

It's Not About Federalism #11: Predatory Lending (and updates on the Death Penalty and Living Wage INAF installments)

Congressman Bob Ney is best known for ordering the House Restaurant to relabel french fries and french toast “freedom fries” and “freedom toast.” But consumer advocates are more concerned by a bill Ney introduced to regulate so-called predatory loans.

Predatory loans are made to low-income (often elderly or minority) borrowers whose income may not be enough to repay the loans but who have enough equity in their homes to cover the loan amount. Lenders typically charge high up-front fees and require large balloon payments at the end of the loan term. Predatory loans lead to foreclosure much more frequently than other mortgages, causing borrowers to lose their homes.

Ney, a Republican first elected as part of the fiercely “federalist” Class of ’94, calls his bill “the Responsible Lending Act.” The bill would put some modest federal restrictions on predatory lending. As the *Wall Street Journal* explained, “If that seems a departure from the traditional Republican preference for state rather than federal oversight, advocates for those home buyers say there is a good reason: Such a bill would pre-empt tougher state regulations already on the books. . . . And liberal Democratic Rep. Barney Frank of Massachusetts—not usually a foe of federal action—says, ‘I would frankly rather leave it to the states.’”

In fact, the contest between state and federal (and local) power is more complex. Legislatures in six states have preempted municipalities from regulating predatory lending and declined to regulate it themselves. As a result, the American Financial Services Organization has not joined other industry groups in supporting the Ney bill, believing that industry should first try to get preemption at the state level without having to accept even the minimal regulation in the Responsible Lending Act. Apparently disagreeing with this strategy, Household International Inc., which recently settled a \$500 million deceptive-lending suit brought by state governments, “figures prominently in a coalition of subprime lenders seeking action on Capitol Hill,” according to the *Journal*.

Other states, including California and New York, have adopted anti-predatory lending laws at the state level. A number of cities, including Washington, D.C., Chicago, and Philadelphia, have passed local ordinances. But while their efforts have borne fruit in states and localities, consumer advocates would support federal regulation if they thought it had teeth. A coalition of consumer, civil rights, and labor groups wrote to House Banking Committee Chairman Michael Oxley: “We all recognize that changes in federal law are necessary to stop predatory lending across the nation, and we strongly endorse efforts to create meaningful federal law, which would address the real problem.” The problem is that the Ney bill is not, in their view, “meaningful.” Meanwhile, ten cities and the Rhode Island Senate have passed anti-preemption resolutions.

The Responsible Lending Act is not without Orwellian overtones. Its preemption provision, which is exceptionally broad in supplanting state law, is entitled “Coordination with State law.” Not only would the bill prevent states and localities from regulating

loans to private borrowers, it would prohibit them from refusing to do business with predatory lenders. In other words, state and local governments would not be allowed to consider an institution's lending practices in deciding how to raise, deposit, or spend their own money. Coordination indeed.

Though the bill has languished in committee since Ney introduced it on Valentine's Day, the controversy over preemption came to a head in late July. The federal Office of the Comptroller of the Currency (OCC) ruled that Georgia's predatory lending law was preempted by the National Bank Act and thus could not be applied to national banks. Shortly before OCC released the decision, Comptroller John Hawke told the Federalist Society's Financial Services & E-Commerce practice group: "The OCC will, of course, continue to defend the right of national banks to be free from state efforts to regulate their business"

Hawke cited a study suggesting that "subprime" borrowers in North Carolina have lost access to capital since that state passed the first statewide predatory lending law in the nation (though another study rebuts that conclusion). He also noted that after the Georgia law passed, Standard & Poor's and Moody's stopped rating securities backed by mortgage loans subject to the law. In short, states and localities might be well-meaning, but their laws actually harm the borrowers they seek to help by chasing lenders out of the market, and OCC would preempt those laws for the borrowers' own good.

William Brennan, director of the Home Defense Program of the Atlanta Legal Aid Society, begged to differ: "Where does this leave the victims of predatory lending? It leaves them in a vacuum," Brennan told the *Atlanta Journal & Constitution*.

It's not about federalism; it's about fleecing low-income home owners

On the Internet:

Text of Responsible Lending Act (H.R. 833), with links to information on bill's status:
<http://thomas.loc.gov/cgi-bin/query/z?c108:H.R.833>:

OCC's press release page, with links to the Georgia preemption order, the proposed rule on preemption, and "Q&A" documents about each:
<http://www.occ.treas.gov/03rellst.htm>

Collected press coverage of the preemption issue:
<http://www.acorn.org/acorn10/predatorylending/ney/>

Study concluding that North Carolina's predatory lending law has curtailed predatory practices while increasing credit available to subprime borrowers:
http://www.mbaa.org/industry/reports/03/NC_AntiPredatoryLaw_Impact.pdf

The Mortgage Bankers Association of America's on-line Predatory Lending Resource Center: <http://www.mbaa.org/resources/predlend/>

Home page of Federalist Society's Financial Services & E-commerce practice group:
<http://www.fed-soc.org/Publications/practicegroupnewsletters/financialservices/financialservices.htm>

Updates

Judging from e-mail and personal responses, many readers were particularly troubled by INAF #10. That installment reported on the Justice Department's decision to seek the death penalty for a crime committed in Puerto Rico, in spite of the Commonwealth's constitutional prohibition on the death penalty and Puerto Ricans' near-unanimous opposition to capital punishment. After INAF #10 went out, the jury acquitted both defendants of all charges, so the question of punishment never came up. Observers noted that even when defendants have been convicted, juries have opted for life imprisonment in 15 of the last 16 death penalty cases prosecuted by the Ashcroft Justice Department; the Attorney General has apparently not been terribly successful in bringing capital cases in over the objections of local U.S. Attorneys, sometimes in states without a death penalty. For more on the Puerto Rico case, see <http://www.puertorico-herald.org/issues/2003/vol7n32/PRClashesUS-en.shtml>

INAF #3 reported that the State of Florida, which has no minimum wage, had passed a law preempting municipalities and counties from adopting local living wage laws. Advocates (including the Brennan Center) have responded by gathering signatures to put an initiative on the state ballot. If passed, the initiative will establish a statewide minimum wage of \$6.15 per hour, with automatic annual adjustments for inflation. More details are at http://www.brennancenter.org/presscenter/pressrelease_2003_0807.html