

## Wrong from the Start? North Carolina's "Predatory Lending" Law and the Practice vs. Product Debate

*Donald C. Lampe\**

### I. INTRODUCTION

Lawmakers seeking to protect consumers from "predatory" lenders face an initial, critical decision: should the state regulate specific loan products or specific loan practices? North Carolina lawmakers have tried both.

The North Carolina high-cost home loan ("predatory lending") statute, enacted in 1999, was the first state statute of its kind.<sup>1</sup> The basic design of the law has been emulated and followed in nearly forty states, municipalities, and counties.<sup>2</sup> As such, the law has become the *de facto* model for state and municipal "predatory lending" legislation, regulation, and ordinances throughout the country.<sup>3</sup> This initial law emerged from a nearly unregulated setting for mortgage loan originations in North Carolina.<sup>4</sup> It was "threshold-based," meaning it imposed severe restrictions and regulations on loans carrying interest rates and terms above a certain numerical threshold. As observers have noted and experience has shown, threshold-based loan regulation ultimately impacts the basic availability of certain loan *products*.

Laws directed toward mortgage originators and their sales practices regulate the *process* by which consumers obtain those

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\* Member, Womble Carlyle Sandridge & Rice, PLLC, Charlotte, North Carolina. The analysis and conclusions herein solely are the author's views and do not represent the views or opinions of any person, firm, entity or organization other than the author. Portions of this article first appeared in the author's white paper, "Trigger Happy: Enactment and Aftereffects of North Carolina's 'Predatory Lending' Law," presented at The Federalist Society's Predatory Lending Conference, July 24, 2003, in Washington, D.C.

<sup>1</sup> Kurt Eggert, *Lashed to the Mast and Crying for Help: How Self-Limitation of Autonomy Can Protect Elders from Predatory Lending*, 36 LOY. L.A. L. REV. 693, 711 (2003).

<sup>2</sup> See *infra* text accompanying notes 68-83.

<sup>3</sup> See *infra* text accompanying note 60.

<sup>4</sup> See *infra* text accompanying notes 14-15.

products—without necessarily impairing availability of credit.<sup>5</sup> Despite the attention given the original 1999 statute, the evidence shows that the state’s consumer protection objectives were better realized by the enactment of a second law, known as the Mortgage Lending Act.<sup>6</sup> It provided for comprehensive mortgage broker licensure and oversight. The recent upsurge in enactment of residential mortgage lending laws has given rise to a lively debate on whether threshold-based (“product”) regulations are appropriate in light of more market-friendly options that reach the sales process and practice.

North Carolina’s experience with comprehensive laws of both types is instructive. It suggests that any state that elects to regulate high-cost home mortgage lending by means of a threshold-based law should first examine whether its existing “practice” regulation is adequate. That is, are mortgage loan originators regulated at the state level in a fashion that assures fairness, disclosure, and accountability to the consumer? Is the process by which consumers, particularly vulnerable populations, obtain mortgage credit appropriately regulated? The practices and procedures approach is inherently less intrusive to the marketplace than regulations that effectively prohibit certain types of loans and may even provide a greater level of consumer protection. Moreover, the availability of credit to deserving borrowers will be less seriously impaired by appropriate regulation of sales practices in residential mortgage lending than by effective prohibition of higher-cost mortgage loan products.

## II. HISTORICAL BACKGROUND

In the late 1990’s, the North Carolina Attorney General’s office fielded numerous complaints and assembled substantial data regarding perceived abuses in the residential mortgage loan business.<sup>7</sup> This data led the Attorney General’s office and the North Carolina Banking Commissioner to conclude that existing federal law and North Carolina’s usury, mortgage banking, and mortgage brokering statutes were not strong enough to protect consumers from overcharging by mortgage lenders.<sup>8</sup> Very often,

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<sup>5</sup> See *infra* text accompanying notes 85-93.

<sup>6</sup> N.C. GEN. STAT. §§ 53-243.01 to 53-244 (2003).

<sup>7</sup> Rah Bickley, *Lending Practices Face Checks*, NEWS & OBSERVER (Raleigh), Apr. 6, 1999, at B4. North Carolina Attorney General Mike Easley noted at a public forum that North Carolina was increasingly beset with mortgage brokers and lenders who made costly loans. Alan Hirsch, the head of the Consumer Protection Division of the Attorney General’s office, said the issue had exploded over the prior eighteen months and mortgage lending abuse was under investigation. *Id.*

<sup>8</sup> See Carol Frey, *Lending Law Showing Its Teeth*, NEWS & OBSERVER (Raleigh), Sept. 10, 1999, at D1. The state Banking Commission received well over 1,000 complaints (in 1999) and three-quarters of them were attributable to mortgage brokers and lenders.

the perceived overcharges were manifested in “junk fees”—numerous separately-named and itemized charges imposed by mortgage brokers and lenders.<sup>9</sup> As the debate over residential mortgage regulation took shape, it became apparent that, due to federal preemption, many mortgage lenders doing business in North Carolina were free to impose and collect these charges without state law limitation.<sup>10</sup>

The Attorney General established a “working group” of interested parties to evaluate the need for reform of North Carolina’s residential mortgage lending laws. In addition to industry representatives the group included consumer advocacy organizations, such as the Self-Help Credit Union and the Coalition for Responsible Lending.<sup>11</sup> Quickly focusing on the possibility of substantive change, the group discerned that the General Assembly was amenable to a broad overhaul of mortgage lending law.<sup>12</sup> As the discussions continued, consumer advocates (and the Attorney General’s staff) brought forth compelling evidence of allegedly abusive mortgage lending practices, including videotapes of national newsmagazine broadcasts dealing with the worst cases of mortgage lending abuse.<sup>13</sup> It was difficult, to say the least, for industry representatives to speak in “support” of such practices.

In North Carolina, the alleged abuses had occurred in a lawless environment. The original North Carolina mortgage banking law, first enacted in 1988, was merely a registration statute.<sup>14</sup> Mortgage bankers and mortgage brokers were not

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*Id.*

<sup>9</sup> *Customers Angry About Loan Fees*, NEWS & REC. (Greensboro), May 10, 1999, at B5.

<sup>10</sup> See *infra* notes 38-43 and accompanying text.

<sup>11</sup> See *Credit Unions Target Unfair Mortgages*, NEWS & REC. (Greensboro), May 7, 1999, at B8. The Coalition for Responsible Lending is “an alliance of financial institutions, religious organizations, community groups and others” that is pushing legislation to end predatory lending practices by mortgage companies. *N.C. Predatory Mortgage Lending Law*, at [http://www.responsiblelending.org/pledend\\_nc/faqs.cfm](http://www.responsiblelending.org/pledend_nc/faqs.cfm) (last visited March 9, 2004). According to the group’s website, the law “was developed over five months of intense discussion by the NC Bankers Association, the NC Mortgage Bankers Association, the NC Credit Union Network, the NC Association of Financial Institutions, the NC Association of Mortgage Professionals, the NC Attorney General’s Office, and the Coalition for Responsible Lending.” *Id.*

<sup>12</sup> See Glenn J. Kalinoski, *NHEMA Fears Bills Could End Home Equity Lending in State*, NAT’L MORTGAGE NEWS, May 17, 1999, at 16. Senator Roy Cooper said the bill is the result of months of negotiations involving the Attorney General’s office, representatives from major banks, representatives from mortgage bankers and brokers groups, and representatives from credit unions. *Id.*

<sup>13</sup> Richard A. Oppel Jr. & Patrick McGeehan, *Along With a Lender, Is Citigroup Buying Trouble?*, N.Y. TIMES, Oct. 22, 2000, § 3, at 1. Martin Eakes, the founder of Self-Help Credit Union, piloted carts carrying VCR’s into the North Carolina capitol building so that legislators could watch tapes about abusive lending practices. *Id.*

<sup>14</sup> N.C. GEN. STAT. §§ 53-233 to 53-243 (1988) (repealed 2002).

subject to examination by the North Carolina Banking Commissioner.<sup>15</sup> In addition, the law exempted all HUD-approved mortgagees (in addition to customary exemptions for banks, credit unions, and savings institutions).<sup>16</sup> Employees and officers were also exempt from registration, meaning that anyone who could find employment with a registered or exempt mortgage firm could make or broker mortgage loans to consumers without registering.<sup>17</sup> Under the original North Carolina law, many, if not most, non-chartered mortgage companies transacted business with little or no state law regulatory oversight.

As first proposed, the North Carolina predatory lending bill, S. 1149, did contain limitations and prohibitions on the practices of mortgage bankers and mortgage brokers in addition to its threshold-based provisions.<sup>18</sup> Almost simultaneously, a second bill focusing more comprehensively on regulation and licensing of mortgage bankers and brokers, S. 866, also reached the Assembly.<sup>19</sup> But S. 866 did not pass, and S. 1149 was finally approved without its provisions for mortgage-banking regulation.<sup>20</sup> In effect, the General Assembly had decided, despite significant issues surrounding compliance, to focus its legislative efforts on thresholds, choosing to regulate loan terms and products rather than brokers, bankers, and originators. In retrospect there is something fateful about this outcome: had the General Assembly instead chosen to emphasize licensing and regulation, the nationwide trend of sweeping “predatory lending” legislation might never have begun at all.

Contrary to some portrayals, the “predatory lending” law did not receive unanimous support from the lending industry in North Carolina. Representatives of the consumer finance industry never formally endorsed it, and community banks and

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<sup>15</sup> *Id.* § 53-234(6)(a) (repealed 2002). See also Joseph A. Smith, Jr., *North Carolina's Predatory Lending Law: Its Adoption and Implementation* (July 26, 2002), available at <http://www.banking.state.nc.us/commissionerpage.htm>. Commissioner Smith observed that:

Prior to the adoption of the Mortgage Lending Act, some mortgage bankers and all mortgage brokers in North Carolina were required to be registered with OCOB. The registration was required only of the firms engaged in these activities, not of individual loan originators. There were several general normative prohibitions in the predecessor law but limited bases for enforcement and little in the way of enforcement measures and resources.

*Id.* at 5.

<sup>16</sup> N.C. GEN. STAT. § 53-234(6) (repealed 2002).

<sup>17</sup> *Id.*

<sup>18</sup> S. 1149, 1999 Gen. Assem., Reg. Sess. (N.C. 1999).

<sup>19</sup> See S. 866, 1999 Gen. Assem., Reg. Sess. (N.C. 1999).

<sup>20</sup> 1999 N.C. Sess. Laws 1999-332 (codified at N.C. GEN. STAT. §§ 24-1.1A to 24-10.2 (2003)).

credit unions could not comprehend at the time how the complex law would affect them.<sup>21</sup> Many mortgage brokers, however, were pleased by a statute that purported “reform” but failed to directly regulate them.

As noted, the regulatory provisions rejected in 1999 did follow S. 1149 into law as the Mortgage Lending Act<sup>22</sup> after further negotiations with consumer advocacy groups, the Attorney General’s office, and industry representatives.<sup>23</sup> The new law, discussed *infra* at Section VI, came about with the support of the same parties who had pressed for S. 1149 in 1999,<sup>24</sup> and was, in effect, a continuation of the original effort to reform predatory lending.<sup>25</sup> As such, it created a strong practice-oriented framework for the regulation of residential mortgage lending in North Carolina. In contrast to S. 1149, the Mortgage Lending Act has proven itself a law that works to prevent lending abuse while sustaining marketplace freedom. But the broad effects of S. 1149 had already been felt, both in North Carolina and nationwide.

### III. THE SCOPE OF S. 1149

S. 1149 was based on the federal Home Ownership and Equity Protection Act (“HOEPA”).<sup>26</sup> Passed in 1994 as part of the federal Truth in Lending Act, HOEPA, in tandem with Section 32 of Federal Reserve Board Regulation Z,<sup>27</sup> established certain fee- and interest rate-based “triggers.” When the terms of a loan exceed these thresholds, the loan is deemed to be covered by the law, and a host of disclosure requirements and prohibitions on loan terms are imposed.<sup>28</sup> Under the federal law, states are left free to impose broader restrictions or more restrictive triggers if they so choose.

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<sup>21</sup> Kalinoski, *supra* note 12, at 16. NHEMA opposed the two predatory lending bills in North Carolina out of fear that they would wipe out home equity lending. *Id.* Some lenders were angered by the unnecessary government intrusion into the free market. Paul Donohue of MoneyNet Mortgage Planning Services stated the law was dangerous precedent. Meredith Barkley, “Predatory Lending” Law Aids Buyers But Lenders Say it May Keep Some Buyers Out of the Market, NEWS & REC. (Greensboro), Nov. 14, 1999, at G1.

<sup>22</sup> See N.C. GEN. STAT. §§ 53-243.01 to 53-243.16 (2003).

<sup>23</sup> Press Release, North Carolina Attorney General, Cooper Applauds House Passage of Bill Toughening Predatory Lending Laws (Aug. 16, 2001), <http://www.jus.state.nc.us/in/press/081601.htm>.

<sup>24</sup> Compare N.C. Predatory Mortgage Lending Law, *supra* note 11, with Press Release, North Carolina Attorney General, *supra* note 23.

<sup>25</sup> See 2001 N.C. Sess. Laws 2001-393.

<sup>26</sup> Riegle Community Development and Regulatory Improvement Act, Pub. L. No. 103-325, §§ 151-58, 108 Stat. 2190-2198 (1994) (codified as amended in 15 U.S.C. §§ 1601-1604 and scattered sections of 15 U.S.C.).

<sup>27</sup> 12 C.F.R. § 226.32 (2003).

<sup>28</sup> 15 U.S.C. §§ 1602(aa)(1), 1639 (1998 & Supp. 2003).

S. 1149 formed part of the state's general usury (interest rate regulation) statute,<sup>29</sup> and its substance was twofold: threshold-based restrictions and limitations on certain types of home loans, as well as certain restrictions or prohibitions applicable to *all* home loans. The threshold-based portion of the law, following HOEPA, established that if a residential mortgage loan carried an interest rate above a certain annual percentage rate or "points and fees" exceeding a set percentage of the total loan amount, it became a "high-cost loan,"<sup>30</sup> and a wide range of restrictions, limitations, and prohibitions were triggered.<sup>31</sup>

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<sup>29</sup> N.C. GEN. STAT. §§ 24-1 to 24-17 (2003).

<sup>30</sup> *Id.* § 24-1.1E(a)(4) (2003). The statute defined high-cost loan:

A "high-cost home loan" means a loan other than a reverse mortgage transaction in which:

- a. The principal amount of the loan (or, in the case of an open-end credit plan, the borrower's initial maximum credit limit) does not exceed the lesser of (i) the conforming loan size limit for a single-family dwelling as established from time to time by Fannie Mae, or (ii) three hundred thousand dollars (\$300,000);
- b. The borrower is a natural person;
- c. The debt is incurred by the borrower primarily for personal, family, or household purposes;
- d. The loan is secured by either (i) a security interest in a manufactured home . . . which is or will be occupied by the borrower as the borrower's principal dwelling, or (ii) a mortgage or deed of trust on real estate upon which there is located or there is to be located a structure or structures designed principally for occupancy of from one to four families which is or will be occupied by the borrower as the borrower's principal dwelling; and
- e. The terms of the loan exceed one or more of the thresholds as defined in subdivision (6) of this section.

*Id.*

<sup>31</sup> N.C. GEN. STAT. § 24-1.1E(b) (2003). The prohibitions included:

- (1) No call provision. —No high-cost home loan may contain a provision which permits the lender, in its sole discretion, to accelerate the indebtedness. This provision does not apply when repayment of the loan has been accelerated by default, pursuant to a due-on-sale provision, or pursuant to some other provision of the loan documents unrelated to the payment schedule.
- (2) No balloon payment. —No high-cost home loan may contain a scheduled payment that is more than twice as large as the average of earlier scheduled payments. This provision does not apply when the payment schedule is adjusted to the seasonal or irregular income of the borrower.
- (3) No negative amortization. —No high-cost home loan may contain a payment schedule with regular periodic payments that cause the principal balance to increase.
- (4) No increased interest rate. —No high-cost home loan may contain a provision which increases the interest rate after default. This provision does not apply to interest rate changes in a variable rate loan otherwise consistent with the provisions of the loan documents, provided the change in the interest rate is not triggered by the event of default or the acceleration of the indebtedness.
- (5) No advance payments. —No high-cost home loan may include terms under which more than two periodic payments required under the loan are

Notably, only the interest rate threshold was left identical to HOEPA; the other definitions and threshold amounts contained in S. 1149 were modified.<sup>32</sup> In fact, the definition of “points and fees” and the mathematical means to calculate the “ceiling” were drafted from whole cloth and had no exact precedent in federal or state law.

The general restrictions and prohibitions of S. 1149 included a ban on prepayment fees for consumer-purpose, owner-occupied, first-mortgage loans.<sup>33</sup> The bill also included a number of new restrictions applicable to all home loans, including prohibitions on encouraging default and on the financing of credit insurance premiums, as well as a requirement that the borrower receive a real benefit from any refinancing transaction.<sup>34</sup> This latter standard, aimed at the predatory practice of “flipping,” required the lender to determine that in any refinance of less than \$300,000, the buyer was provided with “reasonable, tangible net benefit . . . considering all of the circumstances.”<sup>35</sup>

As a general regulation of loan terms, S. 1149 applied to all lenders making residential mortgage loans in North Carolina, not merely those licensed or chartered by the state. That is, the General Assembly assumed that all residential mortgage lenders were in need of strict and punitive regulation, based not on a lender’s legal or regulatory status or track record but solely on loan terms.<sup>36</sup> As a result, even such community and faith-based lenders as Habitat for Humanity were covered by the sweep of S. 1149, and new remedial provisions in the North Carolina statute compounded compliance risk for conforming, law-abiding lenders. Statutory unfair and deceptive trade practice remedies appeared in North Carolina’s usury law for the first time, including

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consolidated and paid in advance from the loan proceeds provided to the borrower.

(6) No modification or deferral fees. —A lender may not charge a borrower any fees to modify, renew, extend, or amend a high-cost home loan or to defer any payment due under the terms of a high-cost home loan.

*Id.*

<sup>32</sup> Donald C. Lampe, *Predatory Lending Initiatives, Legislation and Litigation: Federal Regulation, State Law and Preemption*, 56 CONSUMER FIN. L.Q. REP. 78, 81 (2002).

<sup>33</sup> 1999 N.C. Sess. Laws 1999-332 (codified at N.C. GEN. STAT. § 24-1.1A(b)(1) (2003)).

<sup>34</sup> 1999 N.C. Sess. Laws 1999-332 (codified at N.C. GEN. STAT. § 24-10.2 (2003)).

<sup>35</sup> *Id.* “Flipping” is the practice of refinancing a home loan from one consumer home mortgage to another with no discernible benefit to the consumer. *Id.*

<sup>36</sup> A participant in the working group later referred to this as a “shotgun” approach to the problem of abusive lending. James Creekman, Group Life President, First Citizens Bank, Remarks at Federal Reserve Public Hearing on Home Equity Lending 30 (July 27, 2000), available at <http://www.federalreserve.gov/events/publichearings/20000727/20000727.htm>.

provisions for attorney fees.<sup>37</sup>

S. 1149 succeeded and was enacted in part because of consumer advocates' distaste for the effects of federal preemption in the residential mortgage-lending arena. In the course of drafting the legislation, federal preemption, particularly by the Alternative Mortgage Transaction Parity Act ("AMTPA"),<sup>38</sup> became a sort of demon for state regulators and consumer advocates.<sup>39</sup> The working group came to realize that capping fees and charges under the usury statute would have limited effect against the many lenders in North Carolina claiming some sort of federal preemption, including AMTPA preemption.<sup>40</sup> S. 1149 was therefore written with full recognition of, if not explicit intent to avoid, federal preemption in residential mortgage lending in North Carolina.<sup>41</sup>

State regulators and consumer advocates in North Carolina also were not pleased with the ability of out-of-state financial institutions to "import" interest rates and fees to North Carolina under preemption theories affirmed by the Supreme Court and lower federal courts.<sup>42</sup> At the North Carolina Bar Association's Real Property Section Annual Meeting in May 1999, while the predatory lending bill was still under consideration by the General Assembly, the state's Assistant Attorney General, McNeil Chestnut, detailed his reservations about federal preemption and interpretations thereof by the Comptroller of the Currency and the Federal Deposit Insurance Corporation (FDIC).<sup>43</sup> Chestnut, a member of the working group that advised in the drafting of S. 1149, suggested that the federal banking agencies had, among other things, been misinterpreting the

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<sup>37</sup> See N.C. GEN. STAT. §§ 24-10.2(f) (2003).

<sup>38</sup> 12 U.S.C. §§ 3801-3805 (2001 & Supp. 2003).

<sup>39</sup> See Chris Serres, *Court Battle Brewing for N.C. Law*, NEWS & OBSERVER (Raleigh), Oct. 6, 2000, at A1. Alan Hirsch of the Attorney General's office stated "[t]he State Attorney General's Office was aware of the discrepancy between state and federal law when the bill was being written last year." *Id.*

<sup>40</sup> Brian Collins, *States Promote Own Lending Laws*, NAT'L MORTGAGE NEWS, Sept. 6, 1999, at 7. Philip Lehman, Assistant Attorney General for North Carolina, stated that the state was very aware of preemption at the state level and did everything possible to make the predatory lending law "preemption-proof." *Id.*

<sup>41</sup> Letter from L. McNeil Chestnut, Assistant Attorney General, North Carolina, to Elizabeth H. Eason, Attorney, Law Offices of Patrick W. McKee (July 30, 2001) (on file with the author). The letter states, "More importantly, we believe that the North Carolina Act has been structured in such a manner as to avoid claims of federal preemption." *Id.* at 2.

<sup>42</sup> See, e.g., *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299, 313-14 (1978); *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 831 (1st Cir. 1992).

<sup>43</sup> L. McNeil Chestnut, A Summary Review of Usury Issues, Paper Presented to 1999 North Carolina Bar Association Real Property Section Annual Meeting (1999) (on file with the author).



federal regulations regarding banks' ability to export interest rates.<sup>44</sup> It follows that the proponents of North Carolina's predatory lending act desired the law to appear in the guise of "consumer protection" rather than in the form of direct limitations on rates and fees.

Since it did not explicitly limit rates, fees, prepayment charges or other purely economic loan terms, S. 1149 arguably had no relationship to federal preemption. Rather, the statute imposed a host of consumer protection and compliance requirements on mortgage lenders, enforced by severe remedial provisions, when they made loans carrying a higher interest rate or fees. To the extent that this part of the statute discouraged federally-preempted lenders from making "high-cost" loans in North Carolina, the statute may be viewed as a "stealth override" of federal preemption.

#### IV. THE IMPACT OF S. 1149

The impact of the North Carolina "predatory lending" law must be viewed in terms of increased risk to compliance-oriented mortgage lenders and increased compliance costs. Under its strict liability provisions, even the most diligent and risk-averse lenders could be penalized. That is, it included no element of intent; if the triggers are "tripped," the lender becomes liable for not complying with the many resulting additional requirements. The law also troubled lenders with its ambiguous, non-standard definitions and limited opportunity for cure.

As soon as it appeared that the working group was in the process of creating a broad predatory lending bill, lending industry representatives in North Carolina began to express concerns about the potential impact on credit availability.<sup>45</sup> These arguments clearly did not win the day. In an attempt at compromise, the General Assembly did agree to add a rider to S. 1149, providing for the appointment of a legislative study committee to analyze the effect of the law on the availability of credit.<sup>46</sup> But the appointment of this study committee was not mandatory, and the leadership of the General Assembly ultimately chose not to do so.

Generally speaking, consumer advocates in the predatory lending arena believe that high-cost home loans should not be

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<sup>44</sup> *Id.* at III-6.

<sup>45</sup> Kalinoski, *supra* note 12, at 16. Wright Andrews, a partner at Butera & Andrews, commented that the North Carolina Predatory Lending Law would dramatically curtail credit availability for many North Carolina citizens. *Id.*

<sup>46</sup> 1999 N.C. Sess. Laws 1999-332 § 7.

made available to consumers in the first instance.<sup>47</sup> This was borne out at hearings on HOEPA in North Carolina before the Federal Reserve Board in 2000, where working group participants testified that it was the intent of the legislation to effectively end the making of high-cost home loans to North Carolina consumers.<sup>48</sup>

To a large degree, S. 1149 fulfilled this goal. As detailed *infra*, experience quickly showed that many legitimate lenders would not tolerate the compliance burdens, coupled with the substantial legal risks of non-compliance, not to mention the significant reputation risk. Another measure of the impact can be seen in the incidence of counseling required for high-cost home loans. According to informal statements by the staff members from the Attorney General's office and the North Carolina Housing Finance Authority, very few such counseling sessions have occurred since S. 1149's passage.<sup>49</sup> This is a strong indication that very few such loans have been made, particularly since some loans do not close even after a counseling session has been undertaken. Banks have adopted a novel compliance strategy for the high-cost home loan law: avoidance.<sup>50</sup> Today, no compliance-oriented lender doing business in North Carolina is (knowingly) making loans with costs high enough to trigger the additional restrictions imposed by S. 1149.

Overall, a number of studies show that the North Carolina "predatory lending" law has led to a reduction in the availability of higher cost or "subprime" mortgage loan credit in the state.<sup>51</sup> By contrast, other studies conducted by consumer advocates have attempted to prove that either this is not the case or that, regardless of any reduction, subprime lending continued to have a negative effect on consumers.<sup>52</sup> Taken together, however, the

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<sup>47</sup> See Margot Saunders, *The Increase in Predatory Lending and Appropriate Remedial Actions*, 6 N.C. BANKING INST. 111, 141 (2002).

<sup>48</sup> See Martin Eakes, President and CEO, Self-Help, Remarks at Federal Reserve Public Hearing on Home Equity Lending 85 (July 27, 2000), available at <http://www.federalreserve.gov/events/publichearings/20000727/20000727.htm>.

<sup>49</sup> See William Bost, Gen. Counsel, N.C. Ass'n of Mortgage Profs., Remarks at Federal Reserve Public Hearing on Home Equity Lending 52 (July 27, 2000), available at <http://www.federalreserve.gov/events/publichearings/20000727/20000727.htm>.

<sup>50</sup> Comptroller of the Currency, Adm'r of Nat'l Banks, *Economic Issues in Predatory Lending 20-21* (July 30, 2003), <http://www.mortgagebankers.org/resources/predlend/main.html>.

<sup>51</sup> See Gregory Elliehausen & Michael E. Staten, *Regulation of Subprime Mortgage Products: An Analysis of North Carolina's Predatory Lending Law*, 29 J. REAL EST. FIN. & ECON. (forthcoming 2004), McDonough School of Business Credit Research Center, Working Paper No. 66, 2002, available at <http://www.msb.edu/prog/crc/publications.html>; Keith D. Harvey & Peter J. Nigro, *Do Predatory Lending Laws Influence Mortgage Lending? An Analysis of the North Carolina Predatory Lending Law*, 29 J. REAL EST. FIN. & ECON. (forthcoming 2004).

<sup>52</sup> See Keith Ernst et al., *North Carolina's Subprime Home Loan Market After*

studies to date on the impact of North Carolina's statute either support or do not refute the fact that the North Carolina law's "triggers" form usury ceilings on residential mortgage loans made after the effective date of the law.

Whether state law usury ceilings themselves are valid public policy objectives is debatable. Many economists believe that such legislation is undesirable.<sup>53</sup> From the experience in North Carolina, it can be assumed that complex, non-standard, threshold-based, punitive predatory lending statutes establish usury ceilings at the interest rate/APR and "points and fees" thresholds. That is, reputable lenders will simply not assume the costs and risks of making loans that exceed these thresholds. Accordingly, this makes the state-by-state legislative task of deciding "how low to go" for thresholds highly significant and the question of credit availability very important.<sup>54</sup> The recognition of the usury-ceiling effect of these state and local laws by federal banking regulators (and perhaps the United States Congress) should further inform the preemption debate.

The practical impact of S. 1149 on lending in North Carolina has been strong. Few lenders announced publicly that they would leave the mortgage market in North Carolina following the enactment of S. 1149, but such departures occurred nonetheless.<sup>55</sup> Published reports and anecdotal evidence indicate that a number of prime mortgage lenders withdrew from North

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*Predatory Lending Reform* (Aug. 13, 2002), <http://www.responsiblelending.org>; Roberto G. Quercia et al., *The Impact of North Carolina's Anti-Predatory Lending Law: A Descriptive Assessment* (June 25, 2003), [http://www.kenan-flagler.unc.edu/assets/documents/CC\\_NC\\_Anti\\_Predatory\\_Law\\_Impact.pdf](http://www.kenan-flagler.unc.edu/assets/documents/CC_NC_Anti_Predatory_Law_Impact.pdf).

<sup>53</sup> E.g., Robert E. Litan, *Unintended Consequences: The Risks of Premature State Regulation of Predatory Lending* 18, <http://www.aba.com/NR/rdonlyres/D881716A-1C75-11D5-AB7B-00508B95258D/28871/PredReport200991.pdf> (last visited Mar. 9, 2004). See also Joseph A. Smith, Jr., *The Federal Banking Agencies' Guidance on Subprime Lending: Regulation with a Divided Mind*, 6 N.C. BANKING INST. 73, 75 (2002) [hereinafter Smith, *Federal Banking*]. The author, now Banking Commissioner of North Carolina, concludes, "Subprime lending can accomplish a social good by providing credit to borrowers in need of a second chance because of damaged credit and to borrowers, primarily low income low wealth borrowers, whose financial status would not otherwise allow them to obtain credit through traditional channels. . . . Public policy has stepped into the subprime market to protect the deposit insurance fund from moral hazard and borrowers from predatory conduct. The result has been an increase in the cost of subprime lending and a reduction in revenue potential. Regulation with a divided mind has, in all probability, resulted in less subprime lending at the margin, desirable and undesirable." *Id.* at 107.

<sup>54</sup> See Adam Wasch, *Anticipating Revised Fed Rule, Sarbanes Ponders New Legislation*, 77 BANKING REP. 173, 175 (July 2001).

<sup>55</sup> Erick Bergquist, *Industry Hits Back On Lending Abuse Laws*, AM. BANKER, Jan 26, 2001, at 1. A well-known national lender "quietly pulled its subprime operations out of North Carolina, citing draconian restrictions in the state's law against predatory lending" as the reason. *Id.*

Carolina completely.<sup>56</sup> Many lower-volume lenders, weighing marginal economic return against significant new compliance costs, may have followed suit.<sup>57</sup>

At a minimum, it is apparent that residential mortgage lenders gave increased scrutiny to product offerings and loan terms. In particular, the “anti-flipping” section of S. 1149, with its “reasonable tangible net benefit” provision, probably caused a greater impact on credit availability than the rest of the statute’s provisions combined. It is credited with causing a number of large, otherwise-responsible mortgage lenders doing business in North Carolina to simply stop making subprime loans in the state.<sup>58</sup> Thus, the statute has had an adverse impact on the availability of conforming, lower cost credit as well as targeted “predatory” activities.<sup>59</sup>

## V. ENACTMENTS IN OTHER STATES

The debate over the impact of the North Carolina law remains lively, and has assumed additional importance as S. 1149 continues to be used as a model for other states. In fact, many states and municipalities followed North Carolina’s threshold-based, HOEPA-like approach. By the beginning of 2004, nearly 40 state and local high-cost home loan laws had been enacted since the passage of S. 1149 in North Carolina.<sup>60</sup>

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<sup>56</sup> *Id.*; Smith, *Federal Banking*, *supra* note 53, at 74 n.4.

<sup>57</sup> See Smith, *Federal Banking*, *supra* note 53, at 107.

<sup>58</sup> See David Boraks, *B of A: Subprime Is Not Worth The Trouble*, AM. BANKER, Aug. 16, 2001, at 1.

<sup>59</sup> *Id.*

B of A’s decision to leave the business has also raised eyebrows among consumer advocates, who typically battle banks over their lending practices to poor and minority customers. Robert Gnaizda, general counsel at the Greenlining Institute in San Francisco, said he was saddened to see B of A pulling out of subprime lending.

“It’s not a loss; it’s a disaster. B of A has the potential to be the most responsible and the largest subprime lender,” Mr. Gnaizda said. The company is currently No. 4 [nationwide], writing \$7.8 billion of loans in 2000. But Mr. Gnaizda said he thinks the strict North Carolina law, and legislative rumblings in other states, helped steer the company away from the business. And he blamed the nation’s two major bank regulators, the Office of the Comptroller of the Currency and the Federal Reserve, for failing to set strict enough policies.

“I believe that B of A is being forced to pull out of it by the negligence of the OCC and the Federal Reserve,” he said. “The two primary regulators have not set a standard for subprime lending, to avoid local legislation like the North Carolina legislation. This puts enormous pressure on financial institutions that might like to do the right thing.”

*Id.*

<sup>60</sup> See *2004 State Predatory Lending Bill Scorecard*, at <http://www.butera-andrews.com/state-local/b-index.htm> (Jan. 16, 2004); *Latest State Legislative and Regulatory Mortgage News*, Mortgage Bankers Ass’n, at [http://www.mbaa.org/state\\_](http://www.mbaa.org/state_)

Each state, however, felt the need to “tweak” the North Carolina approach. This resulted in part from development by consumer advocates of their own model laws, including the influential AARP Model Home Loan Protection Act/Model State Statute.<sup>61</sup> The AARP model law, issued on November 1, 2001, was prepared by the same consumer advocates who spearheaded the North Carolina legislative effort,<sup>62</sup> and was based on statutes and regulations from North Carolina, Illinois, Massachusetts, New York, and the District of Columbia.<sup>63</sup> The drafters of this model law, however, made it far stricter than any existing state law or regulation, incorporating such controversial elements as assignee liability and criminal penalties.<sup>64</sup> It was not long until some states, with encouragement from consumer advocates, started contemplating similarly severe, advocacy-driven laws. For example, the Georgia Fair Lending Act,<sup>65</sup> the New Mexico Home Loan Protection Act,<sup>66</sup> and the New Jersey Ownership Security Act<sup>67</sup> each borrow liberally from the language and provisions of the AARP model.

Most states that have evaluated the need for high-cost home loan laws have opted to take the comprehensive, threshold-based approach of the original North Carolina law. Some states, such as Pennsylvania,<sup>68</sup> Ohio,<sup>69</sup> Oklahoma,<sup>70</sup> Florida,<sup>71</sup> Texas,<sup>72</sup> and Kentucky,<sup>73</sup> adopted regulations and statutes that directly tracked HOEPA. Others, including Massachusetts,<sup>74</sup> Illinois,<sup>75</sup> the District of Columbia,<sup>76</sup> Georgia,<sup>77</sup> New Jersey,<sup>78</sup> New Mexico,<sup>79</sup> California,<sup>80</sup> New York,<sup>81</sup> Arkansas,<sup>82</sup> and South

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update/index.cfm?STRING=http://www.mbaa.org/state\_update/states.asp (last visited Apr. 4, 2004).

<sup>61</sup> HOME LOAN PROTECTION ACT: A MODEL STATE STATUTE (AARP Pub. Pol’y Inst. 2001), [http://research.aarp.org/consume/d17346\\_loan.pdf](http://research.aarp.org/consume/d17346_loan.pdf).

<sup>62</sup> The model statute was co-written by Mike Calhoun, an attorney with Self-Help Credit Union and a member of the original North Carolina working group. *Id.* at 1.

<sup>63</sup> *See id.* at 31.

<sup>64</sup> *Id.* at 26-29.

<sup>65</sup> GA. CODE ANN. § 7-6A-4 (1997 & Supp. 2003).

<sup>66</sup> N.M. STAT. ANN. §§ 58-21A-1 to 58-21A-14 (Michie 1978 & Supp. 2003).

<sup>67</sup> N.J. STAT. ANN. §§ 17:3B-1 to 17:3B-46 (West 2000).

<sup>68</sup> 10 PA. CODE §§ 7.1 - 7.9 (1998), available at <http://www.pacode.com/secure/data/010/010toc.html>.

<sup>69</sup> OHIO REV. CODE ANN. § 1.63 (West 1994 & Supp. 2003).

<sup>70</sup> OKLA. STAT. ANN. tit. 59, §§ 2081-2093 (West 2000 & Supp. 2004).

<sup>71</sup> FLA. STAT. ANN. §§ 494.0078-494.00797 (West 2002 & Supp. 2004).

<sup>72</sup> TEX. FIN. CODE ANN. chs. 343-345 (Vernon 1998).

<sup>73</sup> KY. REV. STAT. ANN. §§ 294.010-294.990 (Banks-Baldwin 2001 & Supp. 2003).

<sup>74</sup> MASS. REGS. CODE tit. 209, § 32.32 (2003), available at <http://www.state.ma.us/dob/209cmr32.pdf>.

<sup>75</sup> ILL. ADMIN. CODE tit. 38, §§ 345.10-345.150 (2001).

<sup>76</sup> D.C. CODE ANN. § 26-1151.01 to 26-1155.01 (2001 & Supp. 2003).

<sup>77</sup> GA. CODE ANN. §§ 7-6A-1 to 7-6A-13 (1997 & Supp. 2003).

<sup>78</sup> N.J. REV. STAT. ANN. §§ 17:3B-1 to 17:3B-46 (2000 & Supp. 2003).

<sup>79</sup> N.M. STAT. ANN. §§ 58-21A-1 to 58-21A-14 (Michie 1978 & Supp. 2003).

Carolina,<sup>83</sup> have enacted non-standard, unique statutes or regulations that are comprehensive and unprecedented in that particular state's body of law. But generally speaking, all of the threshold-based laws have been "modeled" after North Carolina's statute in much the same way S. 1149 was based on HOEPA.

The widespread legislative surge toward threshold-based laws has created a regulatory Tower of Babel for multi-state residential mortgage lenders, particularly those specializing in non-prime, higher-risk loans. The various state laws now in effect are generally similar, but no two are exactly alike.<sup>84</sup> A compliance-oriented, multi-state lender must deconstruct each of these laws or ordinances to determine their basic application, mathematical rules, and potential downside risk. Again, the design of nearly all of these laws is *product*-based rather than lender type-based, so it is typically imprudent for any particular lender (whether bank, credit union, finance company, mortgage banker, or mortgage broker) to assume that a state or local law will not apply to it.

As threshold-based mortgage lending laws have spread, however, other states have followed the two-step approach ultimately adopted by North Carolina. That is, many states have either included specific provisions aimed at mortgage loan origination (sales) practices in an otherwise threshold-based law, or—like North Carolina—created a parallel state law on banker/broker regulation and reform. This has occurred, for example, in Oklahoma,<sup>85</sup> Kentucky,<sup>86</sup> Nevada,<sup>87</sup> Arkansas,<sup>88</sup> and South Carolina.<sup>89</sup> Additionally, many states have either passed or amended regulatory and oversight laws governing bankers and brokers outside the immediate context of predatory lending, including Washington,<sup>90</sup> Ohio,<sup>91</sup> Florida,<sup>92</sup> and Idaho.<sup>93</sup>

These competing trends demonstrate the states' central role in the "practice vs. product" debate. The debate was first framed

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<sup>80</sup> CAL. FIN. CODE § 4970-4974 (West 1999 & Supp. 2004).

<sup>81</sup> N.Y. PRIV. HOUSE. FIN. LAW §§ 40-41.11 (McKinney 2002).

<sup>82</sup> ARK. CODE ANN. §§ 23-39-501 to 23-39-516 (Michie 1987 & Supp. 2003).

<sup>83</sup> S.C. CODE ANN. §§ 37-23-10 to 37-23-20 (Law Co-op. 1976 & Supp. 2003).

<sup>84</sup> See Ted Cornwell, *Servicers Want National Standard*, NAT'L MORTGAGE NEWS, Feb. 23, 2004, at 22.

<sup>85</sup> OKLA. STAT. ANN. tit. 59, §§ 2081-2093 (West 2000 & Supp. 2004).

<sup>86</sup> KY. REV. STAT. ANN. §§ 294.010-294.990 (Banks-Baldwin 2001 & Supp. 2003).

<sup>87</sup> NEV. REV. STAT. ANN. §§ 645B.020-645B.050 (Michie 2000 & Supp. 2001).

<sup>88</sup> ARK. CODE ANN. §§ 23-39-503 to 23-39-505 (Michie 1987 & Supp. 2003).

<sup>89</sup> S.C. CODE ANN. § 40-58-10 (Law Co-op. 1976 & Supp. 2003).

<sup>90</sup> WASH. REV. CODE ANN. § 31.04.102 (West 1986 & Supp. 2004).

<sup>91</sup> OHIO REV. CODE ANN. § 1.63 (West 1994 & Supp. 2003).

<sup>92</sup> FLA. STAT. ANN. §§ 494.0078-494.00797 (West 2002 & Supp. 2004).

<sup>93</sup> IDAHO CODE § 26-310 to 26-316 (Michie 2000 & Supp. 2003).

in Comptroller of the Currency John Hawke's remarks before the Exchequer Club in Washington, D.C. in April 2003.<sup>94</sup> Comptroller Hawke expressed his belief that regulation of mortgage lending practices would be less market disruptive and more effective for consumers than the state-by-state regulation of mortgage products via anti-predatory lending laws.<sup>95</sup> In effect, his remarks highlighted the distinction between advisory letters issued by his office on Predatory and Abusive Lending Practices (AL 2003-2)<sup>96</sup> and Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans (AL 2002-3).<sup>97</sup>

Proponents of practice-based regulation<sup>98</sup> and advocates of threshold-based laws<sup>99</sup> promptly joined the debate. The latter observers, including many consumer advocates, argued that the distinction between practice and product regulation is false, and that threshold-based predatory lending laws prohibit practices rather than products.<sup>100</sup> These proponents, however, miss the point: When laws such as S. 1149 are built of ambiguous definitions and unknown legal, reputational, and economic risks, the laws, in effect, do prohibit products because lenders ultimately will refuse to offer them. And it must again be noted that the product-prohibitive statute was not the final solution to the perceived problem of predatory lending in North Carolina.

## VI. NORTH CAROLINA'S MORTGAGE LENDING ACT: A CORRECTIVE STEP

The critical second step in North Carolina's battle against predatory lending, the North Carolina Mortgage Lending Act, was passed in 2001 and took effect July 1, 2002.<sup>101</sup> For the first

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<sup>94</sup> Press Release, John D. Hawke, Jr., Comptroller of the Currency, Remarks Before the Exchequer Club, Washington, D.C. (Apr. 16, 2003), <http://www.occ.treas.gov/scripts/newsrelease.aspx?Doc=NY6CA3Z8.xml>.

<sup>95</sup> See *id.*

<sup>96</sup> David Hammaker, OCC Advisory Letter AL 2003-2, <http://www.occ.treas.gov/ftp/advisory/2003%2D2.doc>.

<sup>97</sup> Julie L. Williams & Emory W. Rushton, OCC Advisory Letter AL 2002-3, <http://www.occ.treas.gov/ftp/advisory/2002%2D3.doc>.

<sup>98</sup> See, e.g., Michele Heller, *In Brief: Focus of Anti-Predator Laws Hit*, AM. BANKER, May 30, 2003, Washington, at 3. Wayne Abernathy, the Treasury Assistant Secretary for financial institutions, stated that to his dismay, anti-predatory lending proposals were more focused on products than on practices. *Id.*

<sup>99</sup> See, e.g., Elizabeth Renuart, Commentary, *Toward One Competitive and Fair Mortgage Market: Suggested Reforms in A Tale of Three Markets Point in the Right Direction*, 82 TEX. L. REV. 421, 422-23 (2003) (arguing that "[m]uch work remains," despite the passage of HOEPA and numerous similar state statutes); John Taylor, *Anti-Predator Laws Target Practices Not Products*, AM. BANKER, June 20, 2003, Viewpoints, at 6 (commenting on speech by Wayne Abernathy, Assistant Secretary for Financial Institutions, United States Department of the Treasury).

<sup>100</sup> Taylor, *supra* note 99, at 6.

<sup>101</sup> S. 904 was signed into law on August 29, 2001 (codified as N.C. GEN. STAT. §§ 53-

time ever, North Carolina's law imposed license requirements on individual employees involved in making or brokering residential mortgage loans in the state.<sup>102</sup> These individuals include all employees of licensed mortgage bankers or mortgage brokers who are "loan officers," "branch managers," and "managing principals."<sup>103</sup> All are now required to demonstrate significant levels of experience in the business and must take a course and pass an examination under the Act.<sup>104</sup> Despite the fact that chartered financial institutions (banks, thrifts, credit unions) are exempt from the Mortgage Lending Act, the North Carolina Banking Commissioner's office received over 10,000 individual "loan officer" applications during the initial licensing period.<sup>105</sup> During the first year of the Act's effectiveness, the North Carolina Banking Commissioner denied about 750 of these applications, or approximately seven percent of the total.<sup>106</sup> Under the Banking Commissioner's authority, grounds for rejection include moral turpitude, past criminal record, or misleading application materials.<sup>107</sup>

The Commissioner's new authority under the Mortgage Lending Act also includes investigatory, oversight, and enforcement powers.<sup>108</sup> In November 2003, Commissioner Joseph A. Smith, Jr. commented that his office was headed for a record year in consumer complaints, with seventy-five percent of the complaints arising from conduct by mortgage lenders, brokers, and their loan officers.<sup>109</sup> Assuming that the persons most likely to engage in abusive or predatory practices will be the ones denied the ability to (lawfully) work in the mortgage lending business, the Act should have the effect of reducing abusive or predatory home loans. The licensing, education, and experience requirements simply reinforce this.<sup>110</sup>

Perhaps the most important policy aspect of the Act and parallel laws in other states is that it places responsibility on the mortgage loan originator to conduct the sale in a fair and honest manner. The originator thus becomes directly and personally

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243.01 to 53-243.16 (2001)).

<sup>102</sup> N.C. GEN. STAT. § 53-243.02 (2003).

<sup>103</sup> *Id.* §§ 53-243.01, 53-243.05.

<sup>104</sup> *Id.* § 53-243.05.

<sup>105</sup> See Letter from Joseph A. Smith, Jr., Commissioner of Banks, to Hon. Michael Easley, Governor, North Carolina 1 (Sept. 23, 2003) (on file with author).

<sup>106</sup> *Id.*

<sup>107</sup> N.C. GEN. STAT. § 53-243.12 (2003).

<sup>108</sup> Joseph A. Smith, Jr., *The North Carolina Mortgage Lending Act: Results of the First Year, Challenges to Come*, Address to Charlotte Area Mortgage Lenders (Nov. 6, 2003), <http://www.banking.state.nc.us/commissionerpage.htm>.

<sup>109</sup> *Id.*

<sup>110</sup> N.C. GEN. STAT. § 53-243.02 (2003).



responsible for his or her conduct toward the borrower, with both legal and economic incentives to behave in an ethical and honest manner.<sup>111</sup> This approach removes esoteric and legally complicated doctrines of third party liability, such as assignee and transferee liability for originator wrongdoing, from the legislative and policy debate. By doing so, it enables legislatures to enact straightforward, understandable laws that prevent abusive and unfair mortgage loans from being made in the first place. Stronger regulation of mortgage loan originators is supported by the National Association of Mortgage Brokers (“NAMB”), the leading national trade group for mortgage brokers. NAMB has published a model statute for states that are considering new laws in this area.<sup>112</sup>

Moreover, any state that enacts non-standard, threshold-based legislation aimed at high-cost loans creates serious compliance burdens on all residential mortgage lenders, particularly if the law generally prohibits or limits certain practices. This has occurred repeatedly, in part because non-standard (non-HOEPA-based) statutes inevitably contain novel, ambiguous definitions and calculation tools for determining the thresholds or triggers.<sup>113</sup> Because many of the new statutes and ordinances are not consistent with HOEPA and Regulation Z, compliance with HOEPA does not automatically equate to compliance with state law, creating increased risk of lender confusion and non-compliance. This provides yet another reason why sales-practices reform is preferable.

If a law regulating mortgage sales practices and procedures creates less disruption in the marketplace, minimizes lender confusion, and places culpability with the actual wrongdoer, then it should be given the first opportunity to function. Only if such regulation fails should the state consider a threshold-based law. This is what North Carolina should have done, and it is the lesson that other states should learn. Nationwide, the states that are coupling relatively moderate HOEPA-based product-prohibitive laws with stronger practice-prohibitive laws like S. 904 are taking the preferable approach. States that enact punitive, threshold-based laws that extend liability to remote participants in the mortgage lending process, such as assignees

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<sup>111</sup> *Id.* §§ 53-243.05, 53-243.12 (2003).

<sup>112</sup> MODEL STATE STATUTE INITIATIVE: LICENSING, PRE-LICENSURE EDUCATION AND CONTINUING EDUCATION REQUIREMENTS FOR ALL ORIGINATORS (Nat'l Ass'n of Mortgage Brokers 2002), [http://www.namb.org/government\\_affairs/state\\_licensing/model\\_state\\_statute.pdf](http://www.namb.org/government_affairs/state_licensing/model_state_statute.pdf).

<sup>113</sup> See *CBA Overview of High-Cost Home Loan Statutes, Regulations and Ordinances*, Consumer Bankers Association, [http://www.cbanet.org/Issues/Subprime\\_lending/subprime\\_lending.html](http://www.cbanet.org/Issues/Subprime_lending/subprime_lending.html) (updated Sep. 2003).

and transferees, are risking market disruption.<sup>114</sup> Whether this is appropriate public policy is open to debate, and whether “stricter” state laws can actually reduce the incidence of predatory practices without disrupting the legitimate flow of loan capital to deserving borrowers is not yet known. The North Carolina experience, as noted, is not encouraging.<sup>115</sup>

#### VII. BEYOND HOEPA: A SINGLE FEDERAL STANDARD?

Against this background of proliferating state and local laws, a significant question today is whether a “single federal standard” is appropriate. Such a standard would presumably impose a single set of rules, applicable as a matter of federal law, to classes of loans deemed to be in need of closer regulation. A straightforward way to achieve this would be by amendments to HOEPA, coupled with federal preemption of contrary state law.

This approach is exemplified by the proposed Responsible Lending Act,<sup>116</sup> introduced into Congress in 2003 by Reps. Robert Ney (R-Ohio) and Ken Lucas (D-Ky.). The bill would lower HOEPA triggers to encompass more home loans, while also adding consumer protections such as limits on mandatory arbitration and default terms, debt-to-income limits, prepayment penalty limitations, and prohibitions against single-premium credit life insurance for those seeking such loans.<sup>117</sup> In essence, the Ney-Lucas bill seeks to codify, uniformly, most of the key protective limitations and prohibitions that have emerged in the states in the last several years. Finally, it establishes uniform licensing and minimum national standards for mortgage brokers and calls for the oft-suggested creation of a national mortgage-broker database.<sup>118</sup> In short, the bill addresses both products and practices, and, as such, is drawing fire from advocates of the strictly threshold-based, product-based approach.<sup>119</sup>

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<sup>114</sup> Subprime lenders plan to cut back loan origination in New Jersey by 70% when the new predatory lending law goes into effect. Erick Bergquist, *N.J. Law Has Lenders Set For Cutbacks*, AM. BANKER, Nov. 25, 2003, at 1. Fitch, Inc. stated they would not rate pools backed by high cost loans because the law allowed for unlimited assignee liability. *Id.* Standard and Poor's Corp. declared that it would no longer rate bonds backed by many loans originated in Georgia, because the law's assignee liability provision made them too dangerous for investors. Erick Bergquist, *Ga. Amended Predator Law After Preapproval by S&P*, AM. BANKER, March 11, 2003, at 1. Lenders argued that, without ratings by the agencies, it would be hard to sell bonds backed by the loans, and thus funding for subprime loans in the state would dry up. *Id.*

<sup>115</sup> See *supra* notes 49, 50 & 58 and accompanying text.

<sup>116</sup> H.R. 833, 108th Cong. (2003).

<sup>117</sup> See *id.* § 102.

<sup>118</sup> *Id.* §§ 302-312.

<sup>119</sup> See *Poll Shows Support for B&C Rules*, NAT'L MORTGAGE NEWS, Sept. 8, 2003, at 13. “When congressmen Ney and Lucas introduced their bill (H.R. 833) in February, consumer groups panned it, claiming it contained few consumer protections and it

Federally chartered banks, thrifts, and credit unions are not in need of a preemptive federal statute due to a host of preemption rulings and regulations from the federal banking agencies regarding state anti-predatory lending laws.<sup>120</sup> Preemption for federal thrifts and national banks applies to the operating subsidiaries of such institutions, but not to all corporate subsidiaries or affiliates.<sup>121</sup> Obviously, federal banking agency preemption results in a competitive disadvantage to non-federally chartered or non-institution-affiliated mortgage companies, who cannot claim its benefits. Accordingly, a single-point federal standard would better serve non-bank mortgage lenders than sporadic preemption rulings and interpretations by federal banking agencies.

### VIII. CONCLUSION

It is well known that the residential mortgage lending industry is national in scope. Most residential mortgage loans, whether originated by banks or mortgage companies, are sold into the securities market.<sup>122</sup> Therefore, originators rely on capital from a national market. If nothing else, the plethora of

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weakened the existing federal anti-predatory lending law [HOEPA].” *Id.*

<sup>120</sup> See Letter from Carolyn J. Buck, Chief Counsel, Office of Thrift Supervision (Jan. 21, 2003) (Form Letter P-2003-1) (preemption of Georgia Fair Lending Act), <http://www.ots.treas.gov/hola03.html>; Letter from Carolyn J. Buck, Chief Counsel, Office of Thrift Supervision (Jan. 30, 2003) (Form Letter P-2003-2) (preemption of New York predatory lending law), <http://www.ots.treas.gov/hola03.html>; Letter from Carolyn J. Buck, Chief Counsel, Office of Thrift Supervision (July 22, 2003) (Form Letter P-2003-5) (preemption of New Jersey predatory lending act), <http://www.ots.treas.gov/hola03.html>; Letter from Carolyn J. Buck, Chief Counsel, Office of Thrift Supervision (Sep. 2, 2003) (Form Letter P-2003-6) (preemption of New Mexico Home Loan Protection Act), <http://www.ots.treas.gov/hola03.html>. See also Letter from Sheila A. Albin, Associate General Counsel, National Credit Union Association, to Carla J. Cerniglia, Senior Compliance Specialist, New York State Credit Union League Inc. (March 2, 2001) (discussing applicability of state lending regulation to federal credit unions), [http://www.ncua.gov/ref/opinion\\_letters/2000/00-0827.html](http://www.ncua.gov/ref/opinion_letters/2000/00-0827.html); Letter from Sheila A. Albin, Associate General Counsel, National Credit Union Association, to Richard P. Kessler, Jr., Macey, Wilensky, Wittner & Kessler, LLP (July 29, 2002) (applicability of Georgia Fair Lending Act to federal credit unions), [http://www.ncua.gov/ref/opinion\\_letters/2002/02-0649.html](http://www.ncua.gov/ref/opinion_letters/2002/02-0649.html). As to national banks, see Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904 (Jan. 13, 2004) (to be codified at 12 C.F.R. pts. 7 & 34).

<sup>121</sup> See Letter from Carolyn J. Buck, Chief Counsel, Office of Thrift Supervision (Jan. 21, 2003) (Form Letter P-2003-1), <http://www.ots.treas.gov/hola03.html>; Letter from Carolyn J. Buck, Chief Counsel, Office of Thrift Supervision (Jan. 30, 2003) (Form Letter P-2003-2), <http://www.ots.treas.gov/hola03.html>; Letter from Carolyn J. Buck, Chief Counsel, Office of Thrift Supervision (July 22, 2003) (Form Letter P-2003-5), <http://www.ots.treas.gov/hola03.html>; Letter from Carolyn J. Buck, Chief Counsel, Office of Thrift Supervision (Sep. 2, 2003) (Form Letter P-2003-6), <http://www.ots.treas.gov/hola03.html>; Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904 (Jan. 13, 2004) (to be codified at 12 C.F.R. pts. 7 & 34).

<sup>122</sup> Henry Savage, *Zoning Curbs Loan Prospects*, WASH. TIMES, Jan. 30, 2004, at F23.

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state and local anti-predatory lending laws impedes the flow of legitimate capital from national sources to local originators.

Needless to say, whether this reduction in funds available to borrowers is salutary or destructive is part of the debate. Some consumer advocates believe that under existing laws, certain home loans simply should not be made. The design and impact of North Carolina's initial anti-predatory lending law is an example of consumer advocates prevailing in this view.