

OCC ADVISORY LETTER

Comptroller of the Currency
Administrator of National Banks

Subject: Abusive Lending Practices

TO: Chief Executive Officers and Compliance Officers of All National Banks, Department and Division Heads, and All Examining Personnel

PURPOSE

This advisory is to alert you to abusive lending practices that may involve violations of fair lending and other consumer protection laws and regulations.

DISCUSSION

Objective, fairly-applied subprime and risk-based lending have been important tools in expanding access to credit. However, certain lending practices -- largely engaged in by non-bank entities -- have come under intense scrutiny recently. Most of these practices involve the setting of prices, fees, and other terms and conditions in a manner that drastically departs from those used by more traditional and responsible prime and subprime lenders.

These practices may involve violations of fair lending statutes and other consumer protection provisions. They may also lead to increased credit, legal, and reputation risk. For this reason, national banks and their direct subsidiaries should review their direct and indirect lending practices to determine whether they are involved in activities that may be considered abusive or predatory, and should take corrective action where needed.

This advisory does not attempt to define what constitutes abusive or predatory lending, and many of the indicators of such lending may not be readily available to examiners. However, examiners should be alert for the following indications that an institution may be engaging in abusive lending practices:

- Collateral or Equity “Stripping” - loans made in reliance on the liquidation value of the borrower’s home or other collateral, rather than the borrower’s independent ability to repay, with the possible or even intended result of foreclosure or the need to refinance under duress;
- Pricing and terms, whether interest rates or fees, that far exceed the true risk and cost of making the loan;

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- Targeting persons, such as the elderly, women, minorities, and persons living in low- or moderate-income areas, who are perceived to be less financially sophisticated or otherwise vulnerable to abusive loan practices;
- Inadequate disclosure of the true costs and risks of loan transactions;
- Lending practices that are fraudulent, coercive, unfair, deceptive or otherwise illegal;
- Loan terms and structures, such as negative amortization, when designed to make it more difficult or impossible for borrowers to reduce their indebtedness;
- Aggressive marketing tactics that amount to deceptive or coercive conduct;
- Padding/Packing - charging customers unearned, concealed or unwarranted fees;
- “Balloon” payment loans that may conceal the true burden of the loan financing and may force borrowers into costly refinancing or foreclosure situations;
- Flipping - frequent and multiple refinancings, usually of mortgage loans, requiring additional fees which strip equity from the borrower; and/or
- Collection of up-front single-premium credit insurance - life, disability, or unemployment, when the consumer does not receive a net tangible financial benefit.

Repeated violations of certain consumer protection laws may also be indications of abusive lending practices. These include patterns of violations of the Truth in Lending Act, Real Estate Settlement Procedures Act, the Home Ownership and Equity Protection Act, the Federal Trade Commission Act, and state consumer protection laws.

In addition, the following practices may suggest the potential for fair lending violations:

- One-way referrals, i.e., a prime lender refers subprime applicants to its subprime subsidiary but the subprime subsidiary does not refer prime applicants to the prime lender;
- Significant differences in the proportion of minority or female applicants between a prime lender and its subprime subsidiary; or
- Significant differences in the proportion of loans made in predominantly minority geographic areas between a prime lender and its subprime subsidiary.

When examiners identify circumstances that may lead to a conclusion that a bank is engaged in predatory lending, they should inform both the supervisory office deputy comptroller and the deputy comptroller for Compliance Operations, who will determine the appropriate course of action.

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Information developed by examiners suggesting the possibility of fair lending violations or other abusive lending practices will be used to identify institutions presenting a higher than normal risk of illegal discrimination. Where appropriate, these institutions will be targeted for examinations that will focus on the specific high risk activity.

For further information, contact:

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