

equity “stripping,” and the refinancing of special subsidized mortgage loans, may well be indicative of practices that are unfair or deceptive practices that violate section 5 of the FTC Act.⁷⁴ For example, loan flipping is generally understood to mean the refinancing of a loan, which results in little or no economic benefit to the borrower, for the primary or sole objective of generating additional loan points, loan fees, prepayment penalties, and fees from financing the sale of credit-related products.⁷⁵ Loan flipping can have particularly harmful results when it involves the practice of encouraging refinancing of special mortgage loans that contain nonstandard payment terms beneficial to the borrower, such as those originated in conjunction with a subsidized governmental or nonprofit organization program, when such refinancing entails the loss of one or more of the beneficial loan terms or is otherwise detrimental to the borrower.⁷⁶ Home equity stripping typically involves making loans with excessively high, up-front fees that are financed and secured by the borrower’s home, often with an excessively high penalty upon prepayment of the loan, for the sole or primary objective of stripping the

borrower’s home equity.⁷⁷ Because the nature and impact of such practices are inherently highly fact-specific, the application of the standards of section 5 and use of the OCC’s authority to enforce compliance with those standards are a particularly appropriate approach to ensure that such practices are not occurring in the national banking system.⁷⁸

Section 8 of the Federal Deposit Insurance Act, 12 U.S.C. 1818, provides the OCC with the authority to bring enforcement actions against national banks and their subsidiaries for violations of any law or regulation, which necessarily includes section 5 of the FTC Act.⁷⁹ The OCC has taken enforcement actions against banks involved in practices the OCC believed were unfair or deceptive and will continue to exercise its enforcement authority in this area where appropriate. Thus, while many types of state laws are not applicable to national banks’ deposit-taking and lending activities, the OCC’s guidance, the new, national anti-predatory lending standard of the proposed rule, the OCC’s enforcement of the FTC Act, and a host of other Federal regulations⁸⁰ will apply on a uniform basis to ensure that the real estate lending activities of national banks are conducted according to high standards.

4. Description of the Proposed Amendments to Part 34

Current § 34.3 states the general rule that national banks may “make, arrange, purchase, or sell loans or extensions of credit, or interests therein, that are secured by liens on, or interests in, real estate, subject to terms, conditions, and limitations prescribed by the Comptroller of the Currency by regulation or order.” The proposal would leave this statement of the general rule unchanged, other than

designating it as paragraph (a) of § 34.3.⁸¹

A new paragraph (b) would add an explicit safety and soundness-based anti-predatory lending standard to the general statement of authority concerning lending. As proposed, § 34.3(b) states that a national bank shall not make a loan subject to 12 CFR part 34 based predominantly on the foreclosure value of the borrower’s collateral, rather than on the borrower’s repayment ability, including current and expected income, current obligations, employment status, and other relevant financial resources. This requirement reflects a bedrock principle of sound banking practices and is consistent with views repeatedly expressed by the OCC concerning the safety and soundness implications arising from loans made in reliance on the foreclosure value of the borrower’s home or other collateral.⁸² The OCC believes that it is axiomatic that lenders following safe and sound lending practices will take reasonable steps to assure themselves and to verify that the borrower has the capacity to make scheduled payments to repay a loan, taking into account all of the borrower’s obligations, including other indebtedness, insurance, and taxes, as well as principal and interest.⁸³

The new prudential standard proposed in § 34.3(b), the preexisting standard under the FTC Act, which the OCC enforces, and the many other applicable Federal laws that we have mentioned, ensure that national banks are subject to consistent and uniform Federal standards, administered and enforced by the OCC, that provide strong and extensive customer protections and appropriate safety and soundness-based criteria for their real estate lending activities. We invite interested parties to suggest other

⁷⁴ AL 2003–2 contains guidance recommending the establishment by national banks of policies and procedures to specify whether and under what circumstances the banks will make loans involving features or circumstances that have been associated with abusive lending practices.

⁷⁵ Federal law prohibits a creditor within one year of having extended credit subject to HOEPA from refinancing that loan to another loan subject to HOEPA, unless the refinancing is “in the borrower’s interest.” 12 CFR 226.34(a)(3).

⁷⁶ If a national bank engages in the practice of “steering” a borrower to a loan with higher costs instead of to a comparable loan offered by the bank with lower costs for which the borrower could qualify, and does this on the basis of the borrower’s race, national origin, age, or gender, for example, the OCC will take appropriate enforcement action under the Federal fair lending laws.

⁷⁷ Frequently equity stripping occurs in connection with loan flipping. “Lenders who flip loans tend to charge high origination fees with each successive refinancing, and may charge these fees based on the entire amount of the new loan. * * * In addition, each refinancing may trigger prepayment penalties, which could be financed as part of the total loan amount, adding to the borrower’s debt burden. * * * Each time the loan is flipped, more equity is lost in the home.” Treasury-HUD Joint Report, *supra* note 66, at 73–74.

⁷⁸ Case-by-case enforcement actions by the OCC to address such predatory lending practices also is particularly appropriate because such activities appear to be limited, if not rare, in the national banking system. See Treasury-HUD Joint Report, *supra* note 66, at 13 (“[T]here is a growing body of anecdotal evidence that an unscrupulous subset of * * * subprime actors—lenders (often those not subject to federal banking supervision), as well as mortgage brokers, realtors, and home improvement contractors—engage in abusive lending practices that strip borrowers’ home equity and place them at increased risk of foreclosure.”).

⁷⁹ In section 8, Congress gave the OCC broad powers to compel national banks’ compliance with Federal and state laws. This includes the ability to issue cease and desist orders when the OCC determines that a national bank is violating or has violated any “law, rule, or regulation.” 12 U.S.C. 1818(b)(1). Recent decisions have acknowledged the OCC’s authority to enforce national banks’ compliance with the FTC Act. See, e.g., *Chavers v. Fleet Bank*, 2002 WL 481797 (R.I. Super. Feb. 25, 2002); *Rossman v. Fleet Bank*, C.A. No. PB01–0479 (R.I. Super. 2001) (transcript of hearing on Nov. 26, 2001, pp. 25–28). See also *Roberts*, 2001 WL 1486226 at *2.

⁸⁰ As set forth above, there is an existing network of Federal laws applicable to national banks that protect consumers in a variety of ways. For lending activities, in addition to the Truth in Lending Act (TILA), Real Estate Settlement Procedures Act, Equal Credit Opportunity Act, and the Fair Housing Act, the Home Mortgage Disclosure Act, the Fair Credit Reporting Act, the Consumer Leasing Act, and the Fair Debt Collection Practices Act may also apply.

⁸¹ We note that in a notice of proposed rulemaking to amend 12 CFR parts 3, 5, 6, 7, 9, 28, and 34, published on February 7, 2003, we have proposed to amend 12 CFR 34.3 to reflect the amendment to 12 U.S.C. 371 that added a reference to 12 U.S.C. 1828(o). See 68 FR 6363.

⁸² See, e.g., Testimony of John D. Hawke, Jr. Before the Committee on Banking and Financial Services of the U.S. House of Representatives, May 24, 2000; AL 2003–2. See also OCC Advisory Letter 2000–7 (July 25, 2000). The standard is reflected elsewhere in Federal law. HOEPA prohibits creditors from engaging in a pattern or practice of extending credit subject to HOEPA “based on the consumers’ collateral without regard to the consumers’ repayment ability, including the consumers’ current and expected income, current obligations, and employment.” 15 U.S.C. 1639(h).

⁸³ OCC regulations provide that a national bank must “establish and maintain loan documentation practices that * * * [i]dentify the * * * source of repayment, and assess the ability of the borrower to repay the indebtedness in a timely manner.” 12 CFR part 30, App. A, II. C.