NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

April 30, 2007

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street NW
Washington, DC 20552

Attention: Docket No. 2007-09, Interagency Guidance on Subprime Lending

Dear Officials of Federal Bank and Thrift Agencies:

The National Community Reinvestment Coalition (NCRC), the nation's economic justice trade association of 600 community organizations, appreciates that the Agencies have proposed formal guidelines to protect against the harms of abusive subprime mortgage lending. We share your concern that subprime lending poses a serious threat to borrowers and the stability of homeownership when not used in combination with proper underwriting practices.

We are specifically pleased with and support several of the proposed guidelines to set higher industry standards on underwriting, consumer protections, and portfolio management practices. At the same time, we urge you to further tighten some aspects of your advisory to incorporate advisement to prime lenders who do not practice similar guidelines regarding adjustable rate mortgage (ARM) lending.

Many borrowers who took out 2/28 and 3/27 subprime loans are subject to unpredictable future costs. Predatory loans, such as these, offer two-year fixed rates and then have rates increasing at a rapid clip. These rate hikes can lead to jumps of 50% or more in monthly payments, resulting in payment shock, unaffordable loans, and default for many borrowers. Often, these same borrowers could have qualified for thirty year fixed rate loans at affordable interest rates. In order to truly expand market participation and financial access to low- moderate income families, secure and responsible means of extending credit must be encouraged.

The upshot of the upswing in dangerous lending is that 223,000 households with subprime loans lost their homes to foreclosure and 725,000 had missed mortgage payments in the third quarter of 2006, according to the Mortgage Bankers Association. The percentage of subprime mortgages delinquent by 90 days or more, in foreclosure, or resulting in seized properties hit 10% in November of 2006. Progress made in lending to working class and minority communities during the 1990's stands to be lost. Attached to this letter is recent NCRC testimony submitted to the House Financial Services Committee describing in detail abusive ARM lending targeted to minority and working class communities.

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

In order to prevent the looming foreclosure crisis, your proposed guidance ensures that borrowers would be able to afford subprime ARM loans because it requires lenders to assess the borrower's ability to repay the loan at the maximum interest rate. Currently, many subprime lenders are assessing repayment ability at the low, initial rate, which will cause several borrowers to default when the interest rate increases. In addition, the proposed guidance suggests an underwriting approach that uses a debt-to-income ratio, which includes consideration of principal, interest, taxes and insurance. A significant problem with abusive lending is that the underwriting has failed to take into account borrower payments for taxes and insurance. Your recommended underwriting approach promises to encourage lenders to carefully consider borrower payments for taxes and insurance.

NCRC appreciates that the proposed guidance addresses low documentation and stated income loans, but we believe there are very few benefits to combining these loans with any nontraditional mortgages and/or subprime mortgages. Stated income and low documentation loans provide too many opportunities for mortgage fraud and over-estimating borrowers' ability to repay, leading to unaffordable loans. The proposed guidance recommends that low documentation and stated income loans do not contain risk-layering features. While this proposal will help reduce the risk posed by these loans, NCRC urges the regulators to further recommend specific procedures for lenders to adopt that would prevent fraud associated with low documentation and stated income loans.

The proposed guidance discourages lenders from assessing prepayment penalties that extend beyond the initial time period of the low teaser rates. This is an important element of the proposed guidance, which if anything, should be strengthened so that borrowers are not trapped by onerous prepayment penalties when confronted with significantly higher rates on their loans. The proposed guidance also advises lenders to honestly discuss the risks as well as the benefits of ARM subprime loans before the loan application stage. Often, borrowers become psychologically locked into a loan when they have submitted an application. Thus, we urge the regulators to retain clear guidance about full disclosure regarding loan features and risks in marketing and communications before the application stage.

We also urge the Agencies to incorporate the Community Reinvestment Act (CRA) into the proposed guidance. CRA mandates lenders to serve credit needs in a safe and sound manner. The guidance must therefore stipulate that issuing ARM subprime mortgages in an unsafe and unsound manner violates CRA and will result in ratings downgrades on CRA exams. Furthermore, the agencies should incorporate into the proposed subprime guidance, their recent letter encouraging lenders to work with borrowers facing financial difficulties meeting loan payments. This was a constructive letter, which also provided the added incentive of CRA points for transitioning borrowers into lower cost loans.

Your request for comment includes questions about whether the proposed guidance would "unduly restrict" the ability of subprime borrowers to refinance their loans and avoid payment shock. NCRC believes that the answer to this question is contained in the testimony delivered by FDIC Chairman Sheila Bair before the Financial Services Committee on March 27. In this testimony, Chairman Bair describes how borrowers with subprime ARM loans posing payment shock dangers could be refinanced into 30 year fixed rate loans without risky features. NCRC agrees with Chairman Bair that curbing abusive lending will not restrict access to credit. Instead if abusive loans are squeezed out of the marketplace by regulation or legislation, responsible prime, subprime, and FHA lending will replace the abusive lending. To state this differently, the responsible lenders will be able to increase their lending because the unscrupulous brokers and lending institutions will be eliminated from the marketplace. The abusive lenders will no longer be able to allure borrowers with false promises and quick sales of predatory products.

In Conclusion

While NCRC aims to increase equal access to credit and capital, we believe that this must be done in a responsible and appropriate manner for all parties involved. Borrowers, particularly those in traditionally underserved neighborhoods, deserve a safe market in which lenders thoroughly explain products, options are understood, and responsible decisions can be made. We believe that the regulatory agencies must eliminate dangerous and abusive non-traditional products offered by both subprime and prime market lenders. We thank you for the opportunity to comment on this proposal. Please feel free to contact us on 202-628-8866 if you have any questions.

Sincerely,

John Taylor
President and CEO

Testimony of the
National Community Reinvestment Coalition
Josh Silver, Vice President of Research and Policy

Before the Subcommittee of the House Financial Services Committee on Financial Institutions and Consumer Credit

Regarding Abusive Mortgage Lending Practices, Exotic Mortgages, and Foreclosures

Tuesday, March 27, 2007

Introduction

Chair Maloney and Ranking Member Gillmor, it is an honor to be here today as the voice for over 600 community organizations from across the country that comprises the National Community Reinvestment Coalition. NCRC is the nation's economic justice trade association dedicated to increasing access to credit and capital for minority and working class families. I testify this morning on behalf of NCRC and John Taylor, President and CEO of NCRC. We appreciate you convening today's hearing on an issue that all of our members have been addressing for the last several years.

Predatory lending is a national epidemic. Abusive lenders have stolen billions of dollars in home equity and have taken thousands of homes in foreclosure proceedings. The abuse is spread throughout the entire transaction process to include appraisal and broker fraud on the front end to abusive servicing and inadequate secondary market due diligence on the back end. On top of the usual predatory traps and tricks, we are now witnessing a surge of exotic mortgage lending such as interest-only mortgages, payment-only Adjustable Rate Mortgages (ARMs), and "hybrid" 2/28 and 3/27 ARMs.

The exotic mortgage lending too often becomes toxic lending when the unsuspecting borrower discovers that the introductory low teaser rates have expired and are replaced by high monthly payments that are no longer affordable. According to the FDIC's testimony at last week's Senate hearing, interest rates are due to rise for borrowers of one million subprime loans in 2007 and another 800,000 next year.[1]

Perceiving profitable opportunities, predatory lenders and unsavory investors have dramatically increased their financing of risky non-traditional lending. According to the Mortgage Bankers Association, 39% of mortgage loans were interest-only or option ARMs in the first six months of 2006 in contrast to 33% in the second half of 2005 and less than 2% in 2000.[2] Low documentation loans have also soared with brokers qualifying consumers that they know should not be qualified. In a recent survey, 43% of brokers using low documentation loans said their borrowers could not qualify under standard debt-to-income ratios, hinting that they used low documentation loans so that they could skirt the usual and careful underwriting.[3]

The upshot of the upswing in dangerous lending is that 223,000 households with subprime loans lost their homes to foreclosure and 725,000 had missed mortgage payments in the third quarter of 2006, according to the Mortgage Bankers Association.[4]

[1] "Regulators are Pressed to Take Tougher Stand on Mortgages," by Gregg Hitt and James R. Hagerty, Wall Street Journal, March 23, 2007

[2] "Nontraditional Mortgages Don't Wane Under Warnings," Kirsten Downey, Washington Post, Tuesday, October 24, 2006.

[3] "The Lowdown on Low-Doc Loans," Kenneth Harney, appearing in the Washington Post, Saturday, November 25, 2006.

[4] "High-Cost Mortgages Putting Many Homeowners at Risk," Kirsten Downey, Washington Post, Thursday, December 14, 2006.

According to industry sources, defaults in the end of 2006 exceeded the rate in the last recession of 2001. The percentage of subprime mortgages delinquent by 90 days or more, in foreclosure, or resulting in seized properties hit 10% in November of 2006, almost double the 5.4% in spring 2005. According to the FDIC, more than 14% of the $1.28 trillion in outstanding subprime loans were delinquent by the end of 2006.[5]

The surge in dangerous lending threatens an already vulnerable group of consumers and communities. Predatory lenders prey on the working class, minorities, and the elderly. Congress needs to enact a strong national bill that protects American families from abusive lending practices that steal homeowner equity, which is the primary or only form of wealth building for most Americans. The recent regulatory guidance on non-traditional mortgages and proposed guidance on subprime ARM lending is helpful. But the guidance by itself provides incomplete protections as it only applies to a subset of lenders, and is not backed by certain and swift penalties for illegal and abusive lending.

NCRC applauds the recent move by Freddie Mac to adopt the non-traditional guidance and include additional safeguards in its secondary market activities. Yet, Freddie Mac and Fannie Mae have not had the dominant role in financing subprime lending while unregulated secondary market players have significantly stepped up their operations in the subprime market. NCRC agrees with Federal Reserve Chairman Ben Bernanke that a federal anti-predatory is desirable but we assert that policymakers already understand the characteristics of predatory lending and do not have to wait while we further ferret out the differences between predatory and responsible lending as the Federal Reserve Chairman urges. NCRC is also encouraged that FDIC Chairman Sheila Bair suggests that Congress must "seriously consider" a national anti-predatory law that would apply to all lending institutions.[6]

In my testimony today, I am going to describe the national dimensions of the problem. I am going to draw upon NCRC's Consumer Rescue Fund program, which is a national level program that identifies victims of predatory lenders on the brink of foreclosure and bankruptcy, and then arranges affordable refinance loans so that they can remain in their homes. I will also highlight the results from national testing (mystery shopping) of subprime lenders from across the country. Finally, NCRC's data analysis demonstrates that lending disparities are a national phenomena, which is stubborn and persistent. The likelihood of steering and price discrimination is too great for policymakers to ignore. While voluntary best practices may reduce the incidence of steering and abusive lending, the strength of the evidence suggests that a comprehensive national law is necessary.

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[5] "Subprime Defaults at Recession Level, FBR Says," Bloomberg News reproduced in the American Banker, February 5, 2007; "Regulators are Pressed to Take Tougher Stand on Mortgages," by Gregg Hitt and James R. Hagerty, Wall Street Journal, March 23, 2007.

[6] "Bernanke: Predator Bill 'Would be a Good Idea,'' American Banker, Friday, February 16, 2007; Gregg Ip and Damian Paletta, "Lending Oversight: Regulators Scrutinized in Mortgage Meltdown," March 22, 2007, Wall Street Journal.

What is Predatory Lending

A subprime loan has an interest rate higher than prevailing and competitive rates in order to compensate for the added risk of lending to a borrower with impaired credit. NCRC defines a predatory loan as an unsuitable loan designed to exploit vulnerable and unsophisticated borrowers. Predatory loans are a subset of subprime and non-traditional loans. A predatory loan has one or more of the following features: 1) charges more in interest and fees than is required to cover the added risk of lending to borrowers with credit imperfections, 2) contains abusive terms and conditions that trap borrowers and lead to increased indebtedness, 3) does not take into account the borrower's ability to repay the loan, and 4) violates fair lending laws by targeting women, minorities and communities of color.

For a number of years, it was accurate to state that predatory lending generally occurs in the subprime mortgage market, where most borrowers use the collateral in their homes for debt consolidation or other consumer credit purposes. More recently, however, the surge of non-traditional lending confronts both prime and subprime borrowers with abusive situations. A significant amount of non-traditional lending starts off as a prime lending, but once the interest rate resets, this non-traditional lending often becomes subprime and predatory. In these cases, borrowers are faced with payment shocks and usurious monthly payments that they can no longer afford. Another significant segment of non-traditional mortgages starts off as subprime loans that stretch the margins of affordability but then become unaffordable as introductory rates expire.

Regulatory Guidance is Necessary but Not Sufficient

We are now confronted with a wider variety of predatory subprime and non-traditional loans. The federal regulatory agencies took too long to recognize the breadth and depth of highly risky subprime loans, but their implemented guidance on non-traditional mortgages and their proposed guidance on subprime mortgages are important steps towards protecting American consumers. Yet, as needed as this guidance is, it does not address the full dimensions of the predatory lending epidemic since the guidance applies to a subset of the industry. Moreover, it does not cover all abusive practices. Congress must pass a strong and comprehensive national anti-predatory bill in order to eliminate predatory lending.

The proposed regulatory guidance insures that borrowers of subprime adjustable rate mortgages (ARMs) will be able to afford their loans. The guidance requires lending institutions to assess borrower capacity to repay at the fully indexed rate, not the introductory "teaser" rate that could be several percentage points lower than the eventual Annual Percentage Rate (APR). In addition, the guidance requires lenders to engage in a robust analysis of borrower debt-to-income ratio, incorporating payments for taxes and insurance. A lack of escrows for insurance and taxes in subprime loans has confronted borrowers with unaffordable loans. Requiring that taxes and insurance be considered in underwriting loans should assist in remedying borrower payment shock due to a lack of escrows. The guidance also discourages prepayment penalties extending beyond the time period of the teaser rates. Finally, the guidance emphasizes full and early disclosure to consumers regarding both the benefits and risks of ARM subprime lending.

The proposed guidance is necessary in that it appears to correct a significant deficiency of not accounting for borrower repayment ability in ARM subprime lending. A fundamental difficulty with ARM subprime lending is that the borrower is confronted with an unaffordable loan after the introductory rate expires.

But as needed as the proposed subprime guidance is, it does not cover most of the subprime market. In testimony last week before the Senate, the Senior Deputy Comptroller of the OCC estimates that hybrid ARM products are about 60% of the subprime market.[7] The coverage of the proposed guidance is even lower considering that the guidance would only apply to depository institutions regulated by the federal banking agencies. The Federal Reserve estimates that state-regulated lenders offered about 52% of subprime loans in 2005.[8] Assuming an even distribution of ARM lending among federal and state-regulated lenders, the proposed federal guidance would cover about 30 percent of subprime lending.

While the Conference of State Bank Supervisors successfully urged many states to adopt the non-traditional mortgage guidance covering non-amortizing option ARMs and interest only loans, a significant number of states have still not adopted the non-traditional mortgage guidance. This uneven application could also occur in the wake of federal agency implementation of the proposed subprime guidance.

Another fundamental reason why the proposed guidance is necessary but not sufficient is that the epidemic of predatory lending is caused by a plethora of actors involved in the beginning and end stages of lending. These actors range from brokers, appraisers, correspondents, depository lending institutions, loan servicers, securitizers, and Wall Street investors. The proposed guidance directly applies to depository institutions; while it asks depository institutions to monitor arrangements with third parties, the guidance cannot effectively act as a watchdog over the thousands of third party agents. Under the guidance, a bank should terminate its relationship with an abusive third party such as a wayward broker, but that broker would still be in business to pursue its abusive practices elsewhere. Moreover, the broker could be in compliance with a particular state law even if it was out of compliance with the federal standard.

Though urgently needed, the proposed guidance also does not address all of the abusive practices in the subprime market. The guidance does not have a clear prohibition on price discrimination or steering of borrowers creditworthy for prime loans or lower cost

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[7] Testimony of Emory W. Rushton, Senior Deputy Comptroller, before the Committee of Banking, Housing, and Urban Affairs of the United States Senate, March 22, 2007, p. 10.
[8] Greg Ip and Damian Paletta, Wall Street Journal, March 22, op cit.

subprime loans into high cost loans (below we discuss evidence of widespread steering). The guidance does not address abusive credit insurance products or the practice of mandatory arbitration, which have been abandoned by responsible financial institutions, but is still a significant problem in the subprime market. Appraisal fraud is pandemic, but not addressed in the guidance. Servicing abuses such as not recording timely mortgage payments and forced placed insurance are all too common, but not addressed in the guidance. Finally and importantly, a lack of due diligence and standards by the secondary market and Wall Street investors are large problems but are not addressed in the guidance. Only Congress has the power to comprehensively attack these abusive practices up and down the loan origination chain.

Another area of incompleteness in the proposed guidance is that it does not cover prime lending. Payment shock with hybrid ARM loans afflicts prime borrowers as well, experiencing sudden increases in monthly payments as initial rates expire. A comprehensive bill would require financial institutions to underwrite all loans at the fully-indexed rate.

Federal legislation is also needed to offer remediation for victims of predatory lending. Just recently, NCRC called upon the Administration and Congress to retool the FHA program so that it can refinance borrowers facing foreclosure and victimized by predatory lending. In addition, a foreclosure prevention fund is needed that would assist borrowers experiencing default through no fault of their own.

Does Rigorous Legislation and Regulation Choke Off Access to Credit?

Congress has been and will continue to be told that rigorous legislation and regulation will reduce lending and choke off the American Dream of Homeownership to millions of Americans. These assertions, however, fail to recognize that lending markets are broken and that legislation and regulation are needed to fix them. According to classical economic theory, markets work when there is a perfect flow of information and when actors internalize the “negative externalities” or harms of their actions. The difficulty with the lending markets is that neither of these conditions exist presently.

Buying a home is the most complex and important transaction for many Americans in terms of accumulating wealth. Yet, it is one of the least understood transactions for consumers. Even the best disclosure regimes imaginable will not eliminate the vast difference in knowledge between the borrower and lender. Unscrupulous lenders and brokers will find it too easy to manipulate borrowers into accepting abusive terms and conditions. Secondly, the loan officer or broker will not internalize the harm of his abusive actions because loans can be sold quickly into the secondary market. Secondary market investors often have no financial incentive to likewise internalize the harm of predatory lending since risk is precisely and surgically diversified by today’s secondary markets. Governments, according to classical economic theory, intervene in the marketplace when the marketplace is broken. Such is the case today with abusive subprime lending.

The current evidence and academic research do not support the assertion that anti-predatory law fundamentally curtails banks' lending activities. In a paper entitled "Do Predatory Lending Laws Influence Mortgage Lending," Peter Nigro of the OCC and Keith Harvey of Boise State University conclude that North Carolina's anti-predatory law, the first in the country, did not affect the subprime market share of loans made to low- and moderate-income borrowers in North Carolina relative to five other Southeastern states. While the authors find a small decrease in the subprime market share to minorities, the change is "significant at the 10 percent level only." In other words, the change for minorities is barely statistically significant.[9]

In a more recent study, Professor Michael Stegman and his colleagues at the University of North Carolina concluded that the North Carolina anti-predatory law did not restrict overall access to credit, but did decrease loans with abusive features such as loans with prepayment penalties beyond three years.[10]

NCRC is aware that other studies come to opposite conclusions regarding the impact of anti-predatory laws. Professor Staten of Georgetown University asserts that anti-predatory law reduces the number of subprime loans to traditionally underserved borrowers.[11] These studies, however, suffer significant data and interpretative shortcomings. Staten's study relies on proprietary data supplied by a trade association of subprime lenders.

Regardless of whose studies are viewed with more credibility, it is beyond doubt that an impartial observer would conclude that the current level of academic research does not support assertions that state laws unequivocally choke off lending. For each study that asserts constriction of credit, another study discounts that possibility. Moreover, only one study, Stegman's, examines the types of loans affected by anti-predatory law. Until more studies are conducted with detailed data on loan terms and conditions, the most reasonable conclusion is that anti-predatory laws stop abusive lending beyond borrowers' repayment abilities instead of causing large scale reductions in loans.

The furious debate over the role of subprime lending obscures the critical role of Community Reinvestment Act (CRA)-related prime lending and FHA lending in serving minorities and working class Americans. If abusive subprime lending is reduced, NCRC believes that responsible lending would take its place in serving minorities and working

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[9] "Do Predatory Lending Laws Influence Mortgage Lending? An Analysis of the North Carolina Predatory Lending Law," September 2002, Keith D. Harvey, Boise State University, and Peter J. Nigro, OCC, see pg. 14 and 25.
[10] "The Impact of North Carolina's Anti-Predatory Lending Law: A Descriptive Assessment," Roberto G. Quercia, Michael A. Stegman, and Walter R. Davis, June 25, 2003, the Center for Community Capitalism, University of North Carolina at Chapel Hill.
[11] "Regulation of Subprime Mortgage Products: An Analysis of North Carolina's Predatory Lending Law," October 2002, Gregory Elliehausen and Michael Staten, McDonough School of Business, Georgetown University.

class Americans. In the mid-1990's, the Clinton Administration ordered regulators to bolster the rigor of CRA exams. As a result, several studies, including those by the Treasury Department and Harvard University, documented a significant surge in prime lending by banks to minorities and low- and moderate-income people.[12] Furthermore, FHA had a much more prominent role in the lending marketplace than it has today.

Unfortunately, CRA-related prime lending has leveled off and FHA market share has plummeted at the same time that abusive subprime lending has surged. The stagnation of CRA prime lending and FHA lending does not mean that these products are inferior or cannot meet the needs in today's marketplace. Instead, abusive lending has a tendency to crowd out responsible prime, subprime, and FHA lending. Unscrupulous brokers and lenders will peddle abusive loans because they reap usurious fees from predatory loans. To these brokers and lenders, predatory loans appear to be more profitable than responsible lending. Too many abusive lenders have been choosing the quick buck extracted from predatory loans rather than the longer term profits and benefits of responsible lending. But if Congress acts to correct the broken marketplace, responsible lending will rise and overall access to credit will not be choked off for minorities and working Americans. The abusive lenders will be out of business, and responsible lending will once again be able to prosper.

Safety and Soundness

For NCRC, protecting American families and communities are paramount. Yet, predatory lending also poses serious risks for financial institutions. In your invitation letter asking NCRC to testify, you ask if the safety and soundness of federally regulated institutions is at issue in the current subprime market. NCRC believes that serious safety and soundness risks are present. A number of years ago, the FDIC reported that although subprime lenders constituted about 1 percent of all insured financial institutions, they accounted for 20 percent of depository institutions that have safety and soundness problems.[13] If this was the case several years ago, it is likely to be worse now. Although regulatory agencies were aware of serious safety and soundness risks, they acted too little, too late as they themselves admitted last week at the Senate hearing.[14]

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[12] The Joint Center for Housing Studies at Harvard University, *The 25th Anniversary of the Community Reinvestment Act: Access to Capitol in an Evolving Financial Services System*, March 2002; Robert Litan, Nicolas Retsinas, Eric Belsky and Susan White Haag, *The Community Reinvestment Act After Financial Modernization: A Baseline Report*, produced for the United States Department of the Treasury, April 2000; *The Performance and Profitability of CRA-Related Lending*, Report by the Board of Governors of the Federal Reserve System, July 17, 2000; Raphael Bostic and Breck Robinson, *Do CRA Agreements Influence Lending Patterns?* July 2002, available via bostic@usc.edu.

[13] Department of Treasury, Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, Proposed Agency Information Collection Activities (Collecting subprime lending information on call reports), Federal Register, May 31, 2000, pages 34801-34819.

[14] Stacy Kaper, "Dodd Takes Aim at Fed; Greenspan Fires Back," *American Banker*, March 23, 3007.

The safety and soundness risks are demonstrated in the commendable action taken by the FDIC in the Fremont Investment and Loan case. Fremont Investment and Loan was one of the country's largest subprime lenders until the FDIC ordered the bank to cease and desist its subprime operations in early March of this year. The FDIC found that Fremont's subprime lending was not safe and sound since ARM loans were underwritten at the initial rate, the underwriting included little documentation of borrower income, prepayment penalties far exceeded the end of the initial teaser rate time periods, and flipping was an increasing likelihood as borrowers could not keep up with loan payments.[15]

The case of Fremont Investment and Loan also illustrates the intersection between consumer protection and safety and soundness. The termination of Fremont's subprime business will likely increase market opportunities for responsible lenders. In 2005, Fremont Investment and Loan issued 58,448 subprime first lien home purchase loans according to the FFIEC web page. At the same time, WMC Mortgage Corp. made 44,513 first lien home purchase loans. WMC announced at last week's Senate hearing that it would adhere to the new regulatory guidance while Fremont Investment and Loan was violating the basic tenets of the regulatory guidance. If regulators stepped up their enforcement, responsible lenders would increase their lending as the abusive lenders such as Fremont Investment and Loan would be driven out of business. Overall access to credit would not be reduced; instead the quality of credit offered in the marketplace would improve.

Fremont Investment and Loan was a rare and significant regulatory action during the last several years. The disturbing question remains about how much more dangerous lending is occurring right under the noses of the regulatory agencies. Will this lending be stopped or will it continue until it bankrupts communities and lending institutions?

NCRC's Consumer Rescue Fund Reveals Breadth and Depth of Predatory Lending

While responsible subprime and non-traditional lending fill legitimate credit needs, all too often, NCRC has seen firsthand the devastation wrought by predatory subprime and non-traditional lending. This devastation is made visible to us through our national Consumer Rescue Fund (CRF) program. NCRC's Consumer Rescue Fund illustrates how abusive tactics have impacted entire communities and hardworking people.

Through the national anti-predatory lending Consumer Rescue Fund (CRF), NCRC works with victims of predatory lenders so their mortgage payment becomes more affordable and foreclosure can be avoided. The CRF identifies consumers who are in predatory mortgages and fixes the mortgages through mediation with lenders or arranging

[15] For the FDIC cease and desist order, see http://www.fdic.gov/bank/individual/enforcement/2007-03-00.pdf

for refinance loans.[16] Consumers contact NCRC member organizations participating in the CRF program. In a number of instances, the NCRC members in the CRF program are counseling agencies assisting consumers experiencing delinquency and default on their loans. NCRC and over 30 participating member organizations in Arizona, Ohio and New York launched the CRF initiative in October 2001 to help victims of predatory lenders. Today, the CRF has a nationwide reach, serving consumers in 17 states.

Targeting Minority and Working Class Americans

A NCRC review of CRF cases indicate that abusive lenders are targeting minority and low- and moderate-income borrowers and communities with high cost and exotic mortgages.[17] The CRF cases also reveal that predatory loans do not usually contain just one or two abusive terms and conditions. More often, a toxic loan in the CRF program contains several abusive features including ARM loans with lax underwriting considering only the initial rates, exaggerated borrower incomes, payments that borrowers cannot afford, exorbitant fees and yield spread premiums, piggyback lending beyond borrower repayment abilities, and abusive servicing. Risk layering of a number of exotic features – interest-only, option ARMs, piggyback Home Equity Lines of Credit (HELOCs), high loan-to-values, stated income – is a recipe for financial disaster for borrowers with limited incomes and/or imperfect credit.

CRF staff report that exotic mortgage lending has increased in recent years as housing costs have increased around the country. Unscrupulous lenders are trying to concoct methods to qualify borrowers for homes they cannot afford or can barely afford. Stated-income loans forego the usual documentation of a borrower's income level through pay stubs and tax returns. Using stated-income loans, abusive lenders/brokers can readily inflate incomes to quality borrowers for unaffordable loans. Abusive lenders are also qualifying borrowers for option Adjustable Rate Mortgage (ARM) loans using initial rates as low as 1%.

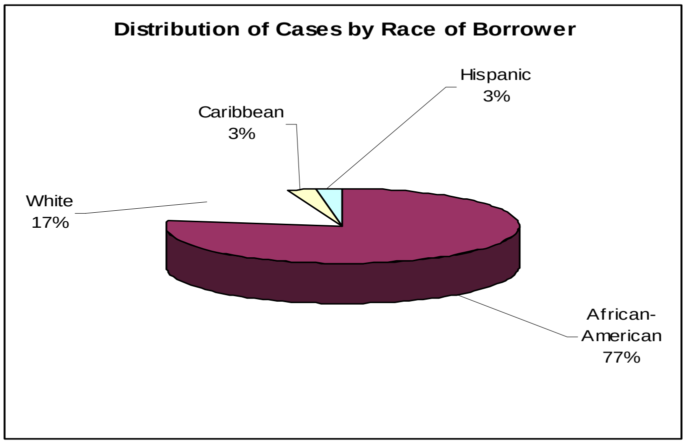
The graphs and charts below reveal that a disproportionate number of CRF customers are people of color and have modest incomes. About 77% of the borrowers in the CRF sample were African-American and 55.4% of the borrowers resided in substantially minority census tracts (more than half the population in the census tract was minority according to the 2000 census). Almost half (47%) resided in low- and moderate-income neighborhoods and 83.6% of the borrowers had incomes below $45,000. The findings that CRF customers were mostly minority and low- and moderate-income is consistent

[16] HSBC North America provides refinance loans for the CRF program and supports CRF counseling. Other sponsors of the CRF program include Select Portfolio Servicing, Inc, the Ford Foundation, Freddie Mac, The Fannie Mae Foundation, Fannie Mae, The JP Morgan Chase Foundation, and The Heron Foundation.

[17] For more detail about the CRF fund, see the report by NCRC and the Woodstock Institute, *Asset Preservation: Trends and Interventions in Asset Stripping Services and Products*, September 2006, at http://www.ncrc.org/policy/analysis/policy/2006/2006-09_LifetimeOfAssets_NCRC-WoodstockPaper.pdf

with NCRC's research below documenting that a disproportionate amount of high cost lending is directed towards minority and working class communities. Traditionally underserved communities suffer from less product choice and consequently are more susceptible to abusive high cost and exotic mortgage lending.

CRF Cases by Race of Borrower



CRF Cases

Distribution of Cases by Minority Level of Neighborhood

Minority Level of Neighborhood	Number	Percent
Not substantially minority	38	33.93%
Substantially minority	62	55.36%
N/A	12	10.71%
Total	112	100.00%

Distribution of Cases by Income Level of Neighborhood

Income Level of Neighborhood	Number	Percent
Low	7	6.25%
Moderate	46	41.07%
Middle	32	28.57%
Upper	15	13.39%
N/A	12	10.71%
Total	112	100.00%

Note: Income of borrower not available for as many cases

Distribution of Cases by Income of Borrower

Income of Borrower	Number	Percent
less than $15,000	6	9.84%
$15,001-25,000	14	22.95%
$25,001-35,000	16	26.23%
$35,001-45,000	15	24.59%
$45,001-55,000	5	8.20%
$55,001-65,000	2	3.28%
$65,001-75,000	1	1.64%
$75,001-85,000	2	3.28%
Total	61	100.00%

Multiple Abuses in Exotic and High-Cost Loans in CRF Sample

Minority and working class borrowers confront an array of predatory abuses described in the graph below. While some abuses have declined in recent years such as prepaid credit insurance, most loans in the CRF program have multiple abuses confronting borrowers with loans that they can no longer afford and loan terms they can no longer negotiate. If the loans had just one or two abuses, it would be easier for the borrower to either afford the loan or succeed in modifying the loan with the lender. The multiple nature of the abuses, however, suggest that the predatory lender or broker maximized profit by designing a loan that was destined to fail or to be flipped. The multiple nature of the abuses suggest that the predator was not interested in satisfying a borrower credit need but instead quickly extracting as much equity as possible.

Abuses	Description
asset-based lending	Lenders evaluate a loan application by looking only at the quality of the security or equity, and not at the ability of the borrower to repay the loan
forced placed insurance	Servicer assigns hazard insurance to borrower, coverage is usually much more expensive
HOEPA loan	A loan with a very high interest rate and/or fees that is covered by federal consumer protections. Predators violate the legal protections of HOEPA loans.
Mandatory arbitration	Stipulation that a borrower cannot sue a lender in a court of law, but must use an arbiter
prepaid credit insurance	Insurance financed into the loan that would cover mortgage payments in a case of disability, unemployment, death. Much more expensive than paying monthly outside of loan
abuse of right to cancel	Abusive practices that make it hard for a consumer to cancel a mortgage (ie. abusing right of rescission)
abusive collection practices	Aggressive tactics of collecting late payments
default interest rate	Increasing interest rate in case of delinquency
excessive prepayment penalty	Excessive fee for paying off a mortgage before its maturity
insincere co-signers	Adding insincere co-signers to the application in order to inflate the income of the borrowers. Abusive lenders will add children and other insincere co-signers who cannot contribute to loan payments.
loans made in excess of 100% LTV	When the loan amount exceeds the fair market value of the home
negative amortization	Loan product that requires a monthly payment that does not fully amortize a mortgage loan, thereby increasing the loan's principal balance
flipping	Persuading a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced
fraud	Example: Forging signatures on loan documents
lack of TNB	Lack of tangible net benefits that justify the origination of a new, higher-balance and high-cost loan
targeting/discrimination	Cases when lenders specifically market predatory loans to customers based on race, ethnicity, or age
predatory appraisal	Overestimating the market value of the house
balloon payment	A mortgage that has level monthly payments over a stated term but which provides for a large lump-sum payment to be due at the end of an previously specified term
equity stripping	A case when a homeowner's equity is reduced due to repeatedly refinancing, high fees, and other abuses
home improvement scam	Home improvement costs financed into the mortgage usually paid by a lender to a home improvement contractor directly.

misrepresentation	Misrepresentation of loan terms to a borrower
falsified application	Falsifying loan applications (particularly income level or adding insincere co-signers, etc.)
Stated income	Not requiring full documentation of income from tax forms and paystubs. Reduced documentation or stated income loans increase the chances of fraud.
yield spread premium	Fee paid by lenders to brokers for loans carrying interest rates above a par rate
abusive servicing practices	Servicers not recording payments, force placing insurance, applying high late fees, etc.
unfair terms	High interest rates and loan terms not justifiable by risk (consumer's credit score)
fee packing	Charging undisclosed, improper, and high fees

The sum total of the abuses equals loans that are considerably beyond borrower repayment ability. A sample of 69 CRF cases included calculations of the monthly housing payment-to-income ratio (front-end ratio) and the monthly total debt-to-income ratio (back-end ratio). The front-end and back-end ratios of the predatory loans in the CRF sample were considerably higher than common limits in standard underwriting guidelines. The average front-end ratio was about 41% and the median was 35.4%. The average back-end ratio was 50.3% and the median was about 50% as shown in the graph below. Standard front-end and back-end ratios for prime loans are 28% and 36%, respectively. The considerably higher ratios of the predatory loans in the CRF sample suggest that the loans were beyond the consumers' abilities to repay, leading to financial distress and/or bankruptcy and foreclosure.

CRF Cases **Unaffordable Loans**

Debt-to-income Ratios

	Front-end Ratio	**Back-end Ratio**
Average	40.77%	50.28%
Median	35.43%	49.78%

Compounding the high front- and back-end ratios was the fact that most of the loans in the CRF sample did not have escrows covering property tax payments and hazard insurance. Two thirds of the borrowers in the CRF sample did not have escrow accounts. On top of housing payments and debt levels that were unsustainable, a number of the CRF borrowers experienced payment shock when they discovered that they had thousands of additional dollars in taxes and hazard insurance payments that were not covered by the loans.

The case studies immediately below illustrate the multiple abuses on the CRF loans, and how predatory lenders and brokers take advantage of hard-working Americans who are striving mightily to achieve or preserve their American Dream of homeownership. The case studies reveal that aggressive “push-marketing” by predators result in consumers receiving loans that are unaffordable and unsuitable, when tragically an appropriate product would have worked fine.

CRF Case Studies

Case Study 1 – Miami, Florida: Steering into Over-Priced and Unsuitable Loan, Fasifying income, Stated-Income and Exotic Mortgage Loan

In January of 2006, Ms. Jean-Simon of Miami, Florida was seeking to become a first-time homeowner. She had a good credit score of 747, and she had a modest income of $3,200 per month. She was a hard-worker, holding a full-time job at the University of Florida and two part-time vendor jobs at local sports stadiums. Incredulously, her mortgage broker pressured her to not use a first-time buyer program through Miami Dade County or other government programs. She was told these programs “take too long” and “require too much paperwork”

The broker falsified Ms. Jean-Simon’s income to $5,000 per month. In other words, her income was exaggerated by 56%. The total loan amount was for $170,000 and was financed at 100%. Her first loan was an option ARM (four payment options, with the lowest being “negative amortization”). The maximum rate on the option ARM was 9.95%. To make matters worse, she had a piggyback loan, which was a line of credit with a maximum rate of 11.75%. Because her income was falsified, she could only afford the minimum payment. Therefore, she was increasing her principal balance through negative amortization.

Case Study 2 – Trevose, Pennsylvania: High Broker Fees, Steering, 2/28 ARM, Abusive Servicing

Sixty-nine year old Gladys Christian refinanced her home twice in her 31 years of homeownership. She used her cash equity from both transactions to pay for a car and to make home improvements. The second refinance, however, presented Ms. Christian with more problems than benefits. Ms. Christian’s loan settled at the cost of over $10,000 in broker and third party fees, and also generated high monthly payments. Despite Ms. Christian’s good credit history, she was qualified for an 8.9% two-year fixed, twenty-eight year adjustable rate mortgage that could climb as high as 15.90%.

Even though Ms. Christian was retired, she used her 33 years of experience in nursing to continue provide nursing services for the elderly. She used this income along with her pension and Social Security payments to keep up with her payments in order to avoid serious delinquencies on her loan. She only called Legal Aid of Southeast Pennsylvania for assistance when she became ill, missed a payment, and struggled to manage this delinquency with her lender's servicer. Rather than work out a forbearance plan, her lender and servicer initiated foreclosure proceedings.

<u>Case Study 3 – Belgium, Wisconsin: Falsified Income, Hybrid ARM, Piggyback Loan, Risk Layering</u>

In September 2006, Duane and April West, a vibrant young African-American couple, contacted NCRC because they could no longer afford their mortgage payments. Although the West's both worked full time jobs (Duane works for Enterprise Rent-a-Car, and April works as a loan closer for a title company), they knew that they were one or two months away from missing their mortgage payments and sinking into foreclosure.

Upon reviewing the West's loan documents, CRF staff noticed the loan had layers of financial risk. First, the West's loan relied on a combined household income that was falsified by 66%. Second, the Wests hoped their refinance loan would pay off their car note, but the loan only increased their indebtedness, left them with an unpaid car note, and not enough funds to pay off any other debt. Third, the two refinance loans were usurious and predatory. The first loan was a two-year fixed, twenty-eight year adjustable rate mortgage combined with a five-year interest only period. The second, piggyback loan was a balloon mortgage with a 13% rate. While severe payment shock was built into these refinance loans, the couple had enough experience to realize that the income falsification was presenting them with unaffordable loans before the reset.

<u>Case Study 4 – Oakland, California: Flipping, high fees, predatory prepayment, stated income loan, ARMs, mortgage payment out of proportion with income</u>.

Ms. Smith is an African-American who bought a home in Oakland, California in December 1999. At the time of the incident, her income was $47,328 annually, or $3,944 monthly. She has undergone a series of unnecessary refinances, each of which has added a multitude of duplicative fees and has inflated the amount that she owes.

In December 1999, Ms. Smith purchased her home for $108,000. Approximately nine months later, she underwent her first refinance, which she thought would lower her rate and allow her to cash out a modest amount of money for roof repairs. Instead, this new mortgage for $140,250 stripped equity by paying off a prepayment penalty without her knowledge. Further, the Good Faith Estimate for this transaction also shows that Ms. Smith was to be charged lender and broker fees of 5.76 points (5.76 percent of the loan, or $8,076), an amount much greater than typical prime fees of 1 percent of the loan amount. Also, Fannie Mae and Freddie Mac have pledged not to purchase loans with fees exceeding 5 percent of the loan amount, and 5 percent is often the threshold in anti-predatory lending laws, triggering additional protections.

In August 2001, less than a year after her first refinance, Ms. Smith refinanced a second time. The new loan for $187,500 was adjustable and carried a three-year prepayment penalty. In October of 2003, Ms. Smith refinanced a *third* time, this time a 30-year fixed loan for $240,000. She refinanced for a *fourth* time in July 2004. On this loan, her income was greatly inflated at $6,000 monthly, when it in fact was only $3,944. Consequently, the monthly payment on this fourth and final refinance was $1,887, which was an overwhelming 47.87 percent of her income.

CRF Encounters Entire Devastated Communities Due to Predatory Loans and Appraisals

In the communities of Staten Island and Long Island, New York, the Consumer Rescue Fund is assisting over 100 New York City police officers and fire fighters who purchased homes from an unscrupulous housing developer and mortgage broker. The broker manipulated the origination system by quickly dumping the fraudulent loans onto the secondary market. For these heroic public employees, the American dream of owning a home has now become their nightmare.

Lastly, but importantly, NCRC's CRF program is intervening in a significant number of cases where borrowers have been victimized by appraisal fraud. A sample of CRF loans revealed that about one fifth of the homes were overvalued by more than 50% of their true value, and two thirds of the homes were overvalued by 15-50% more than their true value.[18] Inflating appraisals leave borrowers with unaffordable loans that they are unable to refinance because the loan amounts are higher than the true value of their homes, especially as the housing market cools in the next few years. The results are too often theft of homeowner wealth, equity stripping, and/or foreclosure.

Fair Lending Testing Provide Vivid Examples of Disparate Treatment and Pricing

NCRC's mystery tests under a Department of Housing and Urban Development Fair Housing Initiative Program (FHIP) Private Enforcement Initiative Grant reveals how borrowers can end up in unsuitable, usurious, and over-priced loans. The mystery tests clearly demonstrated how minorities with creditworthiness similar to whites where steered towards higher priced fixed and ARM loans. Under the FHIP grant, NCRC conducted subprime fair lending testing of large lenders in six major metropolitan areas throughout the United States. The results provide detailed and vivid examples of disparate treatment and pricing in subprime lending based on race and gender.

NCRC conducted forty-eight tests of 12 subprime lenders with retail outlets serving the metropolitan areas of Atlanta, Baltimore, Chicago, the District of Columbia, Los Angeles, and New York City. We conducted this national testing project with the assistance and cooperation of local NCRC members, community organizations, civil rights activists, and consumer protection organizations.

[18] See NCRC's report, *Predatory Appraisals: Stealing the American Dream*, June 2005, http://www.ncrc.org/responsible-appraisal/pdfs/AppraisalReport.pdf

The testing uncovered a 45% rate of disparate treatment based on race. In particular, the testing uncovered several practices that have a disparate impact upon African-American consumers, and predominately African-American communities. Additionally, the testing uncovered a number of instances of sex discrimination. Finally, the testing uncovered the need for changes in the policies and practices of the lenders in order to make loans more accessible to all consumers on an equal basis. Moreover, in a number of the tests, loan staff failed to follow publicly stated lender best practices, such as referral up to a prime loan for qualified mortgage applicants.

NCRC carefully developed testing methodology. NCRC employed matched paired site visit tests in 40 of 48 tests. The second test type was matched paired telephone tests. In all of the testing (which was pre-application testing), the tester contacted the lending institution and indicated that they (the tester and spouse) were interested in obtaining a home equity loan. All testers were given a profile indicating that they were qualified for a prime loan. All tester profiles indicated that the testers were married and were long time homeowners with substantial equity in their homes. All testers had a low loan to value ratio (below 80% after the requested home equity loan), a good debt to income ratio (below the 36% often used for conventional loans), and the tester represented that they had good credit. While tester profiles were substantially similar, African-American testers were given profiles which made them slightly more qualified, in that they had more income, better ratios, higher credit score, and longer time in the home and on the job.

The testing results indicated that 45% of the time there was a difference in treatment by the lender favoring the White tester. The types of differences in treatment detected were:

* Differences in interest rates quoted.

* Differences in information given regarding qualification standards, fees, required ratios, interest rates, loan programs, and terms of loans.

* Differences in levels of courtesy and service.

* Differences in materials and literature given.

* Differences in number and types of questions asked of the testers.

* The White testers were more often "referred up" to the lender's prime lending division.

* The White testers were more often quoted interest rates.

* The White testers were quoted lower interest rates, or range of rates.

* The White testers were given more detailed information.

* The White testers were often assumed to be qualified, and given recommendations based upon assumed qualifications.

* The loan officers spent more time with the White testers.

* The White testers received more follow-up.

* The Black testers were often asked about the condition of their house; the White testers were not.

* The Black testers were more often asked what they wanted to do with the money.

The following two vignettes provide detail of startling differences in treatment and price quotes.

In Baltimore, testers met with the same loan officer at a branch of the subprime affiliate of a major national lender. The Loan Officer assumed the White tester was overqualified and without asking any financial questions, told her she could get better rates at the prime branch of the parent company. The Loan Officer also gave the White tester general rate ranges. However, the Loan Officer would not give the Black Tester any rate information, citing the need for a credit check. The Loan Officer crumpled and discarded the Black tester's application when she would not reveal her Social Security number.

In another test in Baltimore at a suburban branch of a major subprime lender, the White tester was told of a 5.75%, 30 year fixed interest rate, while the Black tester was told the 30 year rate was 8.85%. The White tester was told the 2 year adjustable rate was 4.99% and the Black tester was told the rate for that product was 7.6%. The Black tester was told that since her husband made more money (just slightly more), the lender would rely on the husband's income and credit. The White female tester was not asked about income, nor told about this policy.

Discrimination by Mortgage Brokers in Wholesale Channels

Unfortunately, NCRC's mystery shopping reveals discrimination and abusive practices committed by brokers as well as by mortgage companies and banks. From 2004 to 2006, NCRC conducted mystery shopping of mortgage brokers, both large and small. Posing as loan seekers, both White testers (the control group or Comparison group) and Black or Hispanic testers (the protected group) met with and called local brokers to inquire about their loan options.

Both groups of testers presented themselves as having plenty of equity, stable income and good credit. The protected-class testers were actually given more attractive profiles in terms of their amount of equity, credit standing and employment tenure, and should have logically received better treatment.

However, these Black and Hispanic testers only were favored in a very small minority of the cases. White testers were routinely shown higher levels of service, of encouragement and given more information about loan products. In the most egregious cases, members of the control group were given better pricing, and the tested companies represented their policies differently to the two testers.

In 2006, the lending marketplace finds itself in a unique situation.

Over the last decade, brokers' market share has exploded to about 70% of all originations. Mortgage rates have dropped, and now have been creeping back up as rumblings of a real estate bubble are on the horizon. For an institution lending primarily through a wholesale channel, brokers act like subcontractors. For such a wholesaler, using brokers to sell their products can be cheaper and more efficient. The costs, for example, of maintaining brick-and-mortar branch office infrastructure or paying health insurance are passed on. With the refinance boom ebbing, traditional institutions that use brokers are spared the unpleasantness of having to lay off their own workers. Clearly, brokers can provide a valuable service to mortgage lenders, lowering costs and making the industry more flexible and efficient. Yet, these advantages are compromised when brokers engage in discriminatory and abusive behavior.

NCRC's broker testing yielded 106 total complete, matched-pair tests. Individuals located in the metropolitan areas of Atlanta, Baltimore, Chicago, the District of Columbia, Houston, Los Angeles and Saint Louis tested brokers that were local, established businesses. In conducting the broker testing, NCRC found several companies with particularly egregious initial results. In these cases, testers were again dispatched for follow up testing to confirm and further investigate the practices of these companies. Of the 106 total tests, 84 separate companies were tested, the difference being as a result of 22 follow up tests.

A portion of the follow up tests were directed at Allied Home Mortgage Capital Corporation, against whom NCRC has already filed a fair housing complaint. Additional complaints may also be filed, pending further investigation.

Our results documented the following disturbing patterns:

1. African Americans and Latino's were discouraged 25% of the time concerning their efforts to meet with a broker, while Comparison testers were discouraged only 12% of the time in their efforts to obtain credit.

2. Brokers spent more time with white shoppers then African Americans and Latinos, spending on average 39 minutes with white testers and only 27 minutes with African American and Latino testers.

3. White mortgage seekers received greater encouragement over sixty percent of the time, while African Americans and Latinos were questioned about their credit over 32% of the time. White shoppers were only questioned about credit 13% of the time.

4. White mortgage seekers had specific products discussed with them 91% of the time, while African Americans and Latinos had specific products discussed with them 76% of the time. Further, White testers received two rate quotes for every one quoted to African American and Latino testers.

5. NCRC documented pricing discrimination in 25% of the fair lending tests, and noted that fees were discussed 62% of the time with white testers but only 35% of the time with "protected testers."

6. Fixed rate loans were discussed 77% of the time with white testers but only 50% of the time with African American and Latino testers.

These results are very troubling and document the fact, controlling for credit and individual applicant qualification factors, African Americans are being discriminated against in the marketplace and being forced to pay a "race tax" due to unequal access to credit.

Pricing Disparities Cannot Be Explained Away

So far, the testimony has presented compelling testimony from two NCRC programs (CRF and civil rights enforcement via mystery shopping) revealing predatory and discriminatory practices in high cost and non-traditional mortgage lending. We believe that the experiences under the two NCRC programs are not random, but widespread. Data analysis of a national database, the Home Mortgage Disclosure Act (HMDA) indicates that predatory lending is a national epidemic, and not confined to a few localities or a few lenders.

Price discrimination is not often discussed in the context of predatory lending, but we believe that it is a central element of predatory lending. When a borrower is steered towards a loan with an Annual Percentage Rate (APR) two or three percentage points higher than the loan for which she qualifies, the borrower will pay tens of thousands or hundreds of thousand dollars more in mortgage costs due to the discrimination. This represents a substantial loss of wealth, which could have been used to send a child to college or start a small business.

In 2003, NCRC released a path-breaking study, entitled the *Broken Credit System*, documenting price discrimination on a national level.[19] We found that after controlling for creditworthiness and housing characteristics, the amount of subprime refinance loans increased as the number of minorities and elderly increased in neighborhoods in ten large

[19] See NCRC's *Broken Credit System* at http://www.ncrc.org/policy/cra/documents/ncrcdiscrimstudy.pdf

metropolitan areas. In addition to the NCRC report, two studies conducted by Federal Reserve economists also found that subprime lending increases in minority neighborhoods after controlling for creditworthiness and housing market conditions.[20] The Center for Responsible Lending also recently used the 2004 HMDA data with pricing information to reach the same troubling conclusions that racial disparities remain after controlling for creditworthiness.[21]

NCRC has conducted two more recent studies documenting the persistence and stubbornness of pricing disparities. In a study released in March of 2005, we found that pricing disparities to minorities, women, and low- and moderate-income borrowers are pervasive throughout the great majority of metropolitan areas in the country.[22] Using 2003 Home Mortgage Disclosure Act (HMDA) data, we observed that subprime lenders offered a greater percentage of their loans than prime lenders to women, African-Americans, and Hispanics in 100%, 98.5% and 89.1% of the nation's metropolitan areas, respectively.

Strikingly, the disparities were worst in a number of medium-sized metropolitan areas. In Macon, Georgia, for instance, subprime lenders made 59.3 percent of their home loans to African-Americans while prime lenders issued only 13.7 percent of their loans during 2003 to these borrowers. In Corpus Christi, TX, subprime lenders offered 53.1 percent of their home loans to Hispanic borrowers while prime lenders made just 28.3 percent of their loans to Hispanics in a metropolitan area whose population is 55 percent Hispanic. The finding that many medium sized metropolitan areas in states with relatively weak anti-predatory laws experienced large pricing disparities indicates a need for national legislation.

We also discovered that as the level of racial segregation was higher in a metropolitan area, the portion of subprime loans in minority neighborhoods was higher, controlling for the affordability of homeowner units. Again, this finding reveals that lender decisions are not driven only by legitimate differences in creditworthiness. Instead, the finding suggests intensified targeting of minority neighborhoods as segregation increases since segregation makes it easier for lenders to identify and target minority neighborhoods.

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[20] Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. See also Paul S. Calem, Jonathan E. Hershaff, and Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, in Fannie Mae Foundation's Housing Policy Debate, Volume 15, Issue 3, 2004 pp. 603-622.

[21] Center for Responsible Lending, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages,* see http://www.responsiblelending.org/issues/mortgage/reports/page.jsp?itemID=29371010

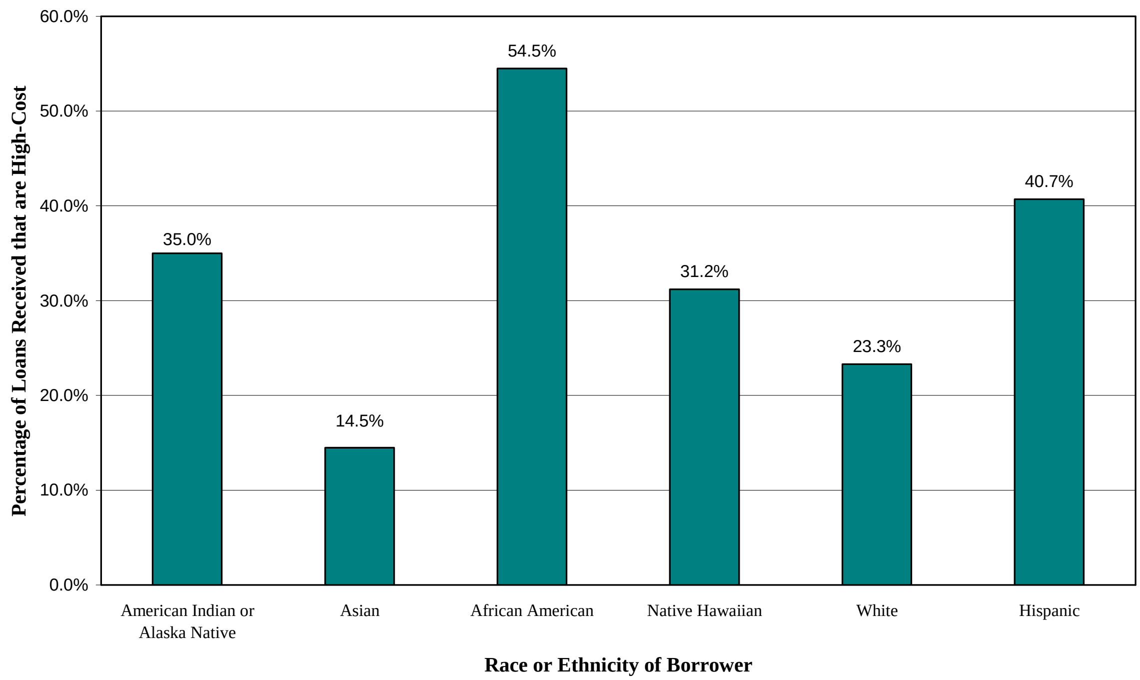
[22] NCRC, *Fair Lending Disparities by Race, Income, and Gender in All Metropolitan Areas in America*, March 2005, available via http://www.ncrc.org. Prior to the 2004 data, researchers have used a list developed by the Department of Housing and Urban Development of subprime and manufactured housing specialists to document patterns of subprime and prime lending.

Another study, NCRC's *Homeownership and Wealth Impeded* report uses the 2004 HMDA data to examine in detail pricing disparities by race and gender when controlling for income levels.[23] The report uncovers troubling evidence that racial disparities increase when income levels increase. For example, subprime loans made up a high 41.9 percent of all refinance loans to low- and moderate-income (LMI) African-Americans. In contrast, subprime loans were 19.2 percent of refinance loans to LMI whites in 2004. LMI African-Americans were 2.2 times more likely than LMI whites to receive subprime loans. Even for middle- and upper-income (MUI) African-Americans, subprime loans made up a large percentage (30.2 percent) of all refinance loans. Moreover, the subprime share of loans to MUI African-Americans was 2.7 times larger than the subprime share of loans to MUI whites. The same pattern of disparities increasing with income occurred when the report examined lending to females compared to males or in immigrant neighborhoods compared to predominantly white neighborhoods.

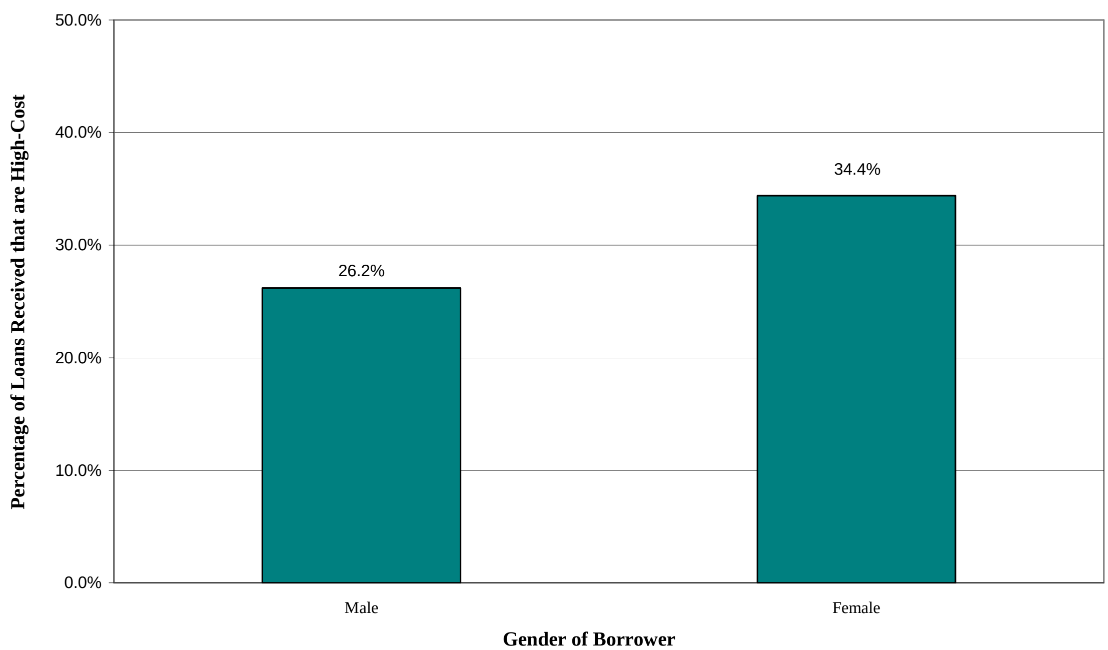
NCRC's report, the *2005 Fair Lending Disparities: Stubborn and Persistent II* was one of the first reports conducted with the new 2005 HMDA data and showed stubbornly persistent disparities by race and gender.[24] The study uses data collected from 17 large lenders. The study finds a large surge in high-cost lending from about 12.2 percent of all loans in 2004 to 28.2 percent of all loans in 2005. Of all the conventional loans made to African-Americans, 54.5 percent were high-cost. In contrast, of all the conventional loans issued to whites, 23.3 percent were high-cost as shown in the graphs below. Hispanics and Native Americans also received a disproportionate amount of high-cost loans. About 40.7 percent and 35 percent of the conventional loans made to Hispanics and Native Americans, respectively, were high-cost loans. Of all the conventional loans issued to females, 34.4 percent were high-cost. In contrast, just 26.2 percent of the loans for males were high-cost during 2005.

[23] To access NCRC's report, *Homeownership and Wealth Building Impeded*, please go to http://www.ncrc.org/policy/analysis/policy/2006/2006-04-20_NCRC-OA-PRRACReport.pdf
[24] To access NCRC's Fair Lending Disparities: Stubborn and Persistent II, plese go to http://www.ncrc.org/policy/analysis/policy/2006/2006-05-23_2005HMDAreport.pdf

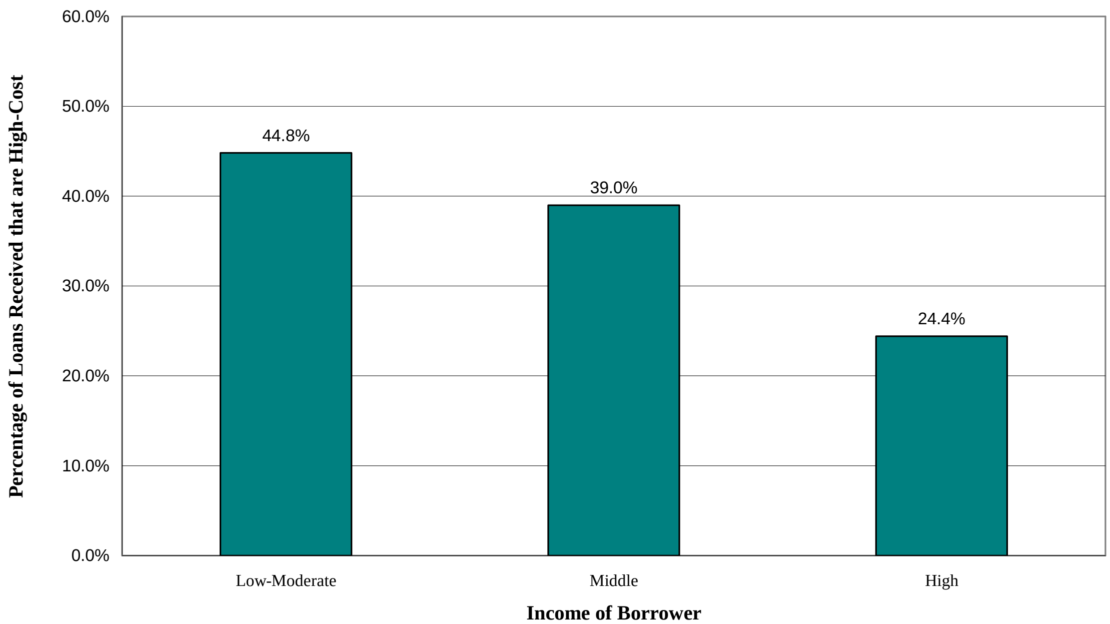
Minorities Receive Disproportionate Amount of High-Cost Loans



Women Receive Disproportionate Amount of High-Cost Loans



High-Cost Lending Prevalent Among Low-Moderate & Middle-Income Borrowers



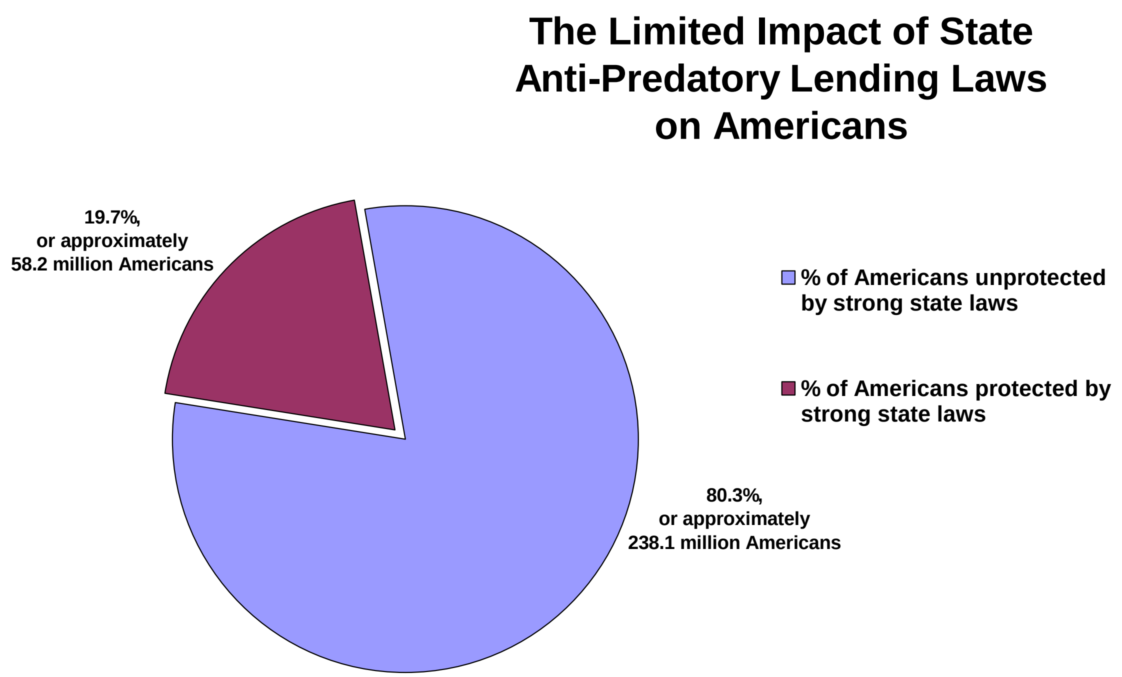
Even middle-income borrowers are now receiving a substantial portion of high-cost loans; 40 percent of the loans made to middle-income borrowers were high-cost loans in NCRC's 2005 sample. In addition, disparities by race and gender remain stubborn and persistent. The facts that lending disparities remain significant by race and gender and impact a significant segment of middle-income Americans suggest that fairness in the lending marketplace is now a pressing issue for a broad segment of Americans. NCRC's studies over the years reveal that unsavory lender behavior is responsible for a significant amount of the persistent pricing disparities. Lawmakers must act to protect homeowner equity.

Need for a Strong and Comprehensive National Bill

While we believe that lenders can operate in the current regime of federal and state legislation, we would favor a strong national anti-predatory law if it is comprehensive and builds on the best state laws such as North Carolina's, New Mexico's, New Jersey's and New York's. It is remarkable that about half of the states in this country have passed anti-predatory laws. The anti-predatory laws that have been passed on a state level, however, have been uneven. While seven states have rigorous laws, several others have relatively weak laws that mostly mimic the federal Home Ownership and Equity Protection Act.[25] In the graph below, we calculate that only 19.7% of the population is

[25] The states with the strong laws are North Carolina, New Mexico, New York, West Virginia, Ohio, Massachusetts, and New Jersey.

currently protected by strong state laws. Thus, a comprehensive national law would provide uniform protection for citizens in all states if it expands upon the best state laws, does not weaken existing federal law, and also draws upon and codifies best practices established by industry.



CRA Modernization Must Accompany a National Anti-Predatory Bill

Building on the experience of our national coalition and state-level coalitions around the country, NCRC believes that a comprehensive anti-predatory bill must apply protections to a substantial number of subprime and non-traditional loans. At the same time that Congress is enacting an anti-predatory bill, NCRC also believes that Congress must pass the CRA Modernization Act of 2007, or HR 1289. HR 1289 would strengthen CRA as applied to banks and would apply CRA to non-bank institutions including independent mortgage companies. Federal Reserve research has demonstrated that CRA encourages banks to increase their prime lending, particularly in geographical areas in which their branches are located. CRA, therefore, acts to introduce product choice in traditionally underserved neighborhoods, meaning that these neighborhoods are less susceptible to steering and abusive lending.[26]

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[26] Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, *Higher-Priced Home Lending and the 2005 HMDA Data* in the Federal Reserve Bulletin, September 2006.

Provisions of an Anti-Predatory Bill

The protections in an anti-predatory lending bill must eliminate abuses during the application stage and mandate that loans are affordable, appropriate, and provide tangible net benefits to borrowers. The bill must also ensure that appraisals are conducted honestly and do not inflate home values. Finally, a bill must prevent servicing abuse. Through our CRF program and in our best practices dialogues with lenders, NCRC understands all to well how servicing abuse is not only disastrous for borrowers but can threaten the viability of financial institutions.

We are pleased that bills introduced in previous sessions recognize that a significantly greater number of subprime loans need to be covered with a federal anti-predatory bill than are currently covered by the Home Ownership and Equity Protection Act. Lowering the fee trigger to 5 percent is an appropriate and necessary trigger for extra protections. In addition, a federal anti-predatory lending bill must include charges paid to affiliates of lenders and indirect compensation received by lenders in calculating if points and fees exceed the trigger level.

The NCRC CRF case studies illustrate how abusive loans often involve fees in excess of 5 percent of the loan amount. In addition, Fannie Mae and Freddie Mac adopted guidelines as early as 2000 clearly stating that they will not purchase high cost loans with fees in excess of 5 percent. Major financial institutions in the industry have therefore recognized that loans with fees in excess of 5 percent are prone to abuses if not executed very carefully.

The following provisions must be included in any national anti-predatory bill. This list is not comprehensive, but covers critical features:

Points and fees – In addition to the provisions discussed above, a points and fees trigger should include prepayment penalties when the penalties exceed three years of duration and exceed a threshold in terms of a percent of the loan amount. A staggered schedule could be established in which prepayment penalties would be included in points and fees if they exceeded 3 percent of the loan amount in the first year, 2 percent in the second year, and 1 percent in the third year. Also, a threshold must be established for discount points to discourage excessive charges for discount points and ensuring that discount points meaningfully reduce the loan's Annual Percentage Rate (APR). Finally, compensation received by a broker and yield-spread premiums must be considered when calculating if points and fees exceed the trigger level.

Sudden Increases in Monthly Payments – Exotic mortgages can escape from the protections of an anti-predatory bill because savvy lenders can keep interest rates and fees below threshold levels triggering extra consumer protections. Congress must consider applying protections of an anti-predatory bill to loans that have sudden and significant increases in monthly payment amounts as a result of the expiration of teaser rates, interest only payment periods, and other features that keep payments artificially low for an initial time period. A bill can establish a clear bright line such as extra protections apply if the monthly payment increases more than 25 percent or the result of the new monthly payment is that a borrower has a debt-to-income ratio higher than 50 percent.

Steering – NCRC's data analysis and fair lending testing reveals that steering is a significant problem in subprime lending, and must be addressed in any bill. Borrowers, particularly borrowers in protected classes, are receiving high-cost loans when they actually qualify for lower cost loans. This can entail tens of thousands of dollars in extra costs for a borrower and can strip millions of dollars from communities when even a few neighbors experience price discrimination.

Prepayment Penalties – One of the first NCRC CRF cases involved a prepayment penalty that almost prevented a pre-foreclosure sale. In this case, not only was the original homeowner victimized, but all the usual stakeholders in a housing transaction (the buyer and real estate agent) also suffered harm. This example illustrates the damage that onerous prepayment penalties pose to the functioning of the housing market in minority and low- and moderate-income neighborhoods. Previous bills would prohibit prepayment penalties on all loans after 3 years, but many if not most subprime loans have prepayment penalties occurring in the time period between two and three years. Congress must carefully consider stringent limits to prepayment penalties between two and three years.

Financing Points and Fees – NCRC's CRF program reinforces the need to prohibit or limit financing points and fees so that loans do not become unaffordable. NCRC supports a prohibition on the financing of points and fees into high cost mortgages. At the very least, the predatory lending bills in previous sessions prohibited the financing of points and fees beyond 3 percent of the loan amount.

Repayment Ability – Previous bills stipulated that monthly debts, including mortgage payments, cannot exceed 50 percent of income, but the bills differed regarding allowing a consumer to affirm his or her income. The difference in required documentation is important. As NCRC's CRF program illustrates, "self-verification" procedures or stated income loans facilitate fraud and unaffordable loans since unscrupulous lenders will fabricate borrower incomes and then have unsuspecting borrowers sign the loan documents.

Single Premium Credit Insurance – NCRC believes that single premium credit insurance (SPCI) must be prohibited on all loans. At the very least, anti-predatory bills must ban the financing of single premium credit insurance (SPCI) and debt cancellation or suspension agreements on high cost loans and include SPCI in the definition of points and fees. These SPCI provisions should be straightforward because major subprime lenders have themselves discontinued single premium insurance products. Prohibiting these products on all loans would best protect consumers and insure that an industry best practice remains intact.

Flipping – An anti-predatory lending bill must establish a rigorous net tangible benefit standard and must avoid a series of safe harbors or exemptions that have the potential for enabling abusive refinancings. Under some previous anti-predatory lending bills, the NCRC CRF case example in California could be construed to be permissible. In this case, the refinance loan offered a tangible benefit of cash for various needs, but was clearly not a tangible net benefit to the borrower, considering that the high fees rendered the loan beyond the borrower's repayment ability. Any flipping language in a federal bill must be air tight and supported by a strong definition of a high cost loan.

Pre-Loan Counseling – NCRC supports pre-loan counseling modeled after the successful counseling requirement in the North Carolina anti-predatory lending law. In that state, a consumer is required to receive counseling by a counseling agency approved by public housing departments before a lender can issue a high cost loan to a borrower. A pre-loan counseling requirement is somewhat analogous to a home inspection conducted by an inspector of a customer's choice before the customer purchases a home. Home inspections have not burdened the real estate market and provide needed protections to consumers. Perhaps, a review by an independent third party should apply to all loans if the lending industry is concerned about singling out subprime loans. This would then make pre-loan counseling a regular and accepted procedure just like home inspections.

Mandatory Arbitration – An anti-predatory lending bill must prohibit mandatory arbitration. Major subprime lenders have given up on mandatory arbitration, meaning that a ban on mandatory arbitration should not be a contentious item in an anti-predatory bill.

Limits on Liability for Secondary Market - Currently, under federal law, a financial institution that purchases a high cost loan from a lender or broker is liable for all claims and defenses arising from violations of law. Applying liability for purchasers of loans is critical because a significant amount of subprime lending is conducted by brokers and mortgage companies who sell their loans to investors and financial institutions. Borrowers often have no recourse if the purchasers of loans have no liability.

Reporting to Credit Bureaus – Previous bills required lenders making high cost mortgages to report monthly borrower payment history to credit bureaus. This is a vital protection. Several years ago, former Comptroller of the Currency, John Hawke, raised alarms concerning lenders holding customers captive by not reporting their credit history. Comptroller Hawke pointed out correctly that consumers would have no way of proving their creditworthiness for lower cost loans if the credit bureaus did not have current information of their payment history due to lenders' withholding payment information. A requirement to report to credit bureaus will protect homeowner wealth by enabling borrowers to lower their interest payments and thus build up their equity faster.

Mortgage Servicers - An anti-predatory bill must apply protections against abuse by servicers of mortgages including force placement of insurance and failure to correct errors relating to payments. A bill must also require establishing escrows for payment of taxes and hazard insurance for high cost loans. NCRC's CRF cases include a number of instances where borrowers had trouble with unaffordable loans because they did not realize that their subprime loans did not have escrows.

Appraisal Fraud - Previous anti-predatory bills applied protections regarding appraisals for high cost mortgages, including physical inspections of the property and two appraisals in the case of two sales within 180 days of each other to protect against property flipping. The bills also prohibited lender influencing or intimidating appraisers. These provisions were encouraging, but we believe that they can be strengthened to address critical funding and staffing shortages of state regulatory agencies. In addition, the Appraisal Subcommittee of the Federal Financial Institutions Examination Council must be provided with meaningful oversight and enforcement powers regarding state regulatory boards.

Certification of Brokers and Mortgage Lenders Making Subprime Loans – A previous bill established certification requirements for mortgage brokers and lenders making subprime loans. This is an important step for establishing ethical conduct by lenders and reducing the amount of predatory lending. A national registry of brokers and lenders should be established that show which brokers and lenders are certified and which ones have lost certification. Many states have this type of registry revealing the current status of licensing for home improvement contractors; it is time to establish transparency for lenders and brokers.

Home Preservation Fund and FHA Role - An anti-predatory bill must establish a home preservation fund finance by Congressional appropriations and loan repayments. A good model is the State of Pennsylvania's Homeowners Emergency Mortgage Assistance Program (HEMAP). Perhaps the only program of its kind in the nation, HEMAP provides loans to borrowers experiencing temporary hardship (the loans make borrowers' mortgage payments current). Counseling agencies work out forbearance agreements with lenders and also counsel families regarding their financial situations. The program is funded by State appropriations and repayment of HEMAP loans. A federal anti-predatory bill should establish nonprofit community-based organizations as the recipient of home preservation funds since the non-profit organizations have the direct connection with homeowners experiencing financial distress. A national home preservation fund should assist borrowers facing default through no fault of their own.

FHA should also be re-tooled so that it can offer refinance loans on a large scale to victims of predatory lending. If FHA could offer these loans on a large scale, it could play a vital role in saving American's homes, reducing high delinquency and foreclosure rates, and saving communities from the devastation of widespread foreclosures and property abandonment.

Suitability Standard - A lively debate has emerged regarding whether an anti-predatory bill should contain a suitability standard imposing a fiduciary duty on lenders and brokers for recommending and making loans appropriate to borrowers' income levels and needs. The lending industry asserts that suitability standards are inherently subjective and will impede access to credit for minorities and low- and moderate-income borrowers. The argument that consumer protections curtail lending is a tired argument without merit if the protections are well designed. NCRC believes that an objective and reasonable suitability standard can be established. A fundamental flaw in today's lending markets is that the industry (including lenders, brokers, and secondary market investors) can escape the consequences of predatory loans through sophisticated secondary market transactions that effectively diversity risk and therefore minimize losses associated with predatory loans. Holding lenders, brokers, and secondary market investors financially accountable for inappropriate and unsuitable loans provides powerful incentives to lend responsibly.

Conclusion

NCRC's 600 member organizations strongly support the enactment of a comprehensive national anti-predatory lending bill and urge Congress to carefully craft a bill that truly serves the interest of consumers. We also believe that enactment of the CRA Modernization Act of 2007 and reviving the FHA program would increase prime lending and product choice in minority and working class communities. Strong leadership and decisive action must be taken to stop the epidemic of predatory lending. Every day, our member organizations struggle to assist families whose American Dream of Homeownership has been turned into nightmares of financial distress by predatory lenders. Thank you and I look forward to addressing all of your questions.