legislative affairs for the Center for Responsible Lending; Massachusetts Rep. John F. Quinn; and Larry A. Stark, commissioner of the West Virginia Division of Banking.

What is Predatory Lending?

The Association for Community Reform Now (ACORN) describes predatory lending as loans that generally involve:

- Aggressive and deceptive marketing;
- Attaching prepayment penalties to a loan, and typically at high rates;
- Balloon payments;
- Charging higher interest rates than a borrower's credit warrants;
- Financing excessive fees into loans;
- Home improvement scams;
- Loan flipping;
- Making loans for more than 100 percent loan to value;
- Making loans without regard to the borrower's ability to pay;



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day, these findings mean fewer borrowers are trapped by prepayment penalties that lock them into expensive loans, hamstrung by balloon payments to secure the actual cost of the loan or unfairly steered to expensive loans. These are the types of processes we at Responsible Lending have estimated have cost homeowners at least \$9 billion a year.”

He said the findings should also show Congress that “proposals that would roll back state law are headed in the wrong direction. Our findings suggest Congress should adopt the strongest state provisions and allow states to tailor other provisions to fit their individual needs.”

The CRL study endorses the Miller-Watt-Frank bill, saying the Ney-Kanjorski bill, and a similar one filed by Rep. William Lacy Clay of Missouri, not only wipe out state laws, they “propose standards that are similar to state laws that have had little or no impact on loans with predatory terms.”

State officials aren't the only people urging Congress to maintain the strength of the state laws when it comes to predatory lending. Diana Dorn Jones, executive director for Project Change/Fair Lending Center in Albuquerque, said the New Mexico law, like other state laws, “has made the mortgage mar-

ket, particularly the subprime market which I feel is a fertile ground for predatory abuse, a safer place for consumers and has given us the tools to keep it safe. It's clear to me, from my experience, that our law and other laws like it across the country should serve as a model ... because they protect consumers from predatory lending practices.”

Predatory lending has been an issue during the last few Congressional sessions. In fact, both pending predatory lending bills were filed in Congress nearly a year ago. There's been little action on the bills, but Miller said in late March those interested in the issue have been meeting to forge a consensus to address major concerns.

“I don't think there's a single answer that applies to all situations,” Miller said. “I think sometimes there truly is a national market ... Inconsistent state laws can make a national market function less well. On the other hand, I think there are times when the states have shown us the way in identifying problems and proved to be laboratories for what the federal government should do.”

—Mary Branham Dusenberry is managing editor of State News.