

Testimony of  
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CONFERENCE OF STATE BANK SUPERVISORS

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Good morning, Chairman Craig, Senator Breaux and members of the Committee. I am Gavin Gee, Director of Finance for the State of Idaho, and I appear today on behalf of the Conference of State Bank Supervisors (CSBS). Thank you for the opportunity to testify on the states' efforts to protect senior citizens and other consumers from fraudulent and predatory lending practices.

CSBS is the professional association of state officials who charter, regulate and supervise the nation's nearly 6,400 state-chartered commercial and savings banks and more than 400 state-licensed foreign banking offices nationwide. Through CSBS, state regulators of banks and nonbank lenders meet to exchange information and share solutions to problems such as predatory lending.

We are also, by and large, the same state officials who license, examine, and handle consumer complaints and enforcement actions against other financial services providers who extend consumer loans and mortgages.

### **Predatory Lending**

Predatory lending is a complex issue, and I want to begin my statement by distinguishing between *predatory* and *subprime* lending. The United States economy depends on the free flow of credit from responsible lenders to worthy borrowers. The average American household has more credit options than consumers in any other country, and certainly more credit options than it had ten years ago. A major reason for this is the ability of lenders to manage risk through pricing. The emergence of "subprime" lending products has made credit available to traditionally underserved markets. These products are loans that are priced, through their interest rate and other terms, consistent with the risks associated with a particular borrower. In particular, the availability of subprime mortgage loans has made homeownership a reality for thousands of low-and moderate-income families. Subprime lending is not necessarily predatory lending.

Predatory lending can be hard to define, and one of its most frustrating aspects is that we too often recognize it by its effects. Predatory lending is all too obvious when we see the harm it does to our most vulnerable citizens, particularly the elderly, the unbanked and those who are isolated by barriers of language or economic status. Our challenge at the state level has been to develop laws and regulations that identify, prohibit and punish activities we know will lead to borrowers destroying their credit ratings, losing their homes, or filing for bankruptcy. At the same time, these laws cannot have the effect of driving creditors away from our states. We recognize that enacting laws is only part of the equation; the most significant components are our continuing effort to educate all types of borrowers and give them the tools they need to make wise credit decisions and strong enforcement of laws to detect and weed out bad actors and bad practices.

The states, individually and together, have been working hard on the issue of predatory lending for many years now. Over this time, we have learned a great deal about what works and what doesn't, about where the problems lie and how best to address them. We have learned that a single set of rules and remedies is not always appropriate for every lender or for every group of borrowers. I currently serve as the Chairman of the CSBS task force on predatory lending. The task force's goal is to consider anti-predatory lending standards that can be adopted by the states, or presented to Congress as a national standard.

Our challenge, and yours, is to prevent abuses without reducing the availability of credit or stifling innovation in new lending products, such as reverse mortgages, which have been a boon to many older Americans when appropriately marketed and underwritten. As you seek to understand the options for state and federal government action on this problem, I ask that you consider this point: federal preemption of state consumer protection laws and enforcement can, for all intents and purposes, deny consumers the real protection that the state can give them.

The state banking system has traditionally been the laboratory for innovation and for developing the best practices in both products and services and consumer protections. As new products and services have emerged over the past ten years, so too have new

opportunities for consumer confusion and, in some cases, abuse. The explosion of the mortgage industry created a new class of lenders for nonprime borrowers, and in some cases, these lenders have engaged in predatory and fraudulent practices. Many states sought remedies through enforcement of existing state laws, new legislation, and financial education campaigns. Our efforts have reached thousands of borrowers and potential borrowers, punished and discouraged predatory lenders, and brought a national spotlight to this problem.

### **Idaho's Approach**

Idaho is not one of that handful of states that have enacted specific laws against predatory lending; instead, we opted to combat instances of predatory lending in Idaho with the laws already under our jurisdiction. But there should be no doubt that even small states like Idaho have their share of instances of predatory lending.

The Idaho Credit Code, which governs finance companies, incorporates the Federal Consumer Credit Protection Act, including Truth in Lending and Fair Credit Reporting. Our Residential Mortgage Practices Act incorporates both the federal Truth in Lending and the Real Estate Settlement Procedures Act. Idaho has found these laws sufficient to take action against predatory lenders, and we have not seen a need to enact separate anti-predatory lending legislation. It may be that this is also the case at the federal level; that existing laws do offer adequate protection and remedies, as long as they are strongly and consistently enforced. No amount of lawmaking will protect consumers without the proper enforcement, including well-trained examiners to discover violations, and appropriate sanctions to back it up.

Together, these two major state laws govern the mortgage industry. One gives us authority to license, examine, and take enforcement actions against mortgage brokers and mortgage lenders. Among other anti-predatory provisions, Idaho law prohibits mortgage brokers from engaging in misrepresentations concerning mortgage loans, and from “accept[ing] any fees at closing which were not previously disclosed fully to the

borrower.” But it also incorporates federal standards, and authorizes our Department to take enforcement action if, for example, a mortgage broker violates the federal Real Estate Settlement Procedures Act.

A priority for my agency under this law has been to establish a program of routine examinations of mortgage brokers and mortgage lenders. We believe the process of routine examinations is critical to consumer protection. Through this process our examiners often uncover and address violations of consumer protection laws before large segments of the population are affected.

Similarly, the law that allows us to license, examine, and take enforcement actions against finance companies incorporates federal standards, specifically the federal Consumer Credit Protection Act. But it also allows the state to take action against a lender who engages in fraudulent or unconscionable conduct. For example, if the lender knows, when the loan is made, that the borrower likely cannot repay the loan, it is an unconscionable loan.

In Idaho, we believe strongly that part of our consumer protection mission is best accomplished through education. We are actively involved in the Idaho Financial Literacy Coalition (IFLC). The IFLC is comprised of individuals from government, education, all segments of the financial industry, and non-profit organizations. The goal of the IFLC is to improve the quantity and quality of information and educational programs related to personal finance by providing resources and instructions to educators, youth leaders, the elderly, and others who are need of assistance or at financial risk.

Department personnel volunteer as speakers at senior centers, and in Idaho high schools, assisting in the introduction of basic financial concepts including investing, financial planning, and consumer credit. These speakers specifically address how consumers can avoid lending and investment fraud and other abusive financial practices. The Department co-sponsors and participates in other financial education programs in

Idaho such as the Governor's Conference on Housing, the State Treasurer's Every Woman's Financial Conference, and the Financial Literacy for Youth Month.

Our Department has five staff people dedicated to investigating consumer complaints received in person, in writing, by telephone, and by email arising from transactions with mortgage brokers, mortgage lenders, and finance companies. Over the past three years, these examiners processed 617 complaints relating to these non-depository lenders, and 247 complaints relating to national banks or their operating subsidiaries. In the same period, we returned over \$3.5 million to Idaho consumers as a result of resolved consumer complaints against mortgage brokers, mortgage lenders, and finance companies, and charged an additional \$216,000 in fines and penalties. Our agency conducted 274 investigations of mortgage brokers, mortgage lenders, and finance companies, and 33 investigations of national banks or their subsidiaries. In the past three years, we also completed 178 enforcement actions against non-depository lending institutions.

Under the regulations recently issued by the Comptroller of the Currency, we would not have been able to take these actions if these businesses were operating subsidiaries of national banks.

## **Preemption**

The states have pursued solutions to predatory lending despite what has sometimes seemed to be deliberate obstruction on the part of federal agencies, in particular the Office of the Comptroller of the Currency (OCC). The OCC began by exempting national banks from specific state laws against predatory lending and has, in recent weeks, vastly expanded that exemption. The OCC now claims that national banks and their thousands of nonbank operating subsidiaries are exempt from virtually all state laws that "condition" or affect their operations, including all state consumer protections and licensing requirements in the area of mortgage lending. The OCC has also said that the states have no authority to enforce a vast number of laws affecting national banks and their state-chartered

subsidiaries, including consumer protections and laws against unfair and deceptive practices. The OCC issued these rulings despite the opposition of the National Governors' Association, the National Conference of State Legislatures, all fifty state attorneys general, all fifty state banking supervisors and countless consumer groups.

We can tell you, Chairman Craig and Senator Breaux, that the worst cases of predatory lending come from nonbank lenders – many independent, some affiliated with federally insured depository institutions, and many thinking of how to become subsidiaries of national banks and thus exempt themselves from state laws. These mortgage lenders and consumer credit companies have traditionally been licensed and regulated at the state level. In many, although not all, cases, the state banking departments are responsible for supervising these companies. In all cases, the states work constantly to coordinate their enforcement and recovery activities among the state agencies responsible for preventing predatory lending.

This is why we are so concerned with the OCC's actions. Taking the states out of enforcement for a large and growing segment of the industry can have serious consequences. We cannot understand how our citizens benefit from taking the local cop off the beat and replacing him with an OCC call center in Houston. The Idaho legislature agrees. A recently-introduced joint resolution asks the Congress to review the significant consequences of this federal regulator's preemption.

The Comptroller's recent regulations would have the effect of displacing much of the investigative and enforcement network states have created for responding to consumer complaints, many related to the operating subsidiaries and affiliates of national banks. This network has been working effectively, with millions, even hundreds of millions of dollars being returned to mistreated consumers. After an historic settlement with a single institution, in 2003 the states returned more than \$500 million to consumers who had been victimized by fraudulent or deceptive trade practices.

CSBS and others have called attention to the problems created by expansive federal preemption, and OCC preemption in particular, in hearings and briefings before the Senate Banking Committee and the House Committee on Financial Services. I bring the matter of preemption to this committee's attention because these problems are very relevant to addressing the threat predatory lenders pose to senior citizens.

The states already have systems in place for referring complaints to the appropriate agencies, and to law enforcement authorities when necessary. The states dedicate hundreds of employees to handling these consumer complaints.

I put forward two final numbers for your consideration. Over the past three years, the staff of our small agency conducted 618 routine examinations of non-depository lending institutions doing business in Idaho. These examinations are the ones that will be left undone if Idaho's mortgage brokers, mortgage lenders, and finance companies continue to surrender their state licenses to us under the claim of OCC preemption. It is very often these inspections that detect small, manageable problems before they become large and costly problems. It is my understanding that the OCC rarely performs on-site, routine examinations of national bank operating subsidiaries.

Finally, if all non-depository financial institutions in Idaho – and remember, these nonbank entities are the most frequent sources of complaints – were to seek OCC preemption by becoming operating subsidiaries of national banks or federal thrifts, Idaho citizens would lose the protection of Idaho's laws and law enforcement when dealing with nearly 1,700 companies.

Mr. Chairman, although the states have had significant success in identifying and punishing predatory lenders, and returning funds to the victims, this is not an easy or a simple process. My colleagues and I all feel the strain of limited resources. With limited resources at both state and federal levels, we should be talking about sharing responsibilities, not preempting valuable resources.

State and federal regulators can and must work in a cooperative alliance that acknowledges their respective strengths. And our state/federal system of financial regulation has generally been touted as the model for cooperative federalism. This push from a federal regulator to push that system aside is dangerous.

This model of cooperative federalism is still alive in the states and among many federal regulatory agencies and national organizations. For example, CSBS is a strong alliance partner with the FDIC in its Money Smart financial education program, and a CSBS representative sits on the board of directors of Jump\$tart, another national financial education program. We also plan to work with the federal panel recently created by the Fair and Accurate Credit Transactions Act to ensure financial education initiatives are used at the state and local levels.

Predatory lending is an issue that affects us all. While Idaho – and, in fact, most states – have not enacted separate laws against predatory lending, we have all learned from the experiences of states that have enacted these laws or promulgated new regulations. A comprehensive account of these measures as well as state enforcement and education efforts can be found on the Regulatory Affairs portion of Conference of State Bank Supervisors' Web site at <http://www.csbs.org>.

Most consumers shopping for a mortgage do not understand that different sets of laws apply to different lenders. As in most states, Idaho borrowers call us if they have a problem with their bank, mortgage broker, or finance company. We are that important local office, much like the offices each of you maintains in your home district. For the elderly, a local contact is critical. And consumers rightly expect that their state officials can go to bat for them when they've been wronged. We want to be able to respond to these calls effectively, whether it's going out to the consumer's home when they can't readily come in to our office, or meeting with them in person when they drop by unexpectedly. Unfortunately, our hands are tied more and more by federal preemption.

Your examination of predatory lending offers an opportunity for a broader discussion on the appropriate interaction of state and federal laws that protect consumers. Given the sweeping preemptions of the Comptroller's recent regulations, it appears that new consumer protection laws governing mortgage lending will have to originate at the federal level, without the benefit of continued experimentation at the state level. As you know, enacting federal legislation is a long and cumbersome process. Federal laws necessarily address problems with broad strokes that may not be appropriate for both large and small organizations within the same industry. And, based on my experience, taking enforcement authority away from the states and centralizing it in Washington, D.C. is bad for the citizens of Idaho.

The state system is much better equipped to respond quickly, and to tailor solutions to the specific needs of various communities and industry sectors. If you lose the states as a laboratory for consumer protections and other innovations, you lose two great attributes of our federalist system – the ability to find out what does and doesn't work, and the ability to tailor the response to the problem. Idaho doesn't necessarily need the solution for the problems identified in New York.

Preemption has always been part of the dynamic of our dual banking system. Congressional preemption may be necessary at times to create uniform national standards, as with the recently-enacted Fair and Accurate Credit Transactions Act. The Conference of State Bank Supervisors supported congressional preemption in that case. But we strongly oppose broad regulatory preemption – such as the OCC's recent actions - - in the absence of express guidance from Congress or meaningful consultation with the states.

## **Conclusion**

Predatory lending is an insidious practice that turns the American dream into the American nightmare. It steals not only the victims' money and homes, but their confidence in our financial system. We at the state level are the first line of defense

against these unscrupulous businesses. We are constantly adjusting our approaches, so that we do not deter legitimate lenders or prevent access to credit by those who need it most.

A long-term solution to predatory lending requires three elements: consumer education, clear and consistent laws, and effective enforcement. My office works with community groups, churches, schools and our federal counterparts to educate consumers about the financial system and their rights and obligations, so that they can make the choices that help them reach their goals. Our examiners are physically present in the institutions we supervise, making sure that these institutions have responsible lending policies in place and adhere to those policies. Finally, we do not hesitate to take action against businesses that violate our consumer protection laws.

For the states, enforcement is becoming the weakest link. Federal preemption continues to hinder our enforcement efforts, and has created incentives for businesses to seek the regulatory structure that guarantees the fewest consumer protections. This hurts the citizens of Idaho. This hurts the citizens of the United States.

We stand ready to work with the Congress and with our federal counterparts on a coordinated stand against predatory lending. Our experience should create a valuable foundation for solutions as we go forward.

I would be happy to answer any questions the Committee may have.