States Fight Predatory Lending Laws in Different Ways

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In terms of coverage, the state laws are typically designed to cover a broader segment of the mortgage market. Loans covered under HOEPA include closed-end home equity loans (refinance and second mortgages only) that have an annual percentage rate (APR) and/or finance points and fees exceeding a certain threshold. The state laws typically extend the coverage of HOEPA by including both closed-end and open-end mortgages (lines of credit, refinance and for-purchase mortgages), as well as lowering the APR and/or fee triggers. However, the extent of coverage increase varies among laws, ranging from almost no extension beyond HOEPA (for example, the Florida law) to almost full market coverage (for example, the Colorado law, which applies to loans of almost all purposes and types).

For covered loans, each law identifies different types of restrictions. Typically, state predatory lending laws strengthen restrictions beyond those required by HOEPA. These restrictions usually include additional limits on allowable prepayment penalties and balloon payments, prohibitions of joint financing of various insurance products with the mortgage, and requirements that borrowers participate in loan counseling. Again, there is substantial variation among the state laws in terms of expanding the law’s restrictions. For example, Maine and Nevada largely leave HOEPA restrictions intact, while Georgia is much more restrictive of balloon payments and prepayment penalties.

Impacts of Laws on Flow of Credit

Predatory lending laws are in large part designed to restrict the availability of high-cost credit because of evidence, although anecdotal, of abusive practices associated with certain product types. Therefore, holding everything else constant, we should anticipate a reduction in originations of subprime loans after a law is implemented. This reduction could come from more applicants being rejected or fewer households applying for subprime loans. A series of studies has used tables of mortgage conditions before and after the North Carolina law took effect and compares these metrics with growth rates in nearby states and the nation as a whole. Using the Home Mortgage Disclosure Act (HMDA) data set, economists at the Center for Responsible Lending in North Carolina concluded that the volume of loan originations declined in North Carolina relative to the rest of the country. However, a group of economists at the Center for Community Capitalism (University of North Carolina at Chapel Hill) used a different data set and found no volume impact on purchases or low credit score loans, but a decline in the volume of refinanced loans.

Other studies have used regression analysis to identify the impact of the laws in North Carolina, Chicago and Philadelphia. (Since publication, the Philadelphia law is no longer in effect.) All of the studies found evidence that the introduction of the North Carolina law substantially reduced the flow of subprime credit. The impact seems to be larger for low-income borrowers and minority borrowers. Also, the volume reduction was largely attributed to lower application rates rather than to increased rejection rates. The lower application rates could result from potential applicants being deterred by the tightened lending standards.
Impacts of State Laws on the Flow of Credit

<table>
<thead>
<tr>
<th>Law Sample (treatment and control loans)</th>
<th>Application</th>
<th>Origination</th>
<th>Rejection</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>3.2</td>
<td>6.7</td>
<td>-25.8</td>
</tr>
<tr>
<td>Connecticut</td>
<td>1.4</td>
<td>2.3</td>
<td>1.3*</td>
</tr>
<tr>
<td>Florida</td>
<td>-3.0</td>
<td>0.8</td>
<td>-5.7</td>
</tr>
<tr>
<td>Georgia</td>
<td>-5.6</td>
<td>-0.7</td>
<td>-11.0</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>-7.4</td>
<td>-3.2</td>
<td>-3.0</td>
</tr>
<tr>
<td>Maryland</td>
<td>2.9</td>
<td>1.8</td>
<td>-6.6</td>
</tr>
<tr>
<td>North Carolina</td>
<td>-6.9</td>
<td>-4.2</td>
<td>-4.8</td>
</tr>
<tr>
<td>Ohio</td>
<td>-0.5*</td>
<td>-0.4*</td>
<td>-2.2</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>3.7</td>
<td>3.2</td>
<td>3.2</td>
</tr>
<tr>
<td>Texas</td>
<td>18.9</td>
<td>10.7</td>
<td>14.8</td>
</tr>
</tbody>
</table>

The impact of a law is measured as the percentage point change in the share of subprime applications (first column), the percentage point change in the share of subprime origins (second column) and percentage point change in the share of subprime applications rejected (third column). In addition, * indicates that the estimated change could not be distinguished in terms of its statistical properties from zero—in other words, the law had no measurable impact.

ENDNOTES
1 As of the end of 2004, the following states had a predatory lending law in effect: Arkansas, California, Colorado, Connecticut, Florida, Georgia, Illinois, Kentucky, Maine, Maryland, Massachusetts, Nevada, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, South Carolina, Texas, Utah and Wisconsin.
2 A refinance mortgage replaces an existing mortgage with a new mortgage; whereas a no-purchase mortgage provides a new mortgage for buying a new home. Lines of credit typically do not have an amortization schedule and, therefore, are considered open-end credit.
3 A prepayment penalty charges the borrower a fee if the loan is paid off early. A balloon payment is payment made at the end of the mortgage to cover any outstanding principal and is typically much larger than the prior monthly payments. A loan with a balloon payment is by definition not fully amortizing.
5 See Ernst, Faris and Stein (2002).
6 See Quercia, Stelmach and Davis (2003 and 2004).
7 See, for example, Harvey and Nigro (2003 and 2004) and Ellisheizen and Staten (2004).
8 California, Connecticut, Florida, Georgia, Maryland, Massachusetts, North Carolina, Ohio, Pennsylvania and Texas.
9 Detailed results on other variables are available upon request.

REFERENCES