State and Local Anti-Predatory Lending Laws: The Effect of Legal Enforcement Mechanisms

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Financing Community Development from the Past, Looking to the Future

Introduction

- Subprime lending's growth has raised concerns
  - General performance
  - Predatory issues
- Federal and state governments have responded by enacting laws and regulations for these activities

Anti-Predatory Lending Laws

- Type I: HOEPA and Mini-HOEPA laws
  - If a loan is "high cost," terms and practices are restricted
  - "High cost" defined in terms of APR or total points and fees as fraction of loan amount
- Type II: Direct restrictions on terms and practices
  - Prepayment, balloons common targets

Current Research

- Do these state-level laws materially impact subprime lending markets?
  - Follow Harvey and Nigro (2004), Ho, and Pennington-Cross (2006)
  - Research innovations
    - New, more comprehensive canvas of laws including Type II laws
    - Consideration of enforcement details
    - More refined assessment of nature of specific mechanisms

The New Legal
Dataset Dimensions

- Coverage
  - Loan type, two APR triggers, points and fees trigger
- Restrictions
  - Prepayment penalty restrictions, balloon payment restrictions, credit counseling requirements, mandatory arbitration limits
- Enforcement mechanisms
  - Assignee liability, enforcement against originators

- Coding: More stringent gets higher score

The New Index

- ## Step 1
  - For each subcomponent, rate state against the maximum score
- ## Step 2
  - Sum up subcomponents within category
- ## Step 3
  - Compare state to average category score
- ## Step 4
  - Sum across categories

Index Example: Alabama

- Steps 1 and 2 for Coverage

Loan type	APR I	APR II	Points
2/4 = 0.5	4/4 = 1	5/5 = 1	4/5 = 0.8

- Coverage score = (0.5+1+1+0.8)/2.1954 = 1.5
- Total across categories

Coverage	Restrictions	Enforcement	Total
1.50	1.50	0.40	3.40

The Research Methodology

- Use HMDA data
- Restrict sample to those loans in counties geographically along a state border
  - Use a random sample of 225,000 such loans
- Include controls for border pair, borrower and location characteristics
- Key variables are state anti-predatory lending law characteristics
  - In effect, total index, category indexes

Empirical Results: Effect of the Laws

- In effect variable
  - Odds of applying for and using subprime loan rises by 5-10 percent
  - No impact on probability of subprime rejection
- Full index variable
  - Subprime originations rise by 3 percent
  - No impact on applications
  - Subprime rejection reduced by 3 percent

Empirical Results: Effect of the Law Components

- Coverage index variable
  - Broader coverage increases odds of applying for (2 percent) and originating a subprime loan (4-5 percent)
  - Likelihood of being rejected falls (2 percent)
- Restrictions index variable
  - Tighter restrictions reduce odds of applying for (-4 percent) and originating a subprime loan (-1-4 percent)
  - No impact on likelihood of being rejected
- Enforcement index variable
  - Same pattern as coverage: originations and applications increase, rejections depressed

Conclusions

- Anti-predatory lending laws do impact subprime lending activity
  - Originations and applications increase, denials fall
  - Suggests that some creditworthy borrowers apply that would not have otherwise

- Implication
  - Properly designed anti-predatory lending laws might actually enhance the subprime lending market