DBF SUP 25-003

DBF GUIDANCE FOR GEORGIA STATE-CHARTERED BANKS, BANK HOLDING COMPANIES, CREDIT UNIONS, AND TRUST COMPANIES

TO:	Supervision Staff
CC:	Georgia State-Chartered Banks and Credit Unions
FROM:	Melissa Sneed Deputy Commissioner for Supervision
SUBJECT:	AVOIDANCE OF PREDATORY LENDING
DATE:	February 17, 2025

The Status of Predatory Lending Statutes in Georgia

In 2002, the Georgia General Assembly enacted the Georgia Fair Lending Act (GAFLA), which provided certain limitations on lending practices related to residential mortgage lending. These limitations impact lenders, brokers, servicers, and assignees and purchasers of mortgage loans. Effective in March 2003, GAFLA was amended to provide guidance in the event that national regulators found that GAFLA was preempted. This amendment provided that in the event of preemption for national banks and federal credit unions, state banks and credit unions would be similarly preempted from the provisions of GAFLA. After the amendment became effective, the Department received written notice of preemption of GAFLA from both the Office of the Comptroller of the Currency (OCC) and the National Credit Union Administration (NCUA). Based on these determinations, the Department determined that GAFLA would be preempted as to state-chartered banks and credit unions as well.

Notwithstanding the inapplicability of GAFLA to banks and credit unions, the Department remains committed to making certain that practices that are predatory or abusive to consumers are actively discouraged and that if other violations of applicable state or federal law are noted, that these violations are cited. In particular, practices which could unfairly or unlawfully threaten the foreclosure of a consumer's residence or result in the stripping of equity are particularly troublesome and objectionable. The Department notes that other federal and state laws related to residential mortgage lending, including the Home Owners Equity Protection Act (HOEPA), the Federal Trade Commission

Act, and other applicable consumer protection laws continue to apply to both state and nationally chartered banks and credit unions.

Based on the observation of our examiners and the consumer complaints received by this office, the Department has noted that predatory lending practices have not typically been found in depository financial institutions. However, it is important that the preemption of the GAFLA should not be misunderstood as an indication that practices that are clearly objectionable or abusive to consumers will be tolerated or condoned in state chartered financial institutions or their subsidiaries.

The Definition of Predatory Lending

The terms "abusive" or "predatory lending" are not specifically defined by statute or regulation and are the subject of considerable discussion among industry, regulatory, and consumer advocacy groups. The federal regulatory agencies have developed guidance related to abusive and predatory loan practices. These directives are maintained on each individual agency's website.

Generally, the granting of credit without a determination of the borrower's ability to repay the credit is a strong indicator of abusive credit relationships. Extending credit designed to result in the foreclosure of residential real estate or to facilitate the stripping of equity in that real estate is considered abusive or predatory lending. There are also a number of other practices which may, depending on the circumstances, be indicative of predatory lending.

Practices which may be indicative of Predatory Mortgage Lending

The following practices may be indicative of abusive or predatory mortgage lending. The total circumstances of the credit and the borrower should be taken into consideration:

1. The granting of credit that the borrower clearly cannot repay based on their level of income, the terms of the loan and the other obligations of the borrower.

2. The use of single premium credit insurance or single premium DCC or DSA products on loans secured by residential real estate.

3. The refinancing of government sponsored or other subsidized lending programs without providing a tangible benefit to the borrower.

4. The use of loan "flipping," the practice of frequent refinancings that result in little or no tangible benefit to the borrower, particularly if these refinancings are characterized by excessive fees.

5. The charging of excessive loan fees, particularly fees which are not reflective of the cost of the lender and which may not be accurately disclosed in the disclosure documentation provided to the borrower.

6. The use of loan rate structures such as negative amortization or accelerated interest rate structures which may be difficult for borrowers to understand and which make it difficult

or impossible for the borrower to pay off the loan.

7. The use of balloon payments on real estate loans unless this payment structure is clearly disclosed to the borrower, including the dollar amount of the balloon payment and when this payment will be due. (Note: The use of a balloon payment structure is not inherently abusive and it may make sense for certain borrowers, depending upon their individual circumstances and the structure of the note.)

8. Making loans to pay a contractor for home improvement or repair, when the underlying improvements have not been completed or have not been completed consistent with established building codes or by other acceptable methods, such as controlling disbursement of proceeds.

9. The abusive structuring of prepayment penalties that make it difficult or impossible for a borrower to repay a loan before scheduled maturity. (Note: There are circumstances where prepayment penalties could be beneficial to the borrower, such as for "no fee" mortgage loans where these structures may be needed during the initial years of the loan to accommodate this mortgage structure. The total circumstances of the credit and the benefits to the borrower need to be considered in determining whether such a structure is abusive.)

10. The use of unrestricted "due on demand" features on residential mortgage loans (specifically, due on demand features that are unduly controlled by the lender and not based upon default).

11. The use of mandatory arbitration clauses in loan contracts. Applicable case law regarding the use of mandatory arbitration should be considered and provisions that are unduly restrictive or weighted to the benefit of the creditor may be considered abusive.

12. The lack of clear and proper disclosures or the making of misleading disclosures to consumers. (For example, deceptive or misleading fee descriptions on HUD I Forms or other loan documentation.)

13. Targeting inappropriate or costly loan products to financially unsophisticated consumers, especially if these individuals would qualify for more reasonably priced credit products and terms.

<u>The Department's response in the event that predatory mortgage lending practices are noted during the examination or visitation process</u>

The practice of making loans which a borrower clearly cannot repay based on income or other creditable sources of repayment is a fundamentally abusive practice. As such, it is considered an unsafe and unsound practice and is subject to administrative action.

The response of the Department regarding other potentially abusive or predatory practices will depend on the severity and prevalence of the problems noted. For example, if a situation is observed that appears to be a singular and isolated incidence, there could be a recommendation in the examination or visitation report that management review the practice noted for possible corrective attention. A pattern of abusive practices could warrant more serious administrative action based on safety and soundness concerns or violation of various applicable consumer protection laws.

The Examiners of the Department will review the financial institution's practices to make certain that the institution is in compliance with the provisions of the Home Owners Equity Protection Act (HOEPA), the Federal Trade Commission Act, and the Georgia Uniform Deceptive Trade Practices Act.

<u>HOEPA</u>

Under the Dodd-Frank Act, the CFPB enforces and implements HOEPA. HOEPA prohibits negative amortization, increases in interest rate upon default and balloon payments for loans with a term of less than five years. It also restricts the use of prepayment penalties and due-on- demand clauses in the first year of the loan, with some exceptions. Currently, HOEPA thresholds are: (1) an interest rate trigger based on 6.5% percentage points in excess of a similarly termed treasury instrument (8.5% for subordinate lien loans or first loans on personal property and a loan of less than $50,000); (2) a point and fees threshold that is adjusted each year based on the CPI index; or (3) the ability of the lender to charge certain prepayment penalties. Violations would be cited in the examination report for any loans which exceed any of these thresholds and which are in violation of any of the HOEPA loan requirements. Violations may also be referred to other enforcement authorities for further administrative actions.

<u>FTC Act</u>

State banks and credit unions are additionally subject to Section 5 of the FTC Act which makes unfair or deceptive acts or practices practiced in commerce unlawful. Practices such as loan flipping, equity stripping, and the refinancing of subsidized or special loans without benefit to the borrower can be considered unfair or deceptive practices in violation of this Section of the FTC Act. In order to be considered ***deceptive*** under the Act, there must be a representation, omission, act, or practice that is likely to mislead a reasonable consumer in a material fashion. In order to be considered ***unfair,*** a practice must cause substantial consumer injury, such as monetary harm, that is not outweighed by benefits to the consumer, and the practice must be one that consumers could not have reasonably avoided.

As apparent from the above requirements, the standards for a practice or representation to be considered deceptive or unfair is a fairly high one; however, if serious acts are noted which meet the above standards, a violation of Section 5 of the FTC Act may be cited by our examiners. Violations of the FTC Act could result in a strong administrative response from the Department to effect corrective action and eliminate the circumstances resulting in this violation of law. This could include a Memorandum of Understanding, Cease and Desist Order, or referral to other enforcement authorities.

Georgia Uniform Deceptive Trade Practices Act

State banks, credit unions, and other financial institutions are also subject to the provisions of the Georgia Uniform Deceptive Trade Practices Act, O.C.G.A. §§ 10-1-370 through 10-1-408. O.C.G.A. § 10-1-372 defines a trade act as deceptive if the conduct "creates a likelihood of confusion or misunderstanding." The specific circumstances surrounding loan transactions including the loan terms and structure and the adequacy of disclosures made regarding the transactions would determine whether a violation of this law would be appropriate. Loans which contain features or a combination of features which appear to be substantially abusive in nature or which may be deceptive in terms of the adequacy of disclosures to consumers could be cited by examiners as in violation of the Act. The standard for what constitutes a deceptive or unfair practice is fairly high and would reflect serious and pervasive practices and representations. However, O.C.G.A. § 10-1-391 states that:

> the purpose of this part shall be to protect consumers and legitimate business enterprises from unfair and deceptive practices in the conduct of any trade or commerce in part or wholly in the state. It is the intent of the General Assembly that such practices be swiftly stopped, and this part shall be liberally construed and applied to promote its underlying purposes and policies.

As in the case of the FTC Act, if the Department cites a violation of the Georgia Uniform Deceptive Trade Practices Act, a financial institution could face a strong administrative response by the Department to correct the violation and eliminate the circumstances resulting in the violation. This could include a Memorandum of Understanding, a Cease and Desist Order, or referral to other enforcement authorities.

Actions financial institutions can take to minimize the possibility of predatory or abusive mortgage lending practices

As noted above, depository financial institutions have overall done an effective job of providing financial services to the consumer with terms and pricing that are appropriate based on the market. Additionally, the financial services marketplace has been able to accommodate consumers with below prime credit and has thereby been able to expand the credit market to individuals that have previously not had access to credit. It is important to maintain this availability of credit; however, practices which may be indicative of predatory or abusive lending should be avoided by banks and credit unions. Financial institutions can avoid these practices by establishing appropriate Loan Policies and Procedures, by following sound loan underwriting, by maintaining other appropriate consumer safeguards, and by managing and monitoring these procedures through proper loan review procedures.

Written Loan Policies

The Department recommends the following practices be addressed in the financial institution's loan policy:

- Testing for HOEPA thresholds and compliance with HOEPA's prohibitions for applicable loans.

- Avoiding any violations of the FTC Act or the Georgia Deceptive Trade Practices Act.
- Making “home loans” (as defined by the GAFLA) with single premium credit insurance.
- Making loans with frequent refinancings unless a demonstrated benefit to the borrower can be shown.
- Making loans refinancing special or subsidized mortgage programs, unless a demonstrated benefit to the borrower can be shown.
- Making loans with negative amortization features.
- Making loans with prepayment features that are not limited to the early years of the loan.
- Guidelines for using balloon payment features for short-term loan transactions.
- Points, Fees and penalties that are excessive, abusive or unjustified.
- Unfair or abusive changes in interest rates or acceleration clauses in the loan contract.
- The use of Mandatory Arbitration clauses (refer to note above regarding these provisions).
- Use of unrestricted “due on demand” features.

Loan Underwriting Procedures

Following sound credit underwriting procedures including determining the ability of the borrower to properly repay the debt is a fundamental safeguard against predatory lending. Consideration should be given to the borrower’s income, other obligations, employment status, and the terms of the proposed loan.

Other Considerations

A bank or credit union should take appropriate action during the credit approval process to make certain that the borrowing is not abusive to the interests of the borrower and is beneficial to borrower overall, especially when dealing with borrowers that are financially unsophisticated, elderly, or otherwise vulnerable. For certain types of credit, such as loans for home improvements where the borrower’s equity in their residence is at risk, it is appropriate to take measures in structuring the loan to make certain that the funds are appropriately released to the contractor and that the home improvements were completed to the property.

Credit Review Procedures

A financial institution’s internal or external credit review process should include compliance with the above limitations or exclusions regarding credit policies and underwriting procedures.

Management Information Systems

A financial institution’s management should have sound management information systems in place to permit the lending function to be properly monitored and to assure adequate compliance with loan policies and procedures.

Practices related to mortgage loans purchased through brokers or loan participations

Financial institutions have a responsibility for determining that loans that are purchased from other financial institutions and from mortgage lenders or brokers are not abusive or predatory loans. An institution should also perform adequate underwriting procedures on such loans, including review of the loan terms and structure, analysis of the financial information on the borrower and their ability to properly repay the loan and other practices that could be indicative of potentially predatory lending activity. The practices outlined above regarding loan policies and procedures should apply equally to loans originated within the financial institution and loan purchased from other parties.

Loans purchased from brokers, lenders, and other financial institutions are subject to similar legal requirements, including the Truth in Lending Act, RESPA, HOEPA, the Equal Credit Opportunity Act and the Federal Trade Commission Act. These statutes provide that certain of the prohibited practices under these acts may result in legal risk to purchasers or assignees.

It is imperative that financial institutions, in order to protect against credit and legal risk, establish appropriate Policies and Practices for doing business with mortgage brokers and third-party originators. At a minimum, these policies should include:

- Confirming that the broker or third-party originator is properly licensed and has not been subject to any significant regulatory sanctions or actions.
- Assessing the competence and experience of the broker.
- Assessing the business practices of the broker including the adequacy of documentary practices.
- Assessing financial history and condition.
- Assessing internal controls and procedures.
- Determining that there are no conflicts of interest regarding lending relationships.

It is also recommended that financial institutions have a written agreement with brokers or third party originators outlining the duties and responsibilities of the respective parties to the agreements, including providing that applicable laws and regulations will be complied with, that procedures to permit a loan to be returned to the broker or the third party originator in the event that certain conditions (such as apparent fraud or apparent predatory lending practices) are noted in the agreement, that establish other limitations on the credit (such as maximum levels of loan fees), and that establish procedures in the event of a breach of the agreement.

It is also important to perform individual loan reviews on loans purchased from brokers or third-party originators. The depth and frequency of these reviews should depend on the volume of loans purchased, the size of the loans and other credit characteristics. Even for high volume standardized portfolio purchases there should be at least a sampling of loans reviewed to insure that proper loan underwriting procedures are followed, that consumer protection and other laws are being followed, and that the terms and structures of the loans do not appear to contain predatory or abusive lending practices.

Mortgage Lending Practices of Subsidiaries

Predatory lending practices that occur at a subsidiary of a financial institution are viewed with as much seriousness as if these practices occur at the institution itself. Possible credit risk and legal risk involved with a subsidiary can result in risk to the financial institution. The Department's examination procedures shall include a review of the activities of subsidiaries. The practices outlined above should be similarly proscribed, limited, or controlled in subsidiaries. Management should properly monitor the policies, procedures, and underwriting that occur at subsidiaries and provide for similar safeguards as outlined above. There should be sound management information systems in place to assure that proper management oversight over the lending activities at subsidiaries occurs.

Note that subsidiaries of holding companies have not been accorded preemption status regarding the GAFLA; therefore, if a subsidiary is not a subsidiary of a state or national bank, the subsidiary would be expected to comply with the provisions of the Act.

Summary

The Department has noted both in the process of examining banks and credit unions for compliance with the GAFLA and by monitoring consumer complaints filed with the Department that state chartered financial institutions have not been involved to any material extent in lending practices that could be characterized as predatory or abusive to consumers. Violations related to the Georgia Fair Lending Act, when applicable, were isolated, inadvertent, and were immediately corrected by financial institution management. All regulatory agencies, both federal (including the Federal Reserve, the FDIC, the OCC, and the NCUA) and state have noted that if such practices are encountered in financial institutions or subsidiaries they will be pursued in accordance with existing guidelines regarding safety and soundness and in accordance with applicable law. Credit unions, banks, and their subsidiaries can safeguard themselves regarding these issues by establishing proper policies and procedures regarding direct mortgage lending and loans purchased from third parties, following sound loan underwriting guidelines, and monitoring compliance through proper loan review and management information systems.