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October 2, 2000

THOMAS J. CURRY
COMMISSIONER OF BANKS
DIVISION OF BANKS
ONE SOUTH STATION
BOSTON, MA 02110

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1 11/2:41

MKS

RE: Proposed Amendments to 209 CMR 32.32

Dear Commissioner Curry:

Please accept my following comments on the above mentioned, proposed regulatory changes.

What is "Predatory Lending" and how prevalent is it? Do we really know the answer to these questions? I would have to agree with the "Report of the Staff to Chairman Gramm on Banking, Housing and Urban Affairs – Predatory Lending Practices: Staff Analysis of Regulators' Responses." (copy enclosed) this report indicates that there is no true distinction made between subprime lending and predatory lending. I would have to agree with this analysis, having been in the subprime field for over twenty years and hearing extensive unfounded comments in the past. The subprime product is vital to our economy, assisting consumers in many ways. "Predatory Lending" has occurred in all aspects of the mortgage industry, whether it be government sponsored FHA or VA loans or the handful of lenders in Massachusetts who made conventional loans with extremely high fees (before the cap was instituted in the 1980's). So, why do we always want to "throw out the baby with the bath water"?

In my opinion, the proposed lowering of the interest rate threshold and allowable loan fees will not produce the desired result that you seek. Unfortunately, what will happen is that many good lenders, with a varied

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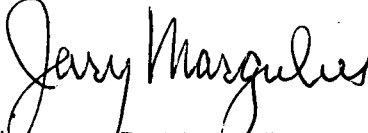
product line, will make a business decision that it will no longer be feasible to lend in Massachusetts. These closures will serve to form a "lending void," thereby leaving the consumers of the Commonwealth with fewer choices and less competition, leading to higher rates and the possibility of some unscrupulous lenders (who don't care about regulations, moving in to fill the void). The five (5%) percent cap on fees alone will eliminate smaller loans or just raise the rates by two (2%) percent or more.

When the statute was passed in 1996, which reversed the fee cap on mortgages, it had the desired result of **lowering fees** by **increasing** the level of **competition**. Over the past ten years the subprime industry has seen a dramatic downturn in rates and fees due to the extremely high level of competition. Why should you let a few bad apples spoil the healthy competition that exists in this market?

I have worked with the Attorney General's office (Ernie Sarason and Pam Kogut) over the past few years, on cases of "lending abuse", and have been certified as an "expert" witness for them. What I have learned from this experience is that the Commonwealth of Massachusetts already has the regulatory and enforcement powers to stop these abuses. Why not use these powers, hire additional staff, and go after the abusers. Instead of examinations every two years, why not go out every six months to known offenders and those with multiple complaints. Cost should not be an object, since it is borne by the licensee examined.

Thank you for hearing my concerns on the proposed changes to 209 CMR 32.32.

Very truly yours,



Jerome D. Margulies
President

enc.

Via overnight delivery

Report of the Staff to Chairman Gramm Committee on Banking, Housing and Urban Affairs

DIVISION OF BANKS
00 057
12: 41

Predatory Lending Practices: Staff Analysis of Regulators' Responses

August 23, 2000

Background

In recent months, many news stories have reported an increasing regulatory concern with "predatory lending." The Federal and state financial regulators, as well as federal and state legislators, have made a variety of proposals to "combat predatory lending."⁽¹⁾ In addition, the federal regulators have established task forces to study the issue. In October 1999, the Federal Reserve Board convened a nine-agency working group⁽²⁾ "to tighten enforcement of existing statutes, to identify those predatory practices that might be limited by tightened regulations or legislative changes, and in general to establish a coordinated attack on predatory practices."⁽³⁾ Subsequently, the Board announced that it would conduct a series of public hearings on predatory lending.

In March 2000, Department of Housing and Urban Development (HUD) Secretary Andrew Cuomo announced the formation of a HUD and Department of the Treasury National Predatory Lending Task Force. The task force conducted forums in Atlanta, Los Angeles, New York, Baltimore, and Chicago, "to solicit information about both local and national aspects of the predatory lending problem." On June 20, 2000, HUD and the Treasury Department issued a joint report titled, "Curbing Predatory Home Mortgage Lending."⁽⁴⁾ The report details their recommendations for legislation and regulatory action to combat predatory lending.

In view of this increasing concern over predatory lending, Senator Phil Gramm, the Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, directed staff to conduct an inquiry to understand what the regulators view as "predatory lending," and what they see as the extent of the problem. On April 12, 2000, Chairman Gramm sent a letter to each of the agencies participating in the nine-agency working group asking for the following information:

- Each agency's definition of "predatory lending;" and
- All data that each agency has regarding predatory lending.

The Senate Banking Committee received responses from all nine of the agencies.

General Summary of the Responses

In general, the following observations can be made with regard to the regulators' responses:

- The regulators do not have and did not provide a definition of "predatory lending."

2. The regulators do not have systematic or organized data on predatory lending; collected data is anecdotal at best.
3. The regulators are still in the early data-gathering stage.
4. The regulators blur the distinction between subprime lending and predatory lending.
5. The regulators do not report any lack of existing legal authority to penalize those abuses that they identify.

Analysis of the Responses to the Inquiry Letter

1. The regulators do not have and did not provide a definition of "predatory lending."

None of the regulators was able to provide the Committee with a definition of "predatory lending." Several of the letters provided blanket statements that the respective agencies did not have definitions of predatory lending. For example, Comptroller of the Currency John D. Hawke, Jr., stated the following:

With respect to your first request, OCC does not have a formal definition of "predatory lending," and I am concerned that attempting to define this term risks either over- or under-inclusiveness.⁽⁵⁾

The Federal Reserve letter explains that "[n]o law administered by the Board has a statutory or regulatory definition of predatory lending."⁽⁶⁾ The NCUA letter similarly states that "NCUA has not developed a hard-and-fast definition of predatory lending."⁽⁷⁾ Moreover, the letter from OFHEO candidly admits that "there is no definition under federal law of the term 'predatory lending.'" Therefore, OFHEO does not have a definition of this term within its statute or regulations."⁽⁸⁾

Instead, the letters provide laundry lists of terms and practices that "may be predatory or abusive either singly or in combination."⁽⁹⁾ For example, the FDIC explains that "abusive lending practices that we would characterize as 'predatory' are more readily described by their features than defined with precision."⁽¹⁰⁾ Some of the practices that are "commonly found in predatory loans"⁽¹¹⁾ include high-pressure and misleading marketing and sales practices; financing single-premium credit life insurance; prepayment penalties; balloon payments; and abusive and aggressive collection practices.

Many of the items in the laundry lists in the various letters involve fraud or deceptive practices. The FDIC letter states that "[s]ome loans that would be considered predatory may involve fraud and deceptive sales practices that are illegal. The regulators are working collectively through an inter-agency working group to improve enforcement of existing laws."⁽¹²⁾ Other items include so-called "predatory" products or terms that may actually be beneficial to consumers under certain instances. For example, balloon payments are cited. But not all balloon payment provisions are harmful to borrowers. In many cases, they serve to enable borrowers to obtain lower-cost credit than they would otherwise be able to, and permit borrowers to take present advantage of positive changes in their economic circumstances that are anticipated at some point in the future.

Moreover, this lack of definition is reflected in the lack of coordination or shared understanding among the regulators as to what types of practices are "predatory." Each of the letters contains different lists of so-called "predatory practices." Although most of the practices mentioned in general are related to mortgage transactions, the letter from NCUA Chairman D'Amours states that "while it seems that the term 'predatory lending' is now largely focused on just predatory mortgage lending, I believe that the term should encompass other abusive practices such as high-interest payday

loans."⁽¹³⁾ The letter also urges that "any definition of predatory lending [should] include all types of loans, not merely mortgage-related transactions."⁽¹⁴⁾ This definition could encompass a wide array of transactions including car loans, credit card transactions, and even business-related loans.

It does not help borrowers or lenders for regulators to target their considerable enforcement power on an array of practices that may or may not be predatory, or that may be of benefit to consumers in some instances and predatory in others, without defining what in essence makes them predatory. Providing a clear definition is the beginning step and cannot be skipped. That step has not yet been taken by the regulators. It is difficult to expect adherence to a standard unless that standard is clear. The lack of a definition threatens to subject those regulated to the abuses of arbitrary and capricious governmental action at worst, and at best will frustrate effective regulatory action to address the problems.

2. The regulators do not have systematic or organized data on predatory lending; collected data is anecdotal at best.

Because there is no definition and no one is quite sure what constitutes predatory lending, the regulatory agencies and the private sector labor under tremendous disadvantages in their effort to produce systematic data on predatory lending. Some of the agencies admit that this lack of a definition has made it impossible to collect data. For example, the letter from OFHEO states:

[I]n the absence of a statutory definition of predatory lending, OFHEO does not maintain a loan-level database on the type of information that would be descriptive of predatory lending. We cannot, therefore, provide you with any specific instances of support of predatory lending by either [Fannie Mae or Freddie Mac].⁽¹⁵⁾

Similarly, the letter from the FDIC states that "[w]ithout a precise definition of predatory lending in the home-equity market, we have not acquired data that measures [sic] bank involvement in this activity."⁽¹⁶⁾ The letter from the OCC also points out the difficulty in collecting data on predatory lending by stating the following:

[T]he OCC has not independently collected or internally analyzed any specific data regarding lending that would be considered "predatory." Assuming that it would be feasible to define the concept precisely, it would be a difficult undertaking for OCC to gather data on predatory lending.⁽¹⁷⁾

The letter from the Federal Reserve states: "With regard to data, the information concerning predatory lending is essentially anecdotal. We are aware of no ready method for identifying predatory loans or measuring the amounts involved."⁽¹⁸⁾ Similarly, the OTS letter explains that "[w]hile there is some data available on the extent of existing predatory lending practices in the United States, most of it is anecdotal."⁽¹⁹⁾ The letters from the OCC and NCUA state that the agency does not have data on predatory lending because the financial institutions subject to the particular agency's regulatory authority are not engaged in predatory lending.⁽²⁰⁾ The OCC letter explains that predatory lending does "not appear to be done to any perceptible degree by national banks."⁽²¹⁾

These admissions serve to reinforce the need for a clear definition in the first instance. Accordingly, it is not surprising that none of the responses from the regulators provided the Committee with systematic data which would enable the Committee to evaluate the nature and extent of the problem, let alone determine whether new legislation is necessary.

3. The regulators are still in the early data-gathering stage.

Because the regulators admittedly do not have organized data on predatory lending (hamstrung by the lack of a definition), the letters explain that the regulators are continuing to attempt to collect data actively on these practices. Several of the letters reference the nine-agency working group which has yet to publish any data. In addition, the OTS letter mentions that on April 5, 2000, the OTS published an advance notice of proposed rulemaking (ANPR) in the Federal Register as a "means to gather information to help identify the extent of predatory lending activities."⁽²²⁾ The NCUA letter states that the NCUA is working with the National Association of State Credit Union Supervisors (NASCUS) Task Force on predatory lending to gather data.⁽²³⁾ The fact that the regulators are only at an early stage in data collection demonstrates that legislative or regulatory proposals are premature.

4. The regulators blur the distinction between subprime lending and predatory lending.

Unfortunately, the anecdotes of wrongdoing have caused confusion by equating legitimate efforts to expand access to capital with obviously illegal practices.⁽²⁴⁾ Some of the letters sent to the Senate Banking Committee further enhance that confusion. For example, the HUD letter cites a recent HUD study titled, *Unequal Burden: Income and Racial Disparities in Subprime Lending in America*,⁽²⁵⁾ as data on predatory lending as if subprime lending, per se, were improper or illegal. That study "documents that the number of subprime home loans is skyrocketing in predominately African-American and low-income neighborhoods" making the bold assumption that all subprime lending is predatory.⁽²⁶⁾

Subprime lending is not necessarily "predatory" in nature. In fact, over the past several years, the rise in subprime lending has significantly expanded access to credit to tens of millions of Americans. Many previously faced a much steeper hill to home ownership or to unlocking the financial benefits of the equity in their existing homes. Today, more Americans than ever before have the opportunity to obtain an affordable mortgage or home equity loan for important credit needs, including education, medical bills and debt consolidation.⁽²⁷⁾

As key government officials have recognized, "subprime lending can and does serve a critical role in the Nation's economy. [Subprime] borrowers may have blemishes in their credit record, insufficient credit history or non-traditional credit sources. Through the subprime loan market, they can buy a new home, improve their existing home, or refinance their mortgage to increase their cash on hand."⁽²⁸⁾ Perhaps the subprime markets are more vulnerable to illegal practices, but this should not be assumed in the absence of systematic data indicating that to be the case. Unfortunately, many of the proposed legislative or regulatory changes could block legitimate subprime lending practices, which, when applied responsibly, have been found to be beneficial to consumers.

5. The regulators do not report any lack of existing legal authority to penalize those abuses that they identify.

The FTC and Justice Department provided the Banking Committee with a wide array of court documents illustrating numerous enforcement actions relating to predatory lending taken by the FTC and the Justice Department. The Federal Trade Commission has enforcement authority under the Federal Trade Commission Act (FTC Act), the Truth in Lending Act (TILA), the Home Ownership and Equity Protection Act (HOEPA), and the Equal Credit Opportunity Act (ECOA). The Justice Department has enforcement authority pursuant to ECOA and the Fair Housing Act.

One of the highlighted enforcement actions in the FTC's letter is "Operation Home Inequity," in which the FTC settled cases against seven lenders for violations of HOEPA in July 1999.⁽²⁹⁾ All seven consent agreements provide substantial remedies and protections for borrowers. Six of the companies agreed to make payments to consumers, totaling \$572,500.⁽³⁰⁾ Two of the companies

agreed to obtain performance bonds before they offer or extend credit in the future, and one company is banned from any future involvement with high-cost loans secured by a home.⁽³¹⁾ The regulators' citation of numerous court settlements and decisions with large damage awards demonstrates that the practices they cited as predatory are illegal practices covered by current law. No letter cited any abuses for which there were no legal remedies.

Conclusions

"Predatory lending," not defined by the regulators, seems to encompass an ever-changing and broad assortment of terms and conditions associated with a variety of financial transactions. It is difficult to understand how the regulators or Congress can formulate proposals to combat predatory lending when there is no clear understanding as to what it is. A definition of the practice is *sine qua non* for any progress toward a remedy.

In the absence of a definition, not only might we miss the target, but we may hit the wrong target. The letters from the regulators recognize that a practice that can be abusive in some contexts can also--in absence of fraud or deception--be highly beneficial to consumers.⁽³²⁾ Moreover, this lack of any definition hampers the effort to gather systematic data on predatory lending; data that exists to date is anecdotal at best. Well-meaning but haphazard reactions on the part of the regulators or the Congress may have the unintended consequence of hurting those whom we intend to help. Accordingly, regulatory and legislative proposals should be formulated only once the problem is properly identified, the data systematically gathered, and the effectiveness of existing laws evaluated.

The regulators and the courts already have a number of tools to combat the illegal and abusive practices that have been labeled "predatory" in the anecdotal information. The host of court decisions and settlements referenced in the letters, and the severe penalties against lenders, demonstrate in these cases that current law is working effectively and that the need for new laws and regulations has not yet been demonstrated. To date, any failures have been failures to apply existing laws rather than any demonstration of inadequacy in the laws themselves.

Recommendations

The staff recommends the following:

- Predatory lending must be carefully and clearly defined so that the problem is comprehensible and can be properly addressed.
- Data must be collected and published in a systematic and organized fashion to avoid the dangerous reliance on anecdotal stories.
- Current laws against fraudulent and deceptive practices should be fully enforced and their effectiveness evaluated before resorting to the imposition of new, complicated and burdensome regulatory or legislative schemes that could have a negative impact on consumers and the financial industry that serves them.

Notes:

1. See, e.g., S. 2415, the Predatory Lending Consumer Protection Act of 2000, 106th Cong. (2000); S. 2405, the Predatory Lending Deterrence Act, 106th Cong. (2000); H.R. 4250, the Predatory Lending Consumer Protection Act of 2000, 106th Cong. (2000); H.R. 4213, the Consumer Mortgage

Protection Act of 2000, 106th Cong. (2000); H.R. 3901, the Anti-Predatory Lending Act of 2000, 106th Cong. (2000); Office of Thrift Supervision proposed rule on Responsible Alternative Mortgage Lending, 65 Fed. Reg. 17811 (April 15, 2000) (advance notice of proposed rulemaking).

2. The relevant agencies are the five that regulate depository institutions: the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA); two that regulate housing finance (HUD and the Office of Federal Housing Enterprise Oversight (OFHEO)), and two that regulate or prosecute deceptive trade practices in general (the Department of Justice and the Federal Trade Commission (FTC)).

3. Federal Reserve Board Governor Edward M. Gramlich, Remarks at the Fair Housing Council of New York, Syracuse, New York (April 14, 2000).

4. Department of Treasury and Department of Housing and Urban Development, "Curbing Predatory Home Mortgage Lending: A Joint Report" (June 2000).

5. Letter from John D. Hawke, Jr., Comptroller of the Currency, OCC, to Senator Phil Gramm, Chairman, Senate Committee on Banking Housing, and Urban Affairs (May 5, 2000) at 1.

6. Letter from Governor Gramlich to Senator Gramm (April 28, 2000) at 1.

7. Letter from Norman E. D'Amours, Chairman, NCUA, to Senator Gramm (May 8, 2000) at 1.

8. Letter from Armando Falcon Jr., Director, OFHEO, to Senator Gramm (June 2, 2000) at 1. See also, Letter from Robert Pitofsky, Chairman, FTC to Senator Gramm (May 16, 2000) at 1 stating that the Commission has not defined the term "predatory lending."

9. Letter from Robert Raben, Assistant Attorney General, Justice Department, to Senator Gramm (June 5, 2000) at 1.

10. Letter from Donna Tanoue, Chairman, FDIC, to Senator Gramm (May 8, 2000) at 1

11. Id.

12. Id.

13. NCUA letter at 1.

14. Id.

15. OFHEO letter at 2.

16. FDIC letter at 2.

17. OCC letter at 2.

18. Federal Reserve Board Letter at 2.

19. OTS letter at 2. See also, FTC letter at 2 : "While the Commission does not have or collect data on predatory lending, the Commission has collected certain information in this area through its enforcement actions"; OCC letter at 2, stating that data on predatory lending is "primarily

anecdotal."

20. *If the institutions that are subject to the regulatory authority of a particular agency are not engaged in the practice of "predatory lending," it is difficult to understand why some of the agencies are expending a great deal of time and resources on the issue of "predatory lending."*

21. *OCC letter at 2. See also NCUA letter at 1, stating, "Since credit unions, by their nature and by statute, are unlikely to engage in predatory practices, NCUA has never had a reason to collect data about predatory lending activity. Thus, we cannot provide an answer to your second question."*

22. *Responses to the ANPR were due on July 5, 2000. It is unclear as to whether the data is comprehensive and organized or anecdotal in nature.*

23. *N UA letter at 1-2.*

24. *See OCC letter at 2 recognizing that the terms "subprime lending" and "predatory lending" have been blurred, and stating the following: "One problem with the fact that 'predatory lending' is not susceptible to precise definition is that many people make the mistake of equating subprime lending to predatory lending. Responsible, risk-based subprime lending, that provides access to credit for individuals with less than perfect credit histories, should not, in and of itself, be considered predatory."*

25. *HUD, Unequal Burden: Income and Racial Disparities in Subprime Lending in America (April 2000). The study was enclosed with the letter from the agency.*

26. *Id. See also Justice Department letter at 1, stating: "We have become aware in recent years of abusive or predatory lending practices that occur most often, but not exclusively, in the subprime market"; FTC letter at 1 identifies subprime lending with "predatory lending" by stating: "This responds to your letter of April 12, 2000, regarding 'predatory lending.' The Commission has played an integral role in combating abusive practices by subprime lenders and I appreciate the opportunity to share our experience in this area with you."*

27. *See supra note 6 at 1*

28. *Testimony of Assistant Secretary for Housing/Federal Housing Commissioner William Apgar before the Committee on Banking and Financial Services, U.S. House of Representatives, May 24, 2000. See also Remarks by Federal Reserve Board Governor Edward M Gramlich at the Fair Housing Council of New York, Syracuse, New York, April 14, 2000: "[T]he subprime lending market . . . has expanded considerably, permitting many low-income and minority borrowers to realize their dream of owning a home and to have a chance for acquiring the capital gains that have so increased the wealth of upper-income households."*

29. *FTC letter at 2-3.*

30. *Id. at 3.*

31. *Id.*

32. *See, e.g., FTC Letter at 2, criticizing "flipping" but acknowledging that "a consumer's option to refinance is an integral part of a functioning mortgage market..."*

Appendix:

Letters from Financial Regulators to Chairman Gramm

John D. Hawke, Jr., Comptroller of the Currency

Norman D'Amours, National Credit Union Administration

Andrew Cuomo, Department of Housing and Urban Development

Robert Raben, Department of Justice

Ellen Seidman, Office of Thrift Supervision

Robert Pitofsky, Federal Trade Commission

Armando Falcon, Jr., Office of Federal Housing Enterprise Oversight

Edward Gramlich, Federal Reserve Board of Governors

Donna Tanoue, Federal Deposit Insurance Corporation

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