FDIC

Federal Deposit Insurance Corporation
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Financial Institution Letter
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PREDATORY LENDING

FDIC's Supervisory Policy on Predatory Lending

Summary: The attached *FDIC Supervisory Policy on Predatory Lending* describes certain characteristics of predatory lending, and reaffirms that such activities are inconsistent with safe and sound lending and undermine individual, family and community economic well-being. The statement describes the FDIC's supervisory response to predatory lending, including a list of policies and procedures that relate to consumer lending standards. The FDIC expects the institutions it supervises to treat consumers fairly, adhere to all applicable legal requirements, and underwrite loan products appropriately.

Distribution:
FDIC-Supervised Banks (Commercial and Savings)

Suggested Routing:
Chief Executive Officer
Chief Loan Officer
Chief Compliance Officer

Related Topics:
Unfair and Deceptive Acts and Practices by State-Chartered Banks; Risks Associated with Subprime Lending; Nontraditional Mortgage Products; Fair Lending; Community Reinvestment; Consumer Financial Education

Attachment:
FDIC Supervisory Policy on Predatory Lending

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Note:
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Highlights:

- The availability of credit to consumers with limited or problem credit histories has increased over the past decade. At the same time, competition in the credit markets to lend to both prime and subprime borrowers has resulted in lenders offering a broad variety of credit products. As credit products become more complex and available to a wider array of borrowers, risks associated with predatory or abusive practices increase.

- The FDIC combats predatory lending by stopping abusive practices through the examination process and supervisory actions; encouraging banks to serve all members and areas of their communities fairly; and providing information and financial education to help consumers make informed choices from the wide array of available financial services.

- The FDIC will continue to address predatory lending through vigorous safety and soundness and compliance examinations and enforcement, industry outreach and adult financial education programs.

FDIC SUPERVISORY POLICY ON PREDATORY LENDING

The availability of credit to consumers with limited or problem credit histories has increased over the past decade. At the same time, competition in the credit markets to lend to both prime and subprime borrowers has resulted in lenders offering a broad variety of credit products. As credit products become more complex and available to a wider array of borrowers, risks associated with predatory or abusive practices increase. The FDIC expects the institutions it supervises to treat consumers fairly, adhere to all applicable legal requirements, and underwrite loan products appropriately.

This policy statement describes certain characteristics of predatory lending and reaffirms the FDIC's position that such activities are inconsistent with safe and sound lending and undermine individual, family and community economic well-being. The statement describes the FDIC's supervisory response to predatory lending, including a list of policies and procedures that relate to consumer lending standards. It encompasses most potential predatory lending issues, but is not necessarily exhaustive.

Characteristics of Predatory Lending

There is no simple checklist for determining whether a particular loan or loan program is predatory. Loan terms that are helpful to one borrower may be harmful to others. For example, it is important to distinguish subprime lending from predatory lending. Subprime lending includes loans to persons who present heightened credit risk because they have experienced problems repaying credit in the past, or because they have only a limited credit history. Loans that serve these borrowers have a legitimate place in the market when they have been responsibly underwritten, priced and administered. Predatory lending, on the other hand, is not limited to one class of borrowers. Signs of predatory lending include the lack of a fair exchange of value or loan pricing that reaches beyond the risk that a borrower represents or other customary standards.

Furthermore, as outlined in the interagency *Expanded Examination Guidance for Subprime Lending Programs,* [1] "predatory lending involves at least one, and perhaps all three, of the following elements:

- Making unaffordable loans based on the assets of the borrower rather than on the borrower's ability to repay an obligation;
- Inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced ("loan flipping"); or
- Engaging in fraud or deception to conceal the true nature of the loan obligation, or ancillary products, from an unsuspecting or unsophisticated borrower."

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[1] *See* Expanded Guidance for Evaluating Subprime Lending Programs – FIL-9-2001, January 31, 2001: http://www.fdic.gov/news/news/financial/2001/fil0109.html

FDIC Response to Predatory Lending

The FDIC combats predatory lending by: stopping abusive practices through the examination process and supervisory actions; encouraging banks to serve all members and areas of their communities fairly; and providing information and financial education to help consumers make informed choices from the wide array of available financial services.

Taking Supervisory Actions

When examiners encounter loans with predatory characteristics, the lending practices will be criticized as unsound. When the FDIC finds practices that violate consumer protection, fair lending and other laws, including applicable state laws or the Federal Trade Commission (FTC) Act prohibition against unfair or deceptive practices, the FDIC will take appropriate action. The supervisory action taken will depend on the violation, whether consumers and/or the institution have been harmed and, if so, to what degree. Actions range from commitments to formal enforcement actions under Section 8 of the FDI Act. The FDIC will also undertake joint enforcement actions with state authorities or with other federal agencies where appropriate.

Further, the Community Reinvestment Act (CRA) examination process[2] reviews each bank's record, based on the standards appropriate for its size and operation. Predatory lending can have a negative effect on a bank's CRA performance, specifically, including violations of: the Fair Housing Act and the Equal Credit Opportunity Act involving discriminatory credit practices; the Truth in Lending Act, regarding rescission of certain mortgage transactions, and regarding disclosures and certain loan term restrictions in connection with credit transactions subject to the Home Ownership and Equity Protection Act; the Real Estate Settlement Procedures Act regarding the giving and accepting of referral fees, unearned fees or kickbacks in connection with certain mortgage transactions; and the Federal Trade Commission Act regarding unfair or deceptive acts or practices. Other practices may warrant the inclusion of comments in an institution's performance evaluation. These comments may address the institution's policies, procedures, training programs, and internal assessment efforts.[3]

In addition to the regular examination process, the FDIC investigates consumer complaints. The findings of such investigations may result in supervisory action if warranted. Examiners also use complaint information during the examination process to focus on potential predatory lending and other issues during an examination.

Encouraging the Delivery of Banking Services to the Entire Community

Financial institutions are expected to help meet the credit needs of their entire communities, including low- and moderate-income areas. Community Affairs Program staff in each of the FDIC regional offices conducts outreach and provides technical assistance to banks and community organizations to foster community economic investment and fair lending. Moreover, the staff facilitates development of bank and community partnerships that strengthen

2 *See* 12 C.F.R. Part 345.
3 *See* Interagency CRA Questions and Answers §_.28 (c)-1 A1

the delivery of bank services to low- and moderate-income and other underserved populations. We encourage financial institutions to take advantage of these resources to help ensure fairness in the provision of financial services to all members of a community.

Disseminating Consumer Information

Well-informed consumers are less likely to be the victims of predatory lenders and are more likely to make informed choices. The FDIC provides a variety of widely disseminated and free information. For example, the FDIC Consumer Affairs Program staff conducts outreach activities to educate consumers about financial services. At the FDIC Call Center, a staff of Consumer Affairs Specialists responds directly via phone, mail and e-mail to consumer complaints and requests for information about consumer protection laws and banking practices.

In addition, the FDIC's Office of Public Affairs, in conjunction with the Division of Supervision and Consumer Protection, publishes the quarterly *FDIC Consumer News* that provides practical information about banking and financial services to consumers. The FDIC's Money Smart Financial Education program also is widely used to help adults outside the financial mainstream enhance their money management skills and create beneficial banking relationships. The free program is available in multiple formats and languages, and new versions are added periodically. Banks are encouraged to work with others in their communities to deliver financial education and appropriate financial services to individuals who may be unfamiliar with the benefits of having a relationship with an insured depository institution. When a bank's CRA performance is reviewed, the institution's efforts to provide financial education and other retail services are a positive consideration.

Conclusion

Predatory lending harms individuals and communities and raises risk management and consumer compliance concerns for financial institutions. Predatory loans can have a negative impact on a bank's CRA evaluation. The loans may violate fair lending laws and other consumer protection laws, resulting in legal or regulatory action. Questionable loan underwriting and the risk of litigation raise additional safety and soundness concerns. The FDIC will continue to address predatory lending through vigorous safety and soundness and compliance examinations and enforcement, industry outreach and adult financial education programs.