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TO: National Home Equity Mortgage Association Members

FROM: Butera & Andrews

DATE: June 7, 2000

RE: May 24, 2000 Predatory Lending Hearing Before
The U.S. House of Representatives' Committee on Banking and Financial Services

This memo summarizes, in considerable detail, the key points raised in the hundreds of pages of written testimony presented by witnesses who appeared at the House Banking Committee's May 24, 2000 hearing on predatory lending. In order to give the reader a better sense of the witnesses' comments, the memo utilizes many quotations from the testimony. (Footnotes contained in full statements are omitted from the quoted sections.) Copies of full statements of witnesses, as well as statements filed by other parties for the hearing record, are available from our firm or the House Banking Committee's web site. If you have questions concerning issues raised during the hearing, please contact us at (202) 347-6875.

The basis for the hearing emerged from increasing concerns, by key Members of the Committee, about alleged predatory abuses in the subprime market. Among other things, questions have been raised regarding whether the Home Ownership and Equity Protection Act (HOEPA), as passed in 1994, is adequate to handle the alleged abusive practices. Specifically, the purpose of the hearing as stated is "to assess whether the incidence of predatory lending, which has been often directed at low-income and elderly borrowers, has increased, and if so, to consider appropriate remedial actions." At the opening of the hearing, Chairman Leach offered the following "**Anti-Predatory Lending Precepts**":

- *"Consumers deserve meaningful and clearly understandable disclosures of loan agreements so that borrowers are informed, rather than confused, by all of the paperwork before them.*
- *Lenders shall not extend credit to a borrower unless they have applied appropriate analysis to determine that the borrower is capable of repayment on the terms of the loan.*
- *Lenders should not require a borrower to finance points and fees associated with a high-cost loan. The consumer should receive a clear disclosure that the financing of points and fees is optional.*
- *A lender should not charge a borrower points or fees to renew, extend, or otherwise modify a high cost home loan, if after the modification the loan remains a high cost loan; or if it is no longer a high cost loan the APR has not been decreased by at least 1.5 percentage points.*
- *Lenders shall not use misleading or deceptive sales and marketing practices that induce consumers to enter loan agreements that they cannot afford.*
- *Attempts to curb abusive practices should not be made at the expense of credit availability in under-served neighborhoods.*

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- *Frequent refinancings, or "loan flipping," which unnecessarily increase the loan balance and eliminate equity should not be acceptable. Points and fees associated with refinancing of a high-cost loan should result in a net-benefit to the borrower.*
- *Greater efforts should be undertaken to educate the public about borrowing. For example, consumers must be able to easily comprehend that a drop in their monthly payments may not translate into owing less over the long term, and may in fact increase their overall costs.*
- *Lenders should provide disclosures, prior to closing, which encourage consumers to seek credit counseling.*
- *Regulators should take necessary measures to ensure that an institution's CRA rating does not improve as a result of loans that were made to low- and moderate-income individuals, but have predatory terms.*
- *The secondary market should not be a facilitator of predatory lending, but should take measures to ensure that loans which contain predatory terms are not purchased."*

PANEL I- Members

Senator Charles E. Schumer

- The subprime industry has grown dramatically over the last ten years and with this growth "there has been an enormous rise in the incidences of predatory lending." In particular, the abuses occur in "minority and low-income neighborhoods."
- "...not all subprime lending is predatory. But nearly all predatory lending is subprime."
- "...not all predatory lending is in minority neighborhoods, but minority neighborhoods seem to be the target of much of the worst loan scam offenders."
- According to a "study" that Sen. Schumer conducted on lending in New York City, using HMDA information, "blacks and whites may as well be living on different planets." Essentially, the study found that "blacks were twice as likely to be rejected for a mortgage from a conventional bank than whites," that a "black applicant with an income greater than \$60,000 was more likely to be turned down for a loan from a conventional lender than a white applicant with income less than \$40,000," that in "solid, professional black neighborhoods, nearly half of all home and refinance loans were made by subprime lenders," that "in similar white neighborhoods, subprime lenders accounted for less than 10% of the home and refinance loan market," and that "borrowers in black neighborhoods were six times more likely to rely on subprime lenders than those who reside in white neighborhoods."
- Supports the LaFalce/Sarbanes and Schakowsky bills.

PANEL II- Regulators

Gary Gensler, Under Secretary for Domestic Finance, Department of the Treasury

- Mentioned the formation of the HUD-Treasury Task Force to study the problem of predatory lending and stated that a joint report will be sent to Congress in June.

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- Noted that access to capital has expanded during this Administration and that according to a recent Treasury study the Community Reinvestment Act has encouraged “competition in lending to lower-income borrowers and communities across the nation.” Specifically, the study revealed that “that between 1993 and 1998, banks and thrifts covered by the CRA increased their mortgage lending to lower-income borrowers and communities by *twice* the rate that their lending to other borrowers increased.”
- Credited the growth of subprime lending for providing greater opportunities for lower-income and minority families.
- “Abusive practices” must be prevented in the prime and subprime markets; a goal should be to “promote the availability of prime credit to all eligible borrowers.”
- Briefly discussed subprime business history, general characteristics, and defined the subprime business stating, “Subprime lending commonly refers to mortgage or consumer lending to borrowers with impaired or limited credit histories or high debt relative to their income. It also includes low balance loans that are smaller than those offered by most prime lenders.”
- “The prime mortgage market is accessed primarily by borrowers seeking loans for home purchase or to obtain better rates or terms in a refinanced loan. In the subprime mortgage market, however, as much as 70 percent of loan proceeds are used for debt consolidation and other consumer credit needs. Subprime mortgage lending is therefore both part of the mortgage market and part of the consumer credit market.”
- Discussed four practices that are “clearly abusive in any context.” These practices include: loan flipping, excessive fees, lending without regard to the borrower’s ability to repay and outright fraud. In connection with these four predatory practices, “three patterns emerge.” The first is that selected companies are “preying on the most vulnerable” groups which include, “the elderly, recent immigrants, minorities, and individuals with lower incomes and less education.” Secondly, borrowers in markets where abuses occur, have “limited access to the mainstream financial sector” and many of these borrowers “would likely qualify for a prime loan.” The reasons for these patterns possibly include, that “banks may not be doing enough to reach out to these borrowers” and “subprime lenders may effectively be capturing borrowers.” The third pattern that emerges is that “these practices are most often coupled with the deceptive or high-pressure sales tactics of mortgage brokers, home improvement contractors or lenders themselves.”
- “Aside from abusive sales practices, there are some terms and conditions in loans that are inherently abusive. An example of such a term is single premium credit life insurance, in which the borrower must pay the cost of credit life insurance up-front. Both HUD and the Federal Reserve Board agreed in their 1998 Report that such requirements should be prohibited for at least some class of loans. Additionally, the President called for the prohibiting the sale of single-premium credit life insurance in May 1999.”
- To correct abusive problems, existing regulatory authority needs to be reviewed and implemented where possible.
- Additional legislation might be needed to address four recommended areas which will be detailed in the HUD/Treasury report to Congress. These areas include consumer financial literacy, sales practices, loans terms and conditions and market structure.
- “In looking at statutory changes, one issue we must consider is whether the current HOEPA structure is the appropriate mechanism for addressing abusive practices. Under HOEPA, specific practices are prohibited that are considered abusive for the most vulnerable borrowers who are taking out high

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cost loans. Measured by the current interest rate trigger, less than one percent of subprime loans are covered by HOEPA. While we need further data on fees, this indicates that HOEPA is likely not covering the bulk of potentially abusive loans. . . .An example of practices that may be appropriate to restrict in this context include limits on the financing of fees and penalties for a refinanced high-cost loan. Short-term balloon payments may also be especially onerous for borrowers of high-cost loans, and further restrictions ?as proposed by HUD and the Board? may also be appropriate in this area. One of the signal achieved in the mortgage market in the last century was the creation by FHA of the self-amortizing 30-year mortgage. This product enabled millions of Americans to own their own homes. That is why, in the context of these loans, we need to be concerned about the impact of balloon payment on homeowners. Further restrictions on balloon payments - as proposed by HUD and the Board - deserve consideration. . . .There may be general agreement, however, that some practices are inappropriate regardless of whether the loan falls under HOEPA. For example, requirements for the purchase of single premium credit life insurance do not appear to be appropriate for any borrower, not just for borrowers under higher cost loans.”

- “Finally, we are looking at a broad range of market structure issues. One such issue is the extent to which increased competition could help to reduce some of these practices. While in some markets there may competition among subprime lenders for business, this competition can sometimes be a ‘race to the bottom’ by brokers and lenders who misrepresent the terms of the loans they are offering. We need to find ways to promote healthy competition in these markets. . . .We are looking at ways to encourage subprime and prime lenders to facilitate the graduation of subprime borrowers to the prime markets. The subprime market should provide borrowers a ladder to the prime markets, rather than acting as a ceiling that keeps borrowers from accessing prime credit. . . .At the same time, we are considering the role that the secondary markets play in this lending. Purchasers of subprime loans in the secondary market have economic incentives to avoid purchasing fraudulent or abusive loans, as such loans are likely to have higher rates of default and loss. . . .As we further examine market structure issues, we continue to examine the need for additional data on loans in the subprime markets. There is a dearth of information on rates and fees in these markets, and many lenders may not report under HMDA. This is an area we will look at carefully in our final report.”

Bill Apgar, Assistant Secretary for Housing-FHA Commissioner, Department of Housing and Urban Development

- “Predatory practices take many forms, including overcharging consumers with illegitimate fees, employing bait-and-switch tactics, aggressive sales solicitation and targeting of low-income, minority and elderly homeowners, racial steering to high rate lenders and home improvement scams. Predatory lenders target untold numbers of the most vulnerable homeowners – focusing on the elderly, minorities, and low-income families, loading them down with debt, and stripping them of equity. In a growing number of cases, these predatory loan terms are too much to bear and, as a result, the family loses its home to foreclosure.”
- These targeted groups are “not well served by the primary market place.”
- Noted that subprime lending does serve a legitimate purpose.
- “While we don’t have enough detailed data on mortgage costs and terms to precisely estimate the growth and current extent of predatory lending, there can be little doubt that these practices are on the rise. This is the consistent report of state consumer affairs organizations, housing counseling

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agencies, legal services organizations, and others who work with low- and moderate-income homeowners on a daily basis.”

- “The most compelling evidence that subprime lending has become a fertile ground for predatory practices is the current, disproportionate percentage of subprime loan foreclosures.”
- Discussed the work of the Joint Task Force, noting that two reports will be released next month. The first report will summarize testimony from the forums and the second report will offer recommendations. These reports will be based on the public forums held in five cities including Atlanta, Los Angeles, New York, Baltimore and Chicago. Each city forum was the focus of a different issue: Atlanta focused on racial targeting, Los Angeles focused on the targeting of the elderly, New York focused on sources of funding for predatory lending, Baltimore focused on “non-lender players such as appraisers and brokers” and Chicago will focus on “state and local initiatives.”
- Included stories of three victims from the city forums, whose stories were described as “more powerful than any statistics or analysis.”
- Stated that “not all predatory practices are confined to the conventional subprime market” and that many abuses occur with FHA, VA and state and local programs borrowers. However, given the dramatic growth of the subprime market and because “many players in the subprime market are not federally regulated, subprime lending is a fertile ground for predatory activities, such as excessive fees, the imposition of single premium credit life insurance and prepayment penalties that provide no countervailing benefit to the borrower.”
- Explained the findings of the 1998 HUD/Federal Reserve report that studied the effectiveness of the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA) to handle abusive practices. This report concluded that there are two “major categories: (1) blatantly fraudulent or deceptive practices that involve unlawful acts, and (2) various techniques used to manipulate borrowers into exorbitantly priced or simply unaffordable loans.” Accordingly:
 - “The first type of abusive practices, blatant fraud or unlawful acts of deception, include: (1) forging signatures or obtaining signatures on blank documents; (2) falsifying loan applicants’ income or the appraised value of the property; (3) overcharging consumers with illegitimate fees; (4) selling credit life or disability insurance to consumers who do not qualify for the insurance, or writing policies for amounts that exceed the consumers’ indebtedness; (5) fraudulently conveying title in the property to third parties to facilitate the diversion of loan proceeds; and (6) employing bait-and-switch tactics.
 - The second type of abusive practices is often more difficult to identify. It includes various manipulative techniques that cause consumers to enter into abusive loans, including: (1) aggressive sales solicitation and targeting of low-income, minority and elderly homeowners; (2) racial steering to high rate lenders; (3) undue pressure to refinance unsecured debt or second mortgages into a new, high-cost first mortgage; and (4) home improvement scams.”
- Of the previously mentioned two categories, the first includes abuses that “involve acts that are already illegal under existing state laws, which should be vigorously enforced,” while the “second category of abuses demands special attention from the public and from state and national legislators and policymakers.”

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- Additional “features” commonly found in predatory loans, according to the 1998 study, include high annual interest rates, excessive closing costs, balloon payments, negative amortization and lump sum credit insurance.
- The HUD/Treasury Task Force has identified the following 8 areas for further review:
 - 1) “We need better information on high cost lending. It is simply unacceptable that this Committee and others charged with oversight of the nation’s housing finance system and the public do not have readily available data on the extent of high cost lending, predatory practices and foreclosures.
 - 2) As the President stated last year, we need to expand the Home Ownership Equity Protection Act (HOEPA) to cover a larger share of high cost loans. HOEPA was passed before the rapid growth of subprime lending. As a result, HOEPA triggers cover only a very small share of high cost lending. The HOEPA triggers must be reviewed in light of current lending trends.
 - 3) Congress should consider restricting certain loan features strongly associated with abusive lending practices. For example, many lenders have already concluded that certain loan products, including single premium credit life insurance, have no place in today’s market. Congress should consider placing similar restrictions on all loans.
 - 4) We must improve consumer protection by increasing enforcement against fraudulent loan practices. In each of the four cities we have been to date, the HUD/Treasury Task Force learned that local enforcement entities often struggle to keep up with the growing mortgage fraud in their area.
 - 5) We are reviewing whether creditors making high cost loans should be required to take into account the consumer’s ability to repay – setting a consumer up for a quick foreclosure has no place in today’s market place.
 - 6) Borrowers need more accurate and meaningful disclosures on the pricing and terms of high cost loans. Consumers are now faced with a bewildering array of documents at closing. In the face of high pressure sales techniques and new predatory lending scams, existing disclosures need a thorough review.
 - 7) We are taking a careful look at the role of the secondary housing market in purchasing or scrutinizing predatory mortgages. We are examining what role better due diligence may have in this regard.
 - 8) We need to expand consumer education and counseling. The importance of expanded education and counseling has been one consistent theme of each of the HUD/Treasury forums. Last year, the Administration requested \$20 million for homeowner counseling, but Congress only appropriated \$15 million. This year the administration requests \$24 million for counseling. Congress should fully fund this request.”
- “These are just some of the areas the HUD/Treasury Task force are examining.”

Edward Gramlich, Governor, Board of Governors of the Federal Reserve System

- Predatory lending occurs predominantly in the subprime market and involves abusive practices such as “excessive fees and interest rates, unnecessary insurance, and fraud.”

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- Explained that there is “debate” over how to define predatory lending and offered several brief definitions. Specifically, he stated, “A narrow definition of predatory lending focuses on specific practices that take advantage of consumers and that are unfair, deceptive, or fraudulent.” Further, he stated that a predatory loan can be broadly defined as a loan that is high-cost.
- “The information we have about predatory lending is essentially anecdotal. Even apart from the conceptual differences I mentioned, there is no ready method for measuring the amount of predatory lending or determining how prevalent a problem it represents. Yet, even without precise data, there are enough anecdotes to suggest that a problem exists. We also know that attempts to deal with predatory lending are hampered by two broad phenomena:
 - Predatory lending often involves the abuse of credit provisions that can be of value to many borrowers.
 - Predatory lending seems to occur most commonly in the unregulated sector of the loan market, by lending institutions that are not forced to undergo periodic compliance exams.”
- “No law administered by the Board contains a statutory or regulatory definition of predatory lending.”
- Explained purposes for TILA and HOEPA.
- Explained the 1998 HUD/Board report noting that this report showed that improved disclosure would help fight abuses, but would not stop abuses that primarily occur in two categories. The first “includes the use of blatantly fraudulent or deceptive techniques that may also involve other unlawful acts, including violations of HOEPA.” The second “involves various techniques used to manipulate borrowers, coupled with practices that may ordinarily be acceptable but can be used or combined in abusive ways.” The 1998 report also recommends the need for carefully crafted legislation that “should focus on abusive practices without interfering with legitimate credit transactions.” Lastly, the report calls for a multifaceted approach” that combines strengthening “enforcement of current laws with several additional consumer protections.” These protections include recommendations that “balloon notes covered by HOEPA might be further restricted, for example, either by applying stronger prohibitions to a subset of these loans or by prohibiting balloon notes for these loans altogether,” that creditors should be limited in their “ability to collect certain credit insurance premiums on HOEPA-covered loans up-front” and that “before any foreclosure sale, creditors should be required to provide a written explanation of any rights the consumer may have to cure the delinquency or redeem the property.”
- “The 1998 report suggested some new substantive protections to deal with predatory lending, some involving legislative action. The report noted that any regulatory scheme involves tradeoffs. Government-imposed rules dictating when and on what terms consumers can obtain credit sometimes raise issues of fairness and economic efficiency. Overly broad rules could unnecessarily burden the entire home-equity credit industry in an effort to regulate a minority of unethical or dishonest players. Any legislation should focus on abusive practices without interfering with legitimate credit transactions.”
- “Given the wide range of practices that are included in the notion of what is ‘predatory,’ a multifaceted approach is likely to be the most effective. We should certainly look at ways to strengthen enforcement of current laws that are being ignored. Nonregulatory strategies should also

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be encouraged and implemented, including voluntary industry action, community outreach efforts, and consumer education and counseling. . . .The 1998 report identified two specific changes to protect consumers who obtain HOEPA-covered loans. One addresses balloon payments; the other addresses single-premium credit insurance. . . .Currently, balloon payments are prohibited for HOEPA-covered loans having maturities of less than five years. . . . Hence the Board and HUD proposed that balloon notes covered by HOEPA might be further restricted, for example, either by applying stronger prohibitions to a subset of these loans or by prohibiting balloon notes for these loans altogether. . . .The Board and HUD also recommended limiting creditors' ability to collect certain credit insurance premiums on HOEPA-covered loans up-front. Consumer advocates express concern about high-pressure sales tactics sometimes used to sell high-priced credit insurance that does not allow for a discount for advance payments. The insurance is sometimes sold with a single premium collected up-front. If for some reason the mortgage loan is paid off early, it is often difficult for consumers to obtain a refund of the unused portion of their premium. . . .Regulation of insurance, including the setting of allowable premium rates, has historically been a matter for state law. Yet some abusive practices could be eliminated by prohibiting the advance collection of premiums on HOEPA-covered loans, so that consumers would pay for insurance periodically--and only for the time the loan is actually outstanding. This means that termination of the loan would automatically cancel both the coverage and any liability for future payments. . . .The Board and HUD also recommended reforms concerning the type of notice that should be provided with consumer loans in general, both HOEPA and non-HOEPA, prior to foreclosure."

- "The Board is required to hold periodic hearings on the effectiveness of HOEPA in curbing abusive lending. The Board did so in 1997, slightly less than two years after the act became effective. Those hearings formed the basis of the 1998 analysis of abusive lending contained in the Board-HUD joint report to the Congress. The Board plans to hold another round of public hearings on HOEPA later this year, with the Board's Consumer Advisory Council taking an active role in developing the specific questions for discussion. . . .At those hearings, consideration will be given to broadening HOEPA's coverage by, for example, lowering the HOEPA rate triggers or including additional costs in the points and fee triggers. In addition, the Board will explore whether its regulatory authority under HOEPA to prohibit practices that harm consumers can, as a practical matter, curb predatory loans. Frankly, the value of rules prohibiting such practices is uncertain, given the nature of predatory practices. Some occur even though they are already illegal, and others are harmful only in certain circumstances. The best solution in many cases may simply be stricter enforcement of current laws."
- "Nonregulatory strategies are also being pursued. Trade associations for subprime lenders and mortgage brokers have been actively engaged in developing self-regulatory guidelines. Secondary market participants such as Fannie Mae and Freddie Mac are developing their own strategies for ensuring that they do not finance predatory loans and are making efforts to develop consumers' awareness of legitimate credit options."
- "There is one final, but important, factor. Whether the concern is high-cost loans generally or specific predatory practices, credit markets operate more efficiently when consumers are well informed. Community outreach efforts, consumer education, and, where appropriate, counseling would increase consumers' understanding of their credit options. Such efforts can and should be supported by both government and industry, working in conjunction with consumer and community organizations."

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Ellen Seidman, Director, Office of Thrift Supervision *[Note an especially long summary of this OTS testimony is given both because the testimony is detailed and because we believe it is useful to highlight OTS's Advance Notice of Proposed Rulemaking (comments due by July 25.)]*

- Stated that “predatory lending can present safety and soundness risks, as well as risks to consumers and communities.” In particular, it can present “legal and reputation risk,” “liquidity,” “operational” and “credit” risks.
- “As I see it, there are three interrelated approaches for combating predatory lending practices—what I call the three ‘E’s’: examination for enforcement of applicable laws and regulations, encouragement of responsible subprime lending, and education of consumers and investors.”
- “While we have no reason to believe there is a significant amount of predatory lending engaged in by the thrift industry, I want to confirm whether that belief is correct and take steps to prevent it from taking root in the future.”
- Subprime lending does serve a legitimate purpose.
- It is difficult to define predatory lending. Ms. Seidman referred to Deborah Goldstein’s predatory lending study, “Understanding Predatory Lending: Moving Towards a Common Definition and Workable Solutions” to present the author’s definition which is stated, “[p]redatory lending describes a set of loan terms and practices that fall between appropriate risk-based pricing by subprime lenders and blatant fraud.”
- Attempted to define “reasonable” subprime lending by stating, “Subprime lending refers to lending to borrowers who do not qualify for the most favorable interest rates and other loan terms because they are not among those with the best credit histories and most stable employment. Responsible subprime lending means making those loans at a price and with terms that appropriately compensate the lender for any enhanced risk, including a reasonable return, and marketing the loan in a manner that is fair to, and understandable by, the borrower.”
- “Freddie Mac has estimated that from 10 to 35 percent of borrowers with subprime loans could have qualified for a prime loan, but were steered to a higher-cost loan anyway.”
- Predatory loans generally have the following features: “interest rates significantly higher than justified by the relative risk profile of the borrower, financing of high fees and points and of a single-payment credit life insurance premium, often called ‘packing’, a balloon payment, negative amortization and prepayment penalties.” However, although these factors may be present, “one or more of these features does not necessarily make a loan predatory.” Specifically, determining if a loan is predatory “depends also on factors related to its marketing, the choices available to the borrower, and whether the borrower has sufficient non-housing assets or income to pay off the loan.” Accordingly, if certain “practices” are combined with the “features” mentioned above, “a predatory loan is the likely result.” These practices include: “high pressure marketing targeted to vulnerable populations, such as the elderly, low- and moderate-income families, and those with medical care or other debts, steering a borrower who would qualify for a prime loan to a high-cost loan, by taking advantage of the borrower’s lack of knowledge or inexperience, excessive refinancing of little or no net benefit to the borrower, often called ‘flipping,’ underwriting the loan based on the equity in the home without regard to whether the income or other non-housing assets of the borrower are sufficient to pay off the loan, making disclosures in a rushed way so the borrower does not understand the nature of the proposed loan and refusing to report complete loan payment experience to credit reporting agencies.”

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- “Another factor that may be contributing to the growth of predatory lending is the existence of the Alternative Mortgage Transaction Parity Act (Parity Act).” This issue is being reviewed in the OTS’s Advanced Notice of Proposed Rulemaking (ANPR).
- The ANPR promotes six goals. These goals were stated as the following:
 1. “Encourage safe and sound lending. Whatever the type of mortgage lending or market, the loans a thrift makes must be prudently underwritten. That means, among other things, that the borrower must have the ability to repay the loan. Because the equity in the home is pledged to repayment of the loan and the loan fees and charges are paid to the lender at or before loan closing, predatory lenders may feel free to ignore whether the loan can be repaid.
 2. Encourage innovation in identifying potential customers and meeting their needs. We must make room for the development of new underwriting approaches and new procedures and marketing strategies as we encourage thrifts to find new ways to meet the needs of qualified subprime borrowers and earn reasonable profits.
 3. Discourage lending that preys upon customers’ lack of knowledge or limited options.
 4. Enable thrifts to compete with other types of lenders. I would reject any suggestion that this means they must have the flexibility to compete with predatory lenders by ‘fighting fire with fire.’ Instead, we must give them the tools and flexibility to fight predatory lending practices with responsible loan products and education of consumers so the business of responsible sound lending to prime and subprime borrowers will flow to thrifts and other ethical lenders.
 5. Maintain the uniform system of regulation that applies to federal thrifts. This will keep costs down and help simplify the confusing array of options for consumers.
 6. Minimize regulatory burden on thrifts. If we give thrifts and other lenders appropriate guidance and flexibility, we believe we can achieve the goal of driving predatory lending off the map of home lending without imposing undue regulatory compliance burdens, with their associated higher costs that flow through to homebuyers.”
- “The ANPR focuses much of its attention on the Alternative Mortgage Transaction Parity Act of 1982. The period from the late 1970s to the early 1980s was a time of high interest rates, when housing credit was relatively unaffordable to many. Congress’s purpose in enacting the Parity Act was to give state-chartered housing creditors, which are entities that regularly make mortgage loans, parity with federally chartered institutions by giving them the authority to make, purchase, and enforce alternative mortgage loans. Alternative mortgage loans are loans with any alternative payment features, such as variable interest rates, balloon payments, or call features. The Parity Act does not apply to other types of mortgages or other loan transactions. . . .State housing creditors have the choice to comply with either OTS regulations or state laws for alternative mortgage instruments. The Parity Act does not, however, give federal agencies supervisory authority over state housing creditors, which remains with the states. . . .For purposes of the Parity Act’s preemption, OTS has designated certain regulations over time as appropriate and applicable to alternative mortgage transactions engaged in by state housing creditors. The earliest approach taken by OTS’s predecessor agency in 1982 was to limit the list of regulations to those that apply exclusively to alternative mortgage transactions. This included (a) the authority to make partially or non-amortizing loans and to adjust the interest rate

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payment, balance, or term of maturity; (b) limits on adjustments on loans secured by property occupied by the borrower; and (c) requirements for disclosures on loans that are not fixed-rate and fully amortized and that are secured by property occupied by the borrower. This approach was possible because, at that time, OTS's lending regulations were highly detailed and 'design-oriented.' In the early 1990s, however, OTS streamlined its lending regulations—both those that apply only to alternative mortgage transactions and those that apply to all mortgages—to provide flexibility, reduce regulatory burden, and encourage innovations to stimulate credit. To protect consumers, OTS has relied on consumer disclosures. Based on these new more 'performance-based' regulations, in 1996 OTS reevaluated and revised its approach to the Parity Act preemption. Since by then the same broad regulation applied to all types of home mortgage loans, no longer distinguishing between traditional fixed-rate and alternative types of loans, some have argued that OTS, in effect, expanded preemption available under the Parity Act."

- "The ANPR solicits comments on how to clarify the interaction between the federal and state regulatory schemes affecting state housing creditors. . . . Thrifts are subject to a comprehensive regime of regular examination, supervision, and enforcement to assure their compliance with applicable laws and regulations. Some non-depository institution state housing creditors are as well, but others are not. How should these differences be taken into account so alternative mortgage transactions by state housing creditors are treated neither more harshly nor more leniently than similar transactions by thrifts? Frankly, we don't yet know. The degree of participation in such practices by housing creditors that have used the Parity Act and OTS's implementing regulations instead of state law has not been studied in a focused manner. The ANPR therefore asks the following questions:
 1. To what extent are housing creditors engaging in predatory or abusive mortgage lending practices that would be contrary to existing state law but for the provisions of the Parity Act and OTS's implementation?
 2. To what extent are state housing creditors engaging in predatory or abusive lending practices that are contrary to applicable laws (such as state laws against fraud) but are not being prosecuted by state authorities whose power is specifically reserved by the Parity Act for that purpose?"
- "Some have argued that the ability of state housing creditors to rely on OTS's regulations may have resulted in abuses in markets where there are fewer competitive pressures and no regular state oversight. To explore whether this has occurred, we have invited comments on these questions:
 1. To what extent do housing creditors lending under the Parity Act use different practices and impose more onerous loan terms in underserved or financially unsophisticated markets than they or their affiliates use in more mainstream markets?
 2. To what extent do housing creditors lending under the Parity Act provide credit to persons with good or excellent credit records at rates and with terms significantly above those for conventional prime mortgages?
 3. To what extent does the use or terms of prepayment penalties, the financing of prepaid credit life insurance or loan fees, or the frequency of partially amortizing, non-amortizing, or negative amortizing loans vary among state housing creditors or

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- between them and insured depository institutions? Do variations relate to characteristics of the borrower (such as race or age) or the neighborhood, or to the relative creditworthiness of the borrower? Do variations result in returns that compensate lenders in excess of risk-adjusted prices or loan terms?
4. Do state housing creditors refinance mortgage loans (including fees) that they or an affiliate have made at rates equal to or greater than the rates on the existing loans? Does this occur at insured depository institutions?
 5. How, if at all, do the answers to these questions differ for housing creditors who do not make alternative mortgage transactions under the Parity Act but rely instead upon state law?"
- “The ANPR also seeks advice on whether OTS should adopt regulations on high-cost mortgage loans. . . .In the context of asking whether OTS should amend its lending regulations to impose high-cost mortgage loan limits stricter than the current HOEPA approach without waiting for new legislation, the ANPR invites comments in response to the following questions:
 1. What loans should be covered?
 2. Should OTS impose limits on financing of certain fees or charges?
 3. Are limits on refinancing appropriate?
 4. Are prepayment penalties appropriate for high-cost loans?
 5. What limits on balloon payments, negative amortization, post-default interest rates, and mandatory arbitration clauses would be appropriate for high-cost loans?
 6. Should OTS require lenders to determine the suitability of a mortgage loan product for particular borrowers?
 7. Should OTS require institutions to notify applicants for high-cost loans of the availability of home loan counseling programs before closing?
 8. Is differential regulation appropriate?"
 - “Some believe that entities related to insured depository institutions engage in lending practices that may disadvantage potentially vulnerable customers. OTS is looking into the extent to which this is a problem, and the ANPR invites comments on various aspects of this issue. Thrift operating subsidiaries may only engage in activities permissible for a thrift, and OTS must receive notice before a thrift creates an operating subsidiary or an operating subsidiary initiates a new activity. These subsidiaries are already subject to OTS examination and supervision, and we act promptly if a problem arises. If we determine subsidiaries pose different or higher risks than the parent thrifts, we would modify our subordinate organizations’ regulations to address these risks or take other appropriate action. With respect to other affiliates of thrifts—that are subsidiaries of a thrift holding company but not of a thrift and are often under the jurisdiction of other state or federal regulatory authorities—our concern is limited to the effect of affiliates on the safety and soundness of thrifts. If we determine an affiliate is placing a thrift at risk, we take appropriate steps to protect the thrift, including full cooperation with the responsible state authorities.”
 - “The most important place to fight predatory lending is in the marketplace itself. We still have communities that are not adequately served by insured depository institutions. One of the reasons predatory lenders are so successful is the absence of competition. Some conventional lenders

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believe that the risk of lending in certain communities is unacceptable and that there are too few business opportunities in those markets. They therefore unwittingly cede this business to the unscrupulous. We need to create an environment that encourages responsible competition in underserved markets typically targeted by predatory lenders.”

- “We have now reached the last—but not least—element of the solution: education of both consumers who are potential victims of predatory lenders and of investors in subprime mortgage loans and securities backed by subprime loans. Giving consumers information about their options for obtaining credit from responsible lenders and about the abuses of those who prey on the vulnerable can be a strong bulwark against the predatory lender. . . .As for investors, they must be more discerning in their purchase of securities backed by high-cost loans to avoid providing liquidity to the unscrupulous. The activities of large predatory lenders will quickly shrivel if they are denied financing. Participants in the secondary market are beginning to recognize that predatory loans are not good business—not just because they are unethical but also because they can damage their reputation and hurt their stock price.”

John D. Hawke, Jr., Comptroller of the Currency

- Predatory lending is difficult to define, but it is clear that “lending practices that take unfair advantage of borrowers are inconsistent with important national policies.” Predatory lending undermines “a central objective of our national social and economic policies for many decades: the promotion of home ownership and its attendant virtues of neighborhood stability, decreased crime, and the building of wealth for a broader spectrum of American families.”
- Predatory lending generally has a combination of the following features: “loans made in reliance on the value of the borrower's home or other collateral, without a proper evaluation of, or reliance on, the borrower's independent ability to repay, with the possible or even intended result of foreclosure or the need to refinance under duress; pricing terms -- whether interest rates or fees -- that far exceed the true risk and cost of making the loan; targeting persons or areas that are less financially sophisticated or otherwise vulnerable to abusive practices, or have less access to mainstream lenders, such as the elderly and persons living in low- or moderate-income areas; inadequate disclosure of the true costs and risks of the transaction; practices that are fraudulent, coercive, unfair, or deceptive, or otherwise illegal; loan terms and structures -- such as negative amortization - - that make it more difficult or impossible for borrowers to reduce their indebtedness; aggressive marketing tactics that amount to deceptive or coercive conduct; ‘packing’ of loan contracts with unearned, inadequately disclosed, or otherwise unwarranted fees; ‘balloon’ payments that may conceal the true burden of the financing and force borrowers into costly refinancing or foreclosure situations; and loan ‘flipping’ -- frequent refinancings with additional fees which strip equity from a borrower.” Explained that these features are not all “inherently abusive” or that these features should be “construed as a working definition of predatory lending, but instead as an effort to illustrate the difficulty of arriving at a general definition of the term.”
- “While predatory lending may be concentrated to date in a sector of the subprime market, it is important to make clear that not all subprime lending is predatory lending. The OCC, in fact, encourages responsible, risk-based subprime lending to borrowers who are willing and able to repay their loans. Lending to subprime credit applicants, whose credit histories, or lack thereof, indicate a higher than normal risk of default, can be conducted in a fair and responsible manner. The basic principles of such lending should be that it is priced based on risk and cost, that it provides adequate

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disclosure for full borrower comprehension, and that it contains repayment terms that the borrower appears reasonably likely to meet, based on an assessment of the borrower's ability to repay. Such fair and responsible subprime lending can be of benefit to a wide range of borrowers who might otherwise not have access to credit.”

- Stated that it is “difficult to determine with any precision the prevalence or the rate of growth of predatory lending.” Furthermore, current reports (referenced the 1998 joint HUD/FED report) that analyze predatory lending growth are “primarily anecdotal.” Also, he noted that some people claim that because the subprime market has grown, so has predatory lending. Mr. Hawke states that this reasoning is flawed because “the situation in these markets is too complex to make that judgment based on the information currently available” and “we simply do not have reliable information adequate to quantify the level of, or trends in, predatory lending at this time.”
- Mentioned that a role of the OCC is to determine “involvement by national banks and other insured depository institutions” in predatory lending. This role is difficult because of definitions and so far the OCC has not found that “national banks and their subsidiaries are engaged to any noteworthy extent in these sorts of practices.”
- “Reports to date suggest that the problem of predatory lending primarily concerns unregulated lenders -- those not subject to routine examinations. As a general matter, our supervisory and other activities, as well as the other information that has been developed concerning predatory lending practices, have not led us to conclude that national banks and their subsidiaries are engaged to any noteworthy extent in these sorts of practices. I note, however, that the OCC does not examine affiliates of national banks that are not subsidiaries of the bank, and we therefore cannot speak to such entities' lending activities.”
- “...there is a significant secondary market for subprime consumer debt instruments.”
- “...it is certainly possible that substantial initiatives by Fannie Mae and Freddie Mac will have a salutary effect on the level of predatory lending by directing secondary market financing toward responsibly-made subprime loans.”
- “[T]he OCC does have tools at its disposal, under current law, to deal with many abusive lending practices where they exist in the institutions we regulate, and we are fully prepared to use those tools aggressively to combat predatory practices. There are, however, limitations in the current legal framework that reduce the effectiveness of those tools. Legislative action may help to remedy those deficiencies, and is certainly worthy of further discussion. We must always be cautious, however, that legislative intervention be carefully considered so as not unintentionally to obstruct access to credit on the part of borrowers whose credit needs can only be satisfied at rate levels that reflect the higher costs and risks of meeting those needs.”
- The OCC has safety and soundness supervisory authority, chartering and licensing power, the power to enforce consumer protection and fair lending laws and to prevent unfair or deceptive practices.
- “The OCC's AMTPA regulation does not affect non-depository institution lenders.”
- It is not clear if AMTPA has effected predatory lending. The OCC will wait and “use the information developed by the OTS in its pending rulemaking in this area to assist us in determining what additional supervisory or regulatory actions may be appropriate for us to take.”
- “While there are some tools that the OCC and the other federal financial institution supervisory agencies have, there are limitations in the existing legal and regulatory framework that might help to permit abusive lending practices to persist. For the most part, these limitations and the related

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troublesome practices raise policy issues appropriate for Congress to consider, though there are some actions that supervisory agencies may be able to take as well, under existing authority. . . . On the legislative side, it should be acknowledged that the current HOEPA requirements are fairly easy to avoid. First, they apply only with respect to a narrow range of loan products -- closed-end refinancings and home equity loans secured by the borrower's dwelling -- and thus can be circumvented simply by structuring the loan as an open-end home equity credit line. Moreover, HOEPA requirements apply only if the interest rate or other pricing for the loan is very high, and thus can be avoided by pricing just below the HOEPA thresholds. . . . Finally, HOEPA addresses only a specified range of problematic practices, albeit an important subset of the practices often classified as predatory.”

- “TILA does not, as a general matter, impose substantive limitations on loan pricing or other practices. Moreover, the TILA disclosure requirements may not cover loan terms and other practices that could have potentially disastrous consequences for some borrowers.”
- CRA credit needs to be evaluated in such a way that does not discourage responsible lending to underserved communities.
- Additional legislation may be needed, but it must not limit credit availability. The OCC commends sponsors of current Congressional predatory lending bills because their proposals “will generate needed policy debate on these matters.” Specifically, the OCC supports the consideration of the bills because they “would expand HOEPA requirements by including more types of products (such as open-end home equity lines of credit), tightening existing requirements on practices such as negative amortization and balloon payments, and other mechanisms, as well as by lowering the threshold for covered loans.” Also these current proposed plans strengthen safety and soundness concerns, would “require the ‘full file’ reporting of positive payment performance to credit bureaus,” would “focus on enhanced disclosure of loan terms and consumer financial counseling” and would “expand Home Mortgage Disclosure Act reporting requirements to include loan pricing information.”
- The OCC would like to see that any additional legislation include: “defining more particularly what practices are unfair or deceptive for purposes of both HOEPA and the Federal Trade Commission Act, a subject that is introduced by at least one of the pending proposals; enhanced disclosures for payday loans so that borrowers are aware of the total finance charges that eventually may be imposed if they are not in a position to repay the loan in accordance with its terms without multiple rollovers; fortifying the enforcement mechanisms under existing laws, particularly for lenders not subject to routine examinations; and considering whether other important consumer assets -- such as retirement savings accounts -- should receive special protection from abusive lending practices akin to that now afforded to homes.”
- “I also hope that this debate results in legislative action that addresses concerns about abusive lending practices without obstructing fair access to credit. While I will defer comment on the merits of other aspects of the pending bills, I urge the Congress carefully to consider all the potential consequences of the different proposals for reform. It is important that any reform not have the unintended consequence of interfering with the flow of credit or limiting the availability of legitimate credit options, including responsibly-made subprime loans. This is perhaps especially important for low- and moderate-income persons and underserved communities. For example, at some point, lowering the interest rate and fee thresholds for loans subject to the HOEPA restrictions risks limiting credit access for subprime borrowers. Further, a general ban on prepayment premiums could limit a consumer's product choices and ability to negotiate other concessions, such as a

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reduced interest rate, in exchange for accepting the risk of a prepayment premium. Such a ban also could raise safety and soundness concerns, and constitute a subsidy to one class of consumers (those who prepay) at the expense of another (those who do not).”

Donna Tanoue, Chairman, Federal Deposit Insurance Corporation

- Stated that predatory lending is “often directed at low-income and elderly borrowers.”
- Among safety and soundness issues, “predatory lending can: cause substantial harm to financially vulnerable and unsophisticated consumers and undermine the stability of the neighborhoods where the loans were made; lead to a high volume of foreclosures which are costly to the holder of the mortgage; undermine the reputation of individual financial institutions and the public’s trust in the financial services industry as a whole; and subject institutions that might unwittingly support predatory lending to the risk of costly litigation.”
- Subprime lending is difficult to define, but the “‘Interagency Guidance on Subprime Lending’ issued a definition on March 1, 1999 that “defines subprime lending as ‘extending credit to borrowers who exhibit characteristics indicating a significantly higher risk of default than traditional bank lending customers.’”
- Subprime lending is an “important source of credit” for borrowers.
- “While most predatory loans are made to subprime borrowers, predatory lending is product-driven.”
- “We would describe as ‘predatory’ those loan products that use certain marketing tactics, collection practices, and loan terms that, when combined, deceive and exploit borrowers. Practices and terms that in combination are commonly found in predatory lending, principally home equity lending, include: high-pressure and/or misleading marketing and sales efforts; excessive fees and interest rates at levels well beyond those appropriate or necessary to cover risk and a profitable return; excessive origination fees and/or excessively priced or unnecessary products, such as can be the case with single premium credit life insurance, that are included in the loan balance; large prepayment penalties that are intended to trap borrowers in an unfavorable or unaffordable loan; balloon payments that have unrealistic repayment terms and often result in foreclosure; ‘loan flipping,’ or frequent refinancing, with fees folded into the loan balance repeatedly, resulting in rising loan balances and the “stripping” of equity; and aggressive, often abusive, collection practices.”
- “We believe that federally insured depository institutions have a good record of avoiding involvement in such activities.” Additionally, she stated, “The FDIC has not uncovered evidence that indicates insured depository institutions are actively originating loans with predatory features. However, the FDIC is concerned that banks and thrifts, like other institutional investors, may be involved in the predatory loan market in an indirect fashion.”
- An example of an “indirect influence” are brokers relationships with banks. These brokers “have a substantial influence on the terms of the loan products eventually received by lenders,” which can be “either positive or negative.” Another example of an “indirect influence” is the occurrence of “banks and thrifts purchasing loans or securities backed by predatory loans, or by offering credit lines to nonbank predatory lenders.” Ultimately, this occurrence “may subject an institution to increased credit, reputation and legal risk because the institution does business with predatory lenders or mortgage brokers.”

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- The FDIC is promoting many initiatives to combat predatory lending. These initiatives include “writing guidance for insured depository institutions describing effective practices,” working on an interagency basis to “revise” CRA in such a way that banks cannot receive CRA credit for predatory loans, working to give “positive CRA consideration to bank sponsored programs which combat predatory lending by fostering financial literacy,” reviewing existing laws and regulations, holding “public forums across the country” and working on consumer education programs.
- The FDIC has been working with various cities and states to collaborate on identifying and finding solutions to predatory lending.
- Briefly mentioned the current federal laws describing them as effective, but not complete. In particular she stated, “However, current law does not fully address a number of predatory practices found in some loans in the mortgage market – especially in the markets for refinancing and for home equity loans, such as unrealistic balloon payment terms likely to lead to foreclosures or inappropriately folding certain fees into the loan balance.”
- “The FDIC is evaluating alternatives to current laws and regulations that might curb predatory lending.” These “alternatives” will be based on a set of “principles” which include: “allowing continued access to credit for the widest range of qualified customers; protecting against the abuse of vulnerable individuals; and allowing sufficient return for lenders to provide credit on a risk-justified basis.”
- Current proposed bills before Congress are may not be advisable. In particular, she stated: “Some proposals ban such practices as balloon payments and prepayment penalties while others prohibit the charging and/or financing of certain fees. While well-intended, outright prohibitions of such practices could unduly limit credit availability or increase the cost of credit to the same consumers that we are trying to protect. For example, a loan amortized over 30 years with a balloon payment due after five years may provide a borrower with a reduced interest rate as well as an opportunity to rehabilitate his or her credit record in order to refinance the loan later at a better rate. Improved disclosure or required credit counseling might be better options than an outright ban on balloon mortgages.”
- The FDIC specifically noted, however, that it does not believe that a number of current legislative proposals “would materially impede the credit markets that serve lower income, minority, and elderly individuals, nor would they impair bank competitiveness.” Significantly, these include: “improving the meaningfulness of disclosures required under current law concerning closing costs, annual percentage rates, and consequences of failure to repay; imposing more limitations on balloon payments and prepayment penalties or requiring better disclosure of such practices; subjecting a larger number of loans to the high cost mortgage protections, including enhanced disclosures, offered under HOEPA; prohibiting the financing of single premium credit life insurance for loans subject to HOEPA; requiring independent credit counseling before closing loans subject to HOEPA; and requiring the reporting of credit payment activity.”

David Medine, Associate Director of the Division of Financial Practices, Federal Trade Commission

- Opened by explaining the FTC role in enforcing existing laws; it has jurisdiction under the FTC Act, TILA, HOEPA and ECOA.

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- Explained that the subprime industry has problems particularly in the home equity segment and the FTC is working to handle these problems through a strategy of “law enforcement” and “consumer education.”
- Described the significant growth of the subprime industry in recent years, noting that a “dramatic” change has been the increased involvement in the business by “large corporations, including bank holding companies, that operate nationwide.”
- “Higher rates and points can be appropriate where greater credit risks are involved, as is often the case with subprime loans.”
- Brief mention of Fannie Mae and Freddie Mac entrance into the market and their efforts to stop abusive practices.
- Subprime lending does provide needed credit to various borrowers, but predatory practices are taking advantage of the “most vulnerable consumers” who typically include minorities, elderly and low-income borrowers.
- Predatory lenders “generally aim either to extract excessive fees and costs from the borrower or to obtain outright the equity in the borrower's home.” Ultimately, these abusive lenders will use a “combination of aggressive marketing practices, high-pressure sales tactics, and loan terms, such as prepayment penalties, that inhibit a borrower's ability to go elsewhere for credit.” Particularly harmful predatory practices include “flipping,” the use of “home improvement contractors who are effectively working as agents of lenders,” “equity-stripping” and “ ‘packing,’ which is the practice of adding credit insurance or other ‘extras’ to increase the lender's profit on a loan.”
- “Lenders often stand to make significant profits from credit insurance, and therefore have strong incentives to induce consumers to buy it as part of the loan. . . .Typically, the insurance or other extra is included automatically as part of the loan package presented to the borrower at closing, and the premium is financed as part of the loan. The lender often fails to provide the borrower with prior notice about the insurance productand then rushes the borrower through the closing. Sometimes, the lender represents that the insurance ‘comes with the loan,’ perhaps implying that it is free. Other times, the lender simply may include the insurance in the loan closing papers with no explanation. In such a case, the borrower may not understand that the insurance is included or exactly what extra costs this product adds to the loan. Even if the borrower understands and questions the inclusion of the insurance in the loan, subprime borrowers often are not in a position to negotiate loan terms. They often need to close the loan quickly, due to high debt, limited financial resources, and limited financing options. Therefore, they generally will not challenge the loan at closing if they believe or are told that any changes may cause a problem or delay in getting the loan. . . .Lenders are not prohibited by federal law from requiring the purchase of credit insurance with a loan, as long as they include the price of the premium in the finance charge and annual percentage rate. As described above, however, sometimes the lender effectively requires the purchase of credit insurance with the loan, but fails to include the premium in disclosures of the finance charge and annual percentage rate, as mandated under the Truth in Lending Act. . . .When the lender excludes the required insurance premium from the borrower's disclosures, the cost of credit may appear significantly lower than the true cost of the credit. As a result, the consumer cannot make an informed decision about the cost of the loan.”
- Described FTC efforts to combat predatory lending through actions taken against Delta Funding, Capital City Mortgage, Money Tree, and Tower Loans and by working on “Operation Home Inequity.”

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- “The Commission recognizes that predatory lending practices are a serious national problem. While some of these practices can be addressed through current laws and regulations, additional statutory changes would enhance consumer protection in this area. The Commission urges the Committee to consider expansion of HOEPA to: (A) prohibit the financing of single-premium, or ‘lump-sum,’ credit insurance premiums (as well as other loan ‘extras’) in loans covered by HOEPA; (B) count lump-sum financed credit insurance premiums (and other extras) toward HOEPA’s fees-based trigger; (C) provide the Commission and other law enforcers with the power to impose civil penalties for HOEPA violations; and (D) prohibit mandatory arbitration clauses in loans covered by HOEPA.”

Thomas Curry, Commissioner of Banks, Commonwealth of Massachusetts, on behalf of Conference of State Bank Supervisors

- Opened stating issues that make the predatory lending debate “complex.” These issues include:
 - “(1) the clear benefit to consumers nationwide from the wider availability of credit in recent years through ‘subprime’ lending, especially to low-to-moderate income citizens, and other traditionally underserved markets; (2) the abusive and predatory practices that have, at times, been associated with such lending and which can severely harm our most vulnerable citizens, causing them to lose their homes and other assets, and; (3) the frustrations of the states that pass laws and enact regulations to protect consumers and to stop clear predatory practices, but which are often hindered in their efforts by federal preemption.”
- “I can assure you that the issue of predatory lending is at the top of the agendas of many state legislatures and state regulatory agencies.”
- “However, I must add that all legislators and regulators, both state and federal, should consider whether enforcement of existing laws has been adequately pursued before considering adding new laws or regulations to the books. No amount of lawmaking will protect consumers without the proper enforcement, including well-trained examiners to discover violations, and appropriate sanctions to back it up.”
- “We suggest that federal preemption itself sometimes has the unintended consequence of limiting state regulators’ ability to protect consumers and ensure a healthy banking and lending industry.”
- Explained efforts by a number of states to combat predatory practices. Among the states were NC, MA, NY, WA, CA, MN, IL, VA and NJ.
- Discussed the need to “review the standards for federal preemption.” In particular, the “the federal agencies should articulate a justification for preemption and explain: (a) how similar existing federal protections adequately protect consumers, or: (b) when no federal regulation exists, why the preempted state law is not necessary for consumer protection.”
- Examined a GAO report on preemption and focused on the Alternative Mortgage Transaction Parity Act of 1982 (AMTPA) part of the report. He commended OTS Director Ellen Seidmen for her working efforts. Also he stated “...that AMTPA allows state-licensed mortgage lenders to rely on applicable OTS regulations, thus often escaping more stringent state consumer protection laws.”

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Andrew G. Celli, Bureau Chief for Civil Rights, Office of the Attorney General for the State of New York

- Opened testimony stating, “Thank you for this opportunity to testify about illegal, discriminatory and financially destructive practices within the sub-prime lending industry in New York State.”
- Explained that the New York Attorney General has been investigating lenders and brokers.
- “Sub-prime lending simply refers to mortgage lending that exists to serve consumers who do not qualify -- by dint of their credit records, income, or otherwise -- for traditional ‘A’ credit.”
- “...indeed, good sub-prime loans can be an important mechanism for bringing credit to underserved communities and borrowers.”
- “Predatory lending practices occur when sub-prime lenders and the mortgage brokers with whom they deal exploit the vulnerability of higher-risk borrowers -- as well as the unavailability of other forms of credit -- to take unconscionable profits.”
- Predatory lending is targeted at minorities and the elderly and “is characterized by far higher interest rates than are warranted, prepayment penalties, balloon payments, excessive broker fees, and, too often, a lack of full disclosure.”
- Based on the Delta Funding case and other ongoing investigations which are still open, Mr. Celli stated, “One broad conclusion is clear, however: predatory practices exist widely within the sub-prime industry, at both the lender and the broker levels. In New York -- particularly in communities for which sub-prime lending is an important source of credit -- predatory practices are a major problem.”
- Described three practices within the context of the “Delta decree” that make up the “core of the problem” in the subprime sector. These include: “first, the extension of credit without regard to borrowers' ability to repay -- to individuals who lack the income or other resources necessary to service the loans and sustain themselves; second, the practice of pressuring borrowers to refinance loans simply to churn additional fees -- even when the refinancing puts the borrower in a worse financial position than had no loan been extended at all; and third, the charging of excessive broker fees.”
- Specific comments on the three above mentioned areas included:
 - “We found that the number of HOEPA-covered loans is shrinking, as lenders evade the HOEPA definition by bringing in loans just under the statutory definition of ‘high cost’. We also found that HOEPA's standard of ‘without regard to ability to repay’ is sufficiently vague that enforcing it in court raises real challenges.”
 - Debt to income ratio (DTI) “does not properly gauge risk for people at the lowest income levels” so urged “serious consideration of a residual income requirement.”
 - Urged addressing “flipping” like they did in the Delta case which “effectively prevents ‘flipping’ by requiring that, whenever a loan is refinanced, the borrower’s monthly payments may not increase by more than 2.5% of the new funds which the borrower obtained from the loan.”
 - “Many mortgage brokers receive outrageous fees for virtually no work.”
 - “. . . [G]iven the grave abuses of yield spread premiums, we have supported state proposals to prohibit yield spread premiums entirely. In the alternative, we have supported a rule that permits lenders to pay -- and brokers to collect -- yield spread

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premiums only where they can show that such yield spread premiums result in lowered up-front broker fees. In other words, the lender must show that the borrower received a benefit in return for paying the higher interest rate -- namely, that the broker charged a smaller up-front fee from the proceeds of the loan. Brokers and lenders should be required to demonstrate this on an aggregate basis, showing that they do loans both without and with the yield spreads, and that the yield spread loans consistently had up-front broker fees reduced in the amount of the yield spread premium.”

- “[W]e advocate an outright cap on the fees which any broker can receive on a particular loan. . . . [A] 3% cap on broker fees seems fair, and we have supported such at the state level. Any legislation or regulatory action on this point must, however, make it clear that the capped amount includes all fees to the broker whether paid directly or indirectly. This would eliminate or severely restrict the payment of yield spread premiums and would prevent brokers from taking fees from some indirect sources, thus evading the cap.”
- Any legislation on broker fees must ensure “that the capped amount includes all fees to the broker whether paid directly or indirectly.”
- “Finally, it is worth reiterating that most of the proposals I have discussed today are more than hypothetical suggestions -- they are part of a court ordered consent decree which this office is presently monitoring. The fact that it is a settlement, and that Delta agreed to abide by these restrictions, indicates that the restrictions can be imposed without banning sub-prime loans altogether or drying up needed credit in poor and minority communities. Therefore, we urge this committee to consider these provisions for adoption in legislation covering the sub-prime industry as a whole.”

PANEL III- Academic and Consumer Advocacy Representatives

Professor Cathy Lesser Mansfield, Associate Professor of Law, Drake University Law School

- “. . . [T]he current subprime market is not meeting the credit needs of lower-income neighborhoods and minority communities.”
- “The primary credit product being offered by subprime mortgage lenders today is the one-size-fits-all refinance loan. In the most common subprime home equity loan transaction, a borrower who already owns his/her home is contacted by or contacts a subprime home equity lender for a loan that one would traditionally think of as a second mortgage loan. The borrower needs money for (or is sold on the idea that he/she needs money for) home repairs, needs cash, or needs to decrease the interest rate on accumulated high rate consumer debt, such as credit card debt. The product this borrower needs is likely to be small in size compared to the size loan it would take to purchase a home. But this is not the product the consumer ends up getting. . . . In most subprime home equity transactions, the product the consumer ends up with is primarily a refinancing loan in which the first mortgage is paid off (although some subprime loans are made to individuals who have no existing mortgage). Any other loan proceeds are purely incidental, although the consumer's sole purpose for getting the loan was probably to fund what has now become the incidental purpose for the loan. The

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reason this product is by its very nature predatory is that it does not meet the borrower's credit needs. The loan is much larger than the loan the borrower needs, and its high interest rates, high points and fees, and high risk of default and foreclosure are augmented and made more predatory by the size and characteristics of the loan. . . .The high rates aspect of the loan is predatory because often the refinanced subprime loan is at a higher rate than the loan being refinanced. The consumer has no choice but to take this loan if the consumer has or is convinced he has credit needs, because the only product being offered by the subprime industry is the refinance loan. Thus any consumer who wants or needs or can be sold a cash out, home repair or debt consolidation loan ends up with a much larger loan that pays off the current first lien, and saddles the consumer with a higher interest rate than the rate on the paid off loan. This abusive practice can range from paying off an existing loan with a slightly higher rate loan, to paying off an existing no-interest or low-interest loan, such as a Habitat for Humanity loan, with a high rate loan. No financial advisor would ever advise a borrower to refinance his/her current first lien loan at a higher rate, and yet this is the standard loan being made today by the subprime mortgage industry. . . .The refinance subprime loan is also predatory by its very nature because by including the existing mortgage in the proceeds of the loan the lender increases the amount of money needed to pay points and fees."

- "The risk of foreclosure in a subprime loan, which based on our data might be as high as a one in four chance of foreclosure, also makes the subprime refinance loan predatory by its nature."
- Explained the difficulty in conducting any research on the subprime industry because of the overall lack of data. Ms. Mansfield stated, "It is impossible to determine or describe with accuracy the rates, points and fees charged by the subprime home equity industry as a whole, because pricing information is not collected by any public source, and is not advertised with specificity by the industry." Furthermore, the data that is available through sources like a prospectus is difficult to interpret. The SEC lender prospectuses "provide the only public source of rate information for subprime loans" and upon review, prospectuses "provided no information about points and fees, nor is there any place to get such information." Ms. Mansfield also mentioned that "default and foreclosure information is not publicly collected anywhere."
- "Collection of and easier access to such important data must be one of the reforms adopted by Congress. Without information no one can know just how predatory subprime loans are, and no one can know what sorts of risks such loans pose to individuals (including risks of foreclosure and investment losses) and to society at large (including risks to urban housing infrastructures and the soundness of the financial institutions that provide credit lines to subprime lenders). Given the dominance of the refinance loan, the information required to be reported must include rates, points and fees, default and foreclosure statistics, and whether individual loans increase the rate paid by the borrower."
- Reviewed a study she conducted which is published in the South Carolina Law Review. This study focused on the top 14 lenders in 1998, 6 of which (Green Tree Financial, Equicredit Corporation, Amresco, Option One Mortgage Corp., Impact and Residential Funding/GMAC) "had made regular filings with the SEC." Rates for subprime loans in the study "increased between 1995 and 1999, with a range in 1995 between 5.00 and 17.99%, and a range in 1999 between 3.00 and 19.99%." She noted that the "conventional market was never more than 2 percentage points." Furthermore, the "median subprime interest rate for the loans we looked at was at least 2.2 percentage points, and as much as 4.06 percentage points, higher than the conventional annualized rate."
- Ms. Mansfield completed another study on subprime loan delinquency, default and foreclosure rates. In this study she and a colleague reviewed the top 16 lenders' (including Associates, Aames,

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Amresco, Contimortgage, Equicredit, Green Tree, IMC/Citifinancial, the Money Store D.C. Inc., New Century, UC Lending, Option One, Advanta, Delta, WMC, Banc One and GE Capital Mortgage Services) SEC filings. For the results she stated, “We found that of \$163,369,070,000 in loans serviced, approximately 4.65% were in serious delinquency (more than 90 days late), foreclosure, or completed foreclosure. In terms of families affected, we estimated that over 72,000 families were included in these numbers.”

- “Defaults for static pools of loans present some of the most disturbing figures. . . . A full 24.75% of the loans in the pool were in 90+ delinquency, foreclosure, bankruptcy, or already foreclosed. With 30 and 60 day delinquencies added to that, the total default and foreclosure rate on the pool was 27.93%. These numbers indicate that one in four borrowers taking a subprime loan will lose or will be in serious danger of losing their home.”
- She also added that, “Clearly, serious default and foreclosure rates are much higher for subprime loans.” Lastly she asserted a general conclusion, saying, “This means that for most borrowers in foreclosure, but for the relationship with the subprime lender the homeowner might not have lost the home to foreclosure.” (This information was based on the 16 sampled lenders and on HMDA data available from 1996.)
- Foreclosures have a “devastating” impact on “America’s housing infrastructure.”
- “It is quite clear that subprime loans carry a high risk of default and foreclosure. What is not clear is whether these risks are caused by the credit condition of the borrower before the loan is made, or by the loans themselves. Lenders argue that subprime borrowers are a risky bunch, and that this causes high delinquency and default rates, and also dictates the high cost of subprime loans. But the tremendously inflated costs of subprime loans, the fact that most borrowers who lose or are headed toward losing their home to a subprime lender already owned their home before taking the subprime loan, and the fact that the subprime credit product in the market is the refinance loan, suggest that the loans themselves create the most risk of default, foreclosure, and the attendant individual and societal costs.”
- “Federal controls on predatory lending practices, including, among other things, restricting refinancing existing mortgages at a higher rate, limiting points and financing of points, limiting interest rates, and prohibiting the sale of single premium insurance and financing the premium, will go a long way in reducing predatory lending and might lead lenders to offer the credit products most subprime borrowers really need, rather than offering a product that increases costs to consumer and drains home ownership.”
- “The Home Mortgage Disclosure Act should be amended and enforced so that all subprime mortgage lenders are required to report information such as loan interest rate and APR, points and fees, the loan-to-value ratio, the borrower's debt-to-income ratio (determined by a national standard), whether the loan is deemed by the lender to be subprime, what category loan the borrower was deemed by the lender to be and why, whether the loan is a refinance of an existing mortgage, regardless of the ‘purpose’ for the loan, the rate on any loan being refinanced, how many times the lender and/or affiliated lenders have made a loan to the same borrower, all fees charged in the loan, and the cost and type of any insurance included in the loan.”
- “In order for consumers to know what they are looking at before they decide to buy, lenders should be required to advertise rates and fees.”
- “Lenders should also be required to inform borrowers long before the transaction is consummated as to what credit category the borrower was placed in by the lender (A, A-, B, etc.) and told why

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this is the case. This would help the problem of borrowers being ‘upsold’ into credit risk categories into which they do not belong, and help them to avoid being charged the attendant higher rates and fees.”

- “During the process of adopting HOEPA, it became clear that setting usury limits at the federal level, or eliminating the federal preemption contained in DIDMCA for purposes of non-purchase money first lien loans was not considered to be an option. This, I believe was a mistake.”
- “This does not necessarily mean that Congress has to set an ironclad limit that cannot adjust to an increase in market interest rates. It is just as plausible for Congress to adopt a floating maximum rate, as it did in its definition of a high rate loan under HOEPA. There also must be regulation of points and fees that can be charged by home equity lenders. Finally, no lender should be permitted to refinance an existing mortgage at a significantly higher rate to the borrower. This can only serve to increase risk, and I can think of no situation in which this is advantageous to the borrower.”

John Taylor, President and CEO, National Community Reinvestment Coalition (NCRC)

- “NCRC is a national trade association representing more than 700 community-based organizations and local public agencies who work daily to increase fair and equal access to credit, capital, and banking services to traditionally underserved populations in both urban and rural areas.”
- “NCRC would argue that, while subprime lending does play a role in expanding access to credit for those with blemished credit records, a growing portion of this industry is responsible for the ‘balkanization of credit,’ whereby vulnerable low- and moderate-income, minority, and elderly individuals are being targeted by predatory lenders whose only intent is to deceive and dispossess them of their property and wealth.”
- “Some industry observers maintain that subprime lending has been responsible for significant increases in lending to minorities and low- and moderate-income borrowers. NCRC believes that these claims are exaggerated.”
- We need “stepped-up enforcement of the Community Reinvestment Act and stronger fair lending provisions” to provide the “American Dream of homeownership.”
- Predatory practices include “charging borrowers exorbitant interest rates unrelated to their credit risk, packing loans with unnecessary and costly fees, refinancing frequently with no benefits to the borrowers, utilizing high-pressure, sometimes fraudulent, sales tactics, and many other abuses.”
- “...predatory lending is a subset of subprime lending.”
- There has been a “tremendous explosion” in the subprime market in recent years. This surge is characterized by a disproportionately large amount of subprime loans in minority and low-income neighborhoods. Discussed HUD’s study “*Unequal Burden: Income and Racial Disparities in Subprime Lending in America*” and a separate NCRC study to support this characterization.
- “In preparation for this hearing, NCRC conducted an analysis of subprime mortgage lending among the top twenty lenders in the New York Metropolitan Statistical Area (MSA) in 1998. For conventional home purchase lending, subprime lenders made 4 percent of all loans in substantially white census tracts compared to 25 percent of all such loans in substantially minority census tracts. For conventional home refinance lending, an even more disturbing picture emerges. In substantially white census tracts, subprime lenders made 8 percent of all loans, while making 79 percent of all such loans in substantially minority census tracts. . . .In Baltimore, Maryland, these patterns are just as stark. Again, NCRC analysis of subprime mortgage lending among the top twenty lenders in the

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Baltimore MSA shows that subprime lenders' market share for home refinance loans in substantially minority census tracts was nearly 39 percent, while their share in overwhelmingly white census tracts was 0 percent. Fourteen of the top twenty refinance lenders in minority census tracts were subprime lenders. For home improvement loans, subprime lenders held 27.5 percent of the market in minority census tracts versus just 6.5 percent in white tracts. Finally, in the home purchase market in Baltimore, subprime lenders controlled 28.7 percent of the market in minority census tracts, and again 0 percent in predominantly white tracts. . . . For the Los Angeles-Long Beach, California MSA, we again found disturbing trends. Looking at all lenders, NCRC's analysis showed that black borrowers as a whole were three times more likely to receive subprime rather than prime loans, and low- and moderate-income blacks were three times more likely to receive subprime loans than low- and moderate-income whites."

- "What does all this mean? Clearly, such extreme disparities in subprime lending by race and income cannot be solely related to the credit history or risk of the borrower. In fact, as both Freddie Mac and Fannie Mae have estimated, anywhere between 30 and 50 percent of subprime borrowers could qualify for prime loans. So what is going on? As the New York Attorney General, HUD, the Federal Trade Commission (FTC), and the Department of Justice (DOJ) know all too well, there are loosely regulated lenders and brokers out there engaged not only in deception and fraud, but also discrimination. Delta Funding is a case in point."
- "While the case of Delta Funding is exemplary of the type of predatory activity being conducted by independent, loosely regulated subprime mortgage companies, NCRC analysis shows that there are other entities with their fingers in the subprime cookie jar, namely CRA-regulated depository institutions and their affiliates."
- A significant portion of "CRA-regulated institutions" are involved in the subprime industry. Specifically, Mr. Taylor referenced an *American Banker* article that said that "eight of the top 10 subprime lenders are subsidiaries of large banks, including Bank of America, Wells Fargo, First Union, and Citigroup."
- Blames part of the growth in predatory lending on Wall Street, noting that "private investment firms and other financiers" buy large amounts of subprime loans which has provided a surge of money, thus creating liquidity to the subprime market.
- "With such astronomical amounts of money providing liquidity to the subprime market, it is no wonder that we are facing a growth in predatory lending problems today. . . . This month, NCRC and the Rainbow/PUSH Coalition unveiled a national initiative to combat Wall Street financing of predatory lending. In the coming weeks, NCRC and Rainbow/PUSH will be meeting with top Wall Street investment firms to develop a set of standards governing loan purchases to ensure that these firms are not providing fuel for unscrupulous predators. We hope that this will be a first step towards limiting the amount of capital flowing into the coffers of usurious lenders."
- "But there are further regulatory steps that can be taken today by the Federal banking agencies to combat predatory activities, particularly the Federal Reserve Board. The Board has direct jurisdiction over the practices of those subprime lenders that are bank holding company subsidiaries (such as those highlighted earlier in NCRC's analysis of subprime lending in the New York MSA in 1998). In addition, the Board also has jurisdiction over many companies that underwrite, purchase, and service mortgage-backed securities based on subprime loans by non-bank lenders."
- Feels that to help control predatory lending, several measures can be taken. Among these measures, the Federal Reserve Board should start conducting "exams of bank holding company subprime

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lenders,” there should be “enhanced data disclosure” and there should be strict enforcement of CRA requirements.

- “The decision not to examine subsidiaries of bank holding companies for consumer compliance limits beneficial scrutiny of the subprime lending units of bank holding companies that are playing a larger and larger role in the subprime industry. If the Fed really wants to take action against predatory lending, here is a clear opportunity. . . . Another important way the Board has jurisdiction over the portion of the subprime market that is abusive and/or predatory is through its supervision of companies which underwrite, purchase, and service mortgage-backed securities based on subprime loans by non-bank lenders.”
- “NCRC urges all of the Federal banking agencies to issue an immediate interagency advisory letter saying that predatory lending will not receive credit under CRA exams and will be penalized through lower CRA ratings and fair lending referrals to the Department of Justice.”
- “I would be remiss, Mr. Chairman, if I didn’t also elaborate on the key role that the Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac, play in influencing the flow of capital into the subprime market and the subprime purchasing practices of Wall Street firms. . . HUD recently proposed a significant increase in the number and percentage of home loans made to traditionally underserved populations that Fannie Mae and Freddie Mac are required to purchase. As part of its proposed rule, HUD is weighing how to count the purchase of subprime loans toward fulfillment of those goals. . . HUD has specifically asked if the standards under the Home Ownership and Equity Protection Act (HOEPA) of 1994 are sufficient to protect against the purchase of predatory loans. The answer is no.”
- Fannie Mae and Freddie Mac help promote the “flow of capital into the subprime market and the subprime purchasing practices of Wall Street firms.”
- “...GSEs should receive no credit under the goals for purchasing loans in which: fees are greater than 3 percent of the loan amount, prepayment penalties are applied if a borrower pays the loan before the end of the loan term or refinances with another lender, and prepaid single-premium credit insurance is required to be financed as part of the loan.”
- “In addition, NCRC also believes that HUD should consider the protections in a model anti-predatory lending bill that NCRC has developed with the assistance of renowned fair lending experts and its member organizations. Among other things, NCRC’s model bill prohibits flipping (repeated refinancing that does not benefit the borrower), making loans without considering the borrowers’ ability to pay, making loans that are substantially larger than the appraised value of the properties, and the practice of encouraging default on existing loans before refinancing. For high cost loans, NCRC’s model bill prohibits the practices of negative amortization and accelerating indebtedness, charging fees to renew or modify loans, mandatory arbitration, and making high cost loans without homeownership counseling. HUD should prohibit the GSEs from counting loans with these abusive features toward their affordable housing goals.”
- Also, GSE’s should “conduct fair lending reviews of subprime loans before they purchase them” and they should not be “allowed to count any loans towards the affordable housing goals if lenders prevent borrowers from establishing good credit histories by withholding payment history information from the credit bureaus.”
- “NCRC also believes that HUD should not allow the GSEs to count B,C, and D subprime loans toward the goals. Subprime loans are grouped into so called A-, B, C, and D loans, with A-borrowers being slightly less creditworthy than borrowers of regular market rate loans and C and D

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borrowers having substantially worse credit histories. According to HUD, A lending accounted for about 63 percent of the subprime loans in 1998, with B loans making up 24 percent and C and D loans making up the remaining 13 percent. Presently, not enough is known about the underwriting standards or the rigor of fair lending reviews on B, C, and D loans to declare them fit for traditionally underserved populations. Clearly, a segment of this lending is predatory. Allowing the GSEs to count B, C, and D lending as part of their goals will legitimate predatory practices before safeguards can be built into this type of lending.”

- “[W]hile all of the regulatory action recommended by NCRC is necessary to combat predatory lending, it is not sufficient. To truly end this scourge, Congress must pass strong anti-predatory lending legislation that significantly strengthens and expands current consumer protection provisions under HOEPA. . . .Some observers will say that voluntary action by the lending industry and/or regulatory responses will be enough to eliminate predatory lending. NCRC does not subscribe to this view for the simple reason that the parties to a lending transaction are unequal in terms of power and knowledge.”
- Voluntary action by industry will not stop abuses.
- “There are several problems with HOEPA as currently written. To begin with, the law’s triggers for what constitutes a high-cost loan—which provide greater consumer protections and disclosures—are set much too high at an annual percentage rate of 10% above current Treasury bill rates, or with total points and fees exceeding 8% of the loan amount. Also, HOEPA does not severely limit or prohibit certain lending practices that are clearly abusive and indicators of predatory tactics, including prepayment penalties, the financing of sizable points and fees, loan flipping, the up-front collection of single-premium credit insurance, encouragement of default, mandatory arbitration, and arbitrary call provisions. In addition, HOEPA does not apply to open-end credit transactions secured by a principal residence, thus allowing abusive home improvement loans that are structured as open-end lines of credit—a favorite of predatory lenders—to avoid regulation.”
- “. . . .NCRC and its members, working with fair lending experts and its nationwide membership, have crafted a model anti-predatory lending bill as part of our efforts to fight unscrupulous lenders, which I’m including with my testimony today along with a summary of its provisions. This bill corrects the flaws I’ve just outlined, while providing additional protections against abusive lending. . . . NCRC is pleased that many of the provisions included in its model bill are also included in the various anti-predatory lending bills currently circulating in Congress.
- Supportive of LaFalce and Schakowsky bills.
- “. . . .Representative Ney’s bill is significantly less community- and consumer-oriented, despite its ‘Consumer Mortgage Protection Act’ moniker. In fact, his legislation would roll back not only current federal consumer protections associated with high-cost loans but also strong state anti-predatory lending laws such as the one passed recently in North Carolina. As far as NCRC and its members are concerned, this legislation is a nonstarter in the fight against predatory lending.”

Margot Saunders, Managing Attorney, National Consumer Law Center

- Predatory lending has grown significantly over recent years and victims include low income, minority and elderly consumers.
- “...[T]here is ample evidence that there are real problems in the mortgage market” including the following:

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- “Between 1980 and 1998 the rate of home foreclosures in the United States has increased by 384%. That means that even though interest mortgage rates were almost twice as high in 1980, as they were in 1998, almost four times the number of homes were being foreclosed upon in 1998 as in 1980.
- This increase in foreclosure rates *cannot* be traced to the increase in homeownership rates, which was only about 3% during the same period. The increase in home secured lending during the same period was almost twofold, from 30 million loans outstanding in 1980 to 52.5 million loans in 1998.
- The problem is that too many home loans are being made for purposes that have nothing to do with the home, and too often these loans are being made with terms that are inherently unconscionable -- that increase the costs of homeownership and the risk of loss of homeownership to the borrower.”
- Contended that a significant issue is the “failure of the marketplace to protect consumers” and that “competition and self regulation do not stop bad loans from being made. The message is, therefore, efforts by industry to rely on enforcement of current laws will only hurt consumers.” One reason for the alleged marketplace failure is that “there are no federal or state [usury] laws that govern the maximum rates or fees that lenders can charge for loans used to purchase or refinance a home.”
- “Refinancing low rate purchase money first mortgages with high rate first mortgage loans has become a serious problem in the low income community leading to the escalating loss of homeownership. The terms of these high rate loans are not necessary to protect the lenders against loss; indeed the terms are generally so onerous that they precipitate default and foreclosure. With these equity based loans, even foreclosure does not pose actual risk of loss to the lender. The Home Ownership Equity Protection Act passed by Congress in 1994 to address these abuses, while helpful, has not significantly reduced the abuses faced by many low-income, minority and elderly homeowners.”
- A “mortgage crisis” was created for low-income homeowners because of the 1986 change to the tax code, disappearance of banks from low-income neighborhoods, “appreciating real estate values” and deregulation.
- Ms. Saunders stated the following are predatory lending abuses:
 - **“Home improvement scams**, which are home loans stemming from unsolicited sellers of home improvements in which the work is generally overpriced, and rarely performed adequately;
 - **Mortgage broker kickbacks** which result in higher priced loans than the borrowers qualify for with their lenders;
 - **Steering** to high rate lenders when consumers qualify for lower rate loans;
 - Lending to people who **cannot afford to repay**;
 - **Falsified loan applications** such that the loan originator pads the borrower's income to make the loan qualify, yet which leads to unaffordable payments for the borrower;
 - **Incapacitated** homeowners;
 - **High interest rates** which are far more than are justified by the alleged additional risks and costs of providing credit to homeowners with lower credit scores;
 - **Balloon payments** terms for which the borrower has no way to meet without refinancing the loan at excessive costs or losing the home;

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- **Negative or non-amortizing loans**, such that even after making loan payments for years the borrowers end up owing more than was originally borrowed;
 - **Padded closing costs**, which can often be fees for settlement services two or three times as high as are charged middle income homeowners;
 - **Credit insurance packing** with high priced pre-paid term credit insurance which add thousand of dollars in unnecessary costs to loans for borrowers who could obtain more reasonably priced credit insurance if paid on monthly basis;
 - High and unfair **prepayment penalties**;
 - **Mandatory arbitration clauses**, which frequently require only the borrower to submit to it and not the lender and which can force a homeowner to pay large sums for their concerns to be addressed by arbitrators who have no incentive to follow consumer protection laws, and whose decisions are not reviewable by any court;
 - **Repeated refinancings** which have the effect of bleeding the homeowner's equity from the home by increasing the amount borrowed exponentially in each refinancing without providing any benefit to the borrower;
 - **Spurious open end loans** whereby the lender is allowed to avoid making the more comprehensive disclosures required by closed end credit, and thereby avoid any chance of the homeowner asserting the right of rescission, as well as completely avoiding the restrictions under the Home Ownership and Equity Protection Act, regardless of the cost of the loan;
 - **Paying off low interest mortgages** such as purchase money loans with FHA with much higher interest rate loans;
 - **Refinancing unsecured debt** for which the borrower could not lose the home, with high interest rate debt which must be paid to avoid foreclosure; and
 - **125% loan to value loans** which effectively prohibit borrowers from selling their homes or filing bankruptcy to escape unaffordable debt, without losing their home.”
- HOPEA does not adequately protect consumers. The most significant problems with HOEPA include:

“1) HOEPA does not in any way limit what the lender can charge as up-front costs to the borrower. It is the excessive, combined fees -- in closing costs, credit insurance premiums, and points -- which deplete the equity in abusive loans. These excessive, combined fees are charged over and over, each time the loan is refinanced. And with each refinancing, the homeowner's equity is depleted by these charges because they are all financed in the loan. The effect of this situation is to encourage lenders to refinance high cost loans because they reap so much immediate reward at each closing. If the law limited the amount of points and closing costs that a lender could finance in high cost loans, this incentive to steal equity would be stopped cold.

2) The interest rate trigger and points and fees triggers for HOEPA are too high, causing many abusive lenders who want to avoid HOEPA strictures to make high cost loans just under the trigger. The effect is that there are no protections whatsoever against these very high cost loans which are just under the HOEPA triggers.

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3) HOEPA does not apply to open end loans. When HOEPA was passed in 1993, there were few predatory open end mortgage loans being made. In the past seven years, that picture has changed. It has become apparent that open end credit provides another vehicle for mortgage abuses. There is no longer any reason to exclude open end mortgage loans from HOEPA's coverage. More importantly, unless open end loans are brought within the scope of HOEPA, the failure to regulate them will simply push the bad actors into that market.”

- “By passing HOEPA, Congress has already recognized two essential truths: that there are some loans for which the marketplace does not effectively apply restrictions; and government must step in to provide balance to the bargaining position between borrowers who either lack the sophistication to avoid bad loans or do not believe they have a choice if they want the credit.”
- Supports LaFalce bill (H. R. 4250), noting: “HR 4250 leaves the basic structure of HOEPA in place while expanding its coverage and prohibiting abusive terms not currently addressed in the law. As part of this change, mandatory arbitration clauses [are] prohibited. . . *The essential core of this proposal is in the expansion of HOEPA protections to prohibit the financing of points, fees and credit insurance premiums, and the charging of prepayment penalties.* . . .HR 4250 does not put a cap on the points or fees that can be charged for high rate loans; it only prohibits lenders from financing more than 3% of them. Presumably, for most borrowers, prohibiting the financing of these charges will be the same as prohibiting the charges altogether, but this will not necessarily mean that these loans cannot be made. It will only mean that these fees will be rolled into the interest rate charged the borrower -- the lender will pay the fees and recoup them through the interest payments on the loan. The rate of interest charged borrowers will increase, but the borrower's equity ownership in the home will be preserved. These loans will be structured exactly the same as the ‘no cost’ mortgage loans provided to prime borrowers all the time.”
- “To the consumer, the worst abuse in the predatory mortgage market is the financing of high points and fees.”
- The “indisputable advantages” that will result if the financing of points, fees and credit insurance are stopped include “no equity will be stripped from the home,” “the lender will have the incentive to make these loans affordable” and “the market will work to keep the interest rate on these loans competitive.”
- “Credit insurance is a big ticket item in each individual loan. Nationally, consumers spend as much as \$2.5 billion per year on credit insurance, often with little understanding of what they have bought. This volume of business conceals overcharges of \$900 million to \$1.2 billion, where 40 to 50% of the premiums are paid to lenders as commissions. The marketplace has created reverse competition because credit insurance premiums are paid up front for term insurance policies which cover the whole or a significant portion of the loan term and lenders receive a commission based on the size of the credit insurance premium. Thus, lenders are rewarded for selling the most expensive forms of credit insurance, rather than the least costly to the consumer. As a result, unsophisticated consumers spend thousands of extra dollars for credit insurance which provides negligible value to them. . . .The remedy for the reverse competition established by the marketplace: only allow credit insurance to be sold when the premiums can be paid monthly, along with the loan payments, and the credit insurance can be canceled at any time. *The Federal Reserve Board and HUD specifically endorsed this proposal in their Report to Congress in July, 1998.*”

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- “The prohibition against financing points, fees and credit insurance premiums only works if it is accompanied by a protection on the backend of the loan: a prohibition against prepayment penalties. Without such a prohibition, predatory mortgage lenders will still be able to strip equity and will not be forced to make their loans actually competitive. . . .Subprime lenders claim that borrowers voluntarily choose prepayment penalties to reduce their interest rates. Borrower choice cannot explain, however, why some 70% of subprime loans currently charge prepayment penalties and only 2% of conventional loans do (almost all in California). The real reason is that conventional mortgage markets are competitive and sophisticated borrowers have the bargaining power to avoid these fees; borrowers in subprime markets often lack sophistication or are desperate for funds and simply accept the penalty that lenders insist that they take. HR 4250 addresses this issue by only allowing prepayment penalties to be charged if the loan is refinanced in the first 24 months and limiting the penalty to that amount of 3% of the loan amount that was not financed in the original loan. The rationale for this is that 3% is sufficient to cover the lender's costs for making the loan; any more than that is unnecessary equity stripping. In this scheme the lender has the option of whether to charge all or part of the 3% up front or if there is an early prepayment of the loan. *This aspect of the bill is crucial to clamping down on the frequent loan flipping which is the cause of the loss of equity.*”
- Argues for elimination of holder in due course rule for assignees and purchasers of home equity loans to prevent home improvement loan abuses.
- Contended that mandatory arbitration clauses should be eliminated, saying: “Creditors use arbitration clauses as a shield to prevent consumers from litigating their claims in a judicial forum, where a consumer friendly jury might be deciding the case. Arbitrators, who typically handle disputes between two businesses, are unfamiliar with consumer protection laws, and may be unsympathetic to consumers. Creditors also prefer arbitration because their exposure to punitive damage awards is dramatically reduced, and the threat of class actions is generally nullified. . . .Arbitration also limits discovery in most cases, which benefits the creditor, not the consumer, and the arbitration may cost the consumer far more than bringing an action in court. By comparison, indigents in many jurisdictions can file court actions in forma pauperis. And consumers lose their rights to appeal the decision maker’s erroneous interpretation of the law. This allows arbitrators to ignore state or federal consumer protection statutes and judicial precedent.”
- HMDA should be expanded such that there is “better information about all mortgage loans made by financial institutions, including information about rates, points and fees charged, refinancings and foreclosures.”
- CRA should be expanded to include “all mortgages made by a bank, as well as its subsidiaries and affiliates” when determining CRA credit. Also, “there should be explicit negative consequences” and counted against the bank’s CRA rating if a loan made by a “bank or its subsidiaries or affiliates” matches any of the following measures:

“1. Loans with excessive costs. Loans in which more than 3% of the total loan amount (or 4% if the loan is FHA-insured) consists of upfront points and fees.

2. Loans with higher annual percentage rates: Loans in which the annual percentage rate equals or exceeds four percentage points (4%) over the yield on United States Treasury securities having comparable maturities at the time the loan is made.

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3. Loans with prepayments penalties and other abusive terms. Loans which (a) have a prepayment penalty provision; (b) have a clause allowing for the interest rate to increase upon default; or (c) negatively amortize at any point during the term.

4. Loans in which credit insurance is financed. Loans in which the lender financed, directly or indirectly, any credit life, credit disability, credit unemployment or credit property insurance, or any other life or health insurance, or any payments financed by the lender directly or indirectly for any debt cancellation or suspension agreement or contract, except insurance premiums or debt cancellation or suspension fees calculated and paid on a monthly basis shall not be considered financed by the lender.

5. Loans which contain mandatory arbitration clauses. Loans which contain a mandatory arbitration clause that limits in any way the right of the borrower to seek relief through the judicial process for any and all claims and defenses the borrower may have against the lender, broker, or other party involved in the loan transaction.”

- Argues that federal law should be expanded to offer foreclosure protections.
- The 1986 Tax Reform Act should be amended to “limit [tax deductions for] home secured debt to home related debt, and to allow all individuals some measure of deductions for unsecured personal credit.”

Gale Cincotta, Executive Director of National Training and Information Center and National Chairperson, National People’s Action

- “Predatory lending is stripping equity and investment from communities and leading to a boom in foreclosures.”
- Described a 1999 NTIC study of the Chicago neighborhoods which “found that between 1993 and 1998, the Chicago area experienced a 52% increase in foreclosures completed—foreclosures where the homeowners certainly lost their homes. The study found ‘subprime lenders’ are the engine behind the foreclosure explosion. Their share of Chicago foreclosures increased from 1% in 1993 to 38% in 1998. Foreclosures on loans made by subprime lenders increased from 131 foreclosures in 1993 to 4,958 foreclosures in 1999.”
- “Predatory loans are subprime loans with fraudulent practices and flimsy underwriting that have led to an explosion of foreclosure in Chicago and other areas.”
- Predatory loans include practices such as the following:
 - “Bait and switch, offering a teaser rate and increasing that rate upon closing.
 - Charging excessive fees ranging anywhere from 5% to 20% of the total loan amount or requiring unnecessary credit life or credit disability insurance which is financed over the life of the loan.
 - Flipping, repeated refinancing without financial benefit to the borrower.
 - And improvident lending or basing a loan on the equity in the borrower’s home without regard to the ability to repay.”
- Predatory lending is “reverse redlining.”

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- “Mortgage brokers are the most common point of entry for borrowers on the subprime market and brokers are virtually unregulated. Subprime mortgage bankers are directly responsible for gouging, flipping, and improvident lending. They solicit aggressively over the phone, through the mail and on residents’ doorsteps. Brokers must be regulated effectively and be prohibited from taking kick-backs from subprime, predatory lenders.”
- “The connection between banks and predatory mortgage lenders must also be brought to public attention. Banks are responsible when they have predatory, subprime subsidiaries and affiliates such as First Union’s The Money Store and BankAmerica’s EquiCredit. Banks must also be held accountable when banks and industry associations railroad proposed laws and regulations to restrict predatory practices. Investment banks are also responsible for funding predatory mortgage companies, for investing and securitizing predatory, subprime loans.”
- The proposed Chicago City ordinance on predatory lending should be followed by other cities.
- HMDA needs to be amended to “include disclosure of the points and fees, the interest rate, Annual Percentage Rate (APR), and credit score for all loans.”
- “...Congress and the regulators should prevent financial institutions from getting CRA credit for subprime loans. Also as referenced First Union, a bank, owns The Money Store, a subprime lender known for using predatory practices and loan terms. While the bank doesn’t make many loans in Chicago, its subprime subsidiary floods the City with expensive loans, most of which are refinance and home improvement loans. BankAmerica and its subprime subsidiary, EquiCredit, have a similar record.”
- Congress should “kill bogus reforms like H.R. 4213 introduced by Rep. Ney (Ohio). The Ney bill masquerades as consumer protection but will take away the rights of the states and Congress to pass real reforms.”

William Brennan, Jr., Director, Home Defense Program, Atlanta Legal Aid Society

- Predatory lending targets “elderly, minority, low and moderate income, and women homeowners.”
- “The financial services industry (including banks and thrifts, local and national, large and small mortgage lenders and finance companies) has evolved a system of financial apartheid in our country. . . . people with B and especially C and D credit (and some of those with A credit) are often egregiously overcharged and subjected to abusive lending practices. Moreover, these high cost, abusive loan products are marketed disproportionately among our elderly, minority, and low and moderate income communities. The rationale that risk justifies exploitation is bogus.”
- Explained that based on his 32 years of experience, involving “hundreds of subprime lending cases,” he has “never seen a subprime mortgage lender not engage in one or more of three distinct categories of predatory lending practices.” He stated that these three “categories” include overcharging on interest and points, “they perpetrate other profitable abuses” and “they target groups based on age, race, income and sex.” The following points were discussed about these categories:
 - Noted that the high rates charged by lenders are “not justified by the risk involved because these loans are collateralized by valuable real estate.”
 - Stated that subprime companies “generate additional profits” from foreclosures. These profits are reflected in various companies including Associates, First Union, Bank of America, Green Tree and Equicredit.

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- In reference to “other profitable abuses,” the following actions are noted as abusive: loan flipping; packing the loan with overpriced single premium-financed credit life, disability and unemployment insurance; balloon payments; high prepayment penalties; using scam home improvement companies to generate originations; paying kickbacks to mortgage brokers to generate originations; and paying off low cost or forgivable mortgage loans.
- Elderly homeowners “are perhaps the principal targets” and are targeted because of the substantial equity in their homes.
- Minorities are “disproportionately targeted” because often their “their access to legitimate sources of loans and other financial services is disproportionately denied.” This occurrence is a result of redlining by various “banks and other conventional mortgage lenders.” He stated, “Redlining creates a credit vacuum filled by the predatory lenders (many of which are owned by the same banks which redline communities). Ultimately, this redlined group becomes a “captive market” and “reverse redlining” results.
- “Conventional lenders tend to deny loans to these individuals and often steer them to predatory lenders.”
- Women are targets of subprime lenders because they are “deemed by lenders to be vulnerable.”
- Mentioned the HUD report on Atlanta which allegedly demonstrates the spread and severity of predatory lending.
- Increasingly, according to Brennan, selected banks are a part of the spread of predatory lending problems because they own subprime mortgage companies, “make capital loans to support” subprime companies, purchase subprime mortgage loans, act as “trustees in the securitization” of the loans and engage in “redlining.”
- “In sum, the involvement of these banks [Bank of America/Nations; First Union; Citibank; Bankers Trust] with subprime lending has been a devastating development in terms of the expansion of abusive, predatory mortgage lending practices in low and moderate income and minority communities. . . .I know why these banks got involved: profitability. . . .I would argue that these banks use the profits from the subprime mortgage lending business to keep the costs of their prime mortgage lending business at the lowest possible levels. These banks target their low cost mortgage loan products primarily into middle income and wealthy, white homeowner communities and target their subprime, abusive mortgage loan products into low and moderate income, minority homeowner communities. The result is a shifting of home equity wealth out of the low and moderate, minority neighborhoods into middle class and wealthy, white neighborhoods.”
- Against Fannie Mae and Freddie Mac entrance into the subprime market and feels that they will not act any differently than the banks. He noted that their entrance may be “even worse because even more capital will be infused into the subprime business.” Furthermore, these GSE’s “will use the profits from the subprime mortgage lending business to keep the costs of their prime mortgage lending business at the lowest possible levels, just as the banks have done.” Also, he explained that Fannie and Freddie’s entrance could be dangerous if there was a market down cycle because there would be increased foreclosures and there may be Federal “bailout” scenario like the “savings and loan industry in the 1980’s which cost taxpayers billions of dollars.” These GSEs also may be subject to civil liability for predatory lending practices if they get involved in subprime. He feels that “HUD and/or Congress should require that Fannie Mae and Freddie Mac expand their support for conventional mortgage lending in minority and low and moderate income communities.”

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- “There is a non-regulatory, non-legislative solution to the problem of predatory mortgage lending. The financial services industry could easily agree to tear down the artificial wall that has been erected between the A borrowers and the B, C, and D borrowers. Lenders could make fairly priced, profitable loans based on accurate analysis of risk. They could also stop the abusive practices.”
- “Unfortunately, self-reform does not seem to be occurring. Subprime, predatory mortgage lending is expanding. Bank of America, First Union, CitiGroup and others still operate subprime mortgage entities with the attendant overpricing and abusive practices. Accordingly, legislative and regulatory responses are desperately needed. . . .The trend toward prohibiting some but not all of the abusive mortgage lending practices as a solution is grossly insufficient. Lenders might very well refrain from the few prohibited practices, but would simply expand into the permissible abuses because they are so closely tied to profitability. All the abuses must be stopped. It is simply bad public policy to prohibit some egregious abuses but to allow the others to flourish.”
- Brennan proposed amending HOEPA so that “interest rate and points and fees triggers [are] substantially lowered,” and prohibiting “all of the abuses” listed above under the “category” of “other profitable abuses.”

Gloria Waldron, ACORN, Brooklyn, New York

- Opened testimony with stories of victims.
- Stated that subprime lenders target low-income and minority neighborhoods according to ACORN studies using HMDA data. Also, referenced a HUD study, *1998 HMDA Highlights*, which allegedly reveals similar patterns of disproportionate nature of subprime lending as follows:

“In 1998, subprime loans were three times more likely in low-income neighborhoods than in high-income neighborhoods. While 11% of refinance mortgages in 1998 were subprime nationwide, the percentage more than doubles in low-income neighborhoods to 26% and quadruples in the poorest communities, where families make only 50% of the median income, to 44%. . . .That same study indicates even more troubling trends for African-Americans, as subprime loans are five times more likely in black neighborhoods than in white neighborhoods. The disparities increase as incomes rise. Homeowners in low-income black communities are almost three times as likely as homeowners in low-income white communities to have subprime refinancing. For moderate income neighborhoods, black neighborhoods are four times as likely and in the upper income neighborhoods, blacks neighborhoods are six times as likely as white neighborhoods to have subprime financing. Almost unbelievably, homeowners in high-income black neighborhoods are more than twice as likely as homeowners in low-income white neighborhoods to have subprime loans. In fact, the entire growth from 1995 to 1998 in home loans made to African-Americans was due to subprime loans.”

- Blamed the high number of foreclosures on subprime lenders.
- Banks are partially at fault for the current abuses because they are failing to lend in low-income and minority neighborhoods according to an ACORN study of HMDA data from 41 cities. Noted that “as Freddie Mac estimates that up to 30% of borrowers in subprime loans should be qualifying for ‘A’ loans, there can be no doubt that banks bear a substantial amount of responsibility for the extra

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costs subprime loans impose upon the families and neighborhoods they have abandoned.” Also stated that banking regulators are aware of the problems but are “lax” in their “enforcement of banks’ Community Reinvestment Act (CRA) obligations.”

- Subprime lenders and mortgage brokers engage in predatory practices through their marketing efforts. Ms. Waldron stated, “Subprime lenders win customers primarily on the basis of their marketing efforts instead of on the pricing of their loans.” In this marketing effort, she charged that deceptive advertising and phone solicitations trick consumers.
- Some subprime loans are “legal under current law but clearly predatory.”
- Subprime lenders and mortgage brokers engage in predatory practices “during application process and setting of loan terms.” Ms. Waldron stated, “Subprime lenders regularly engage in deliberate deceptions that result in applicants paying excessive rates and fees. They use consistent strategies of misleading borrowers about the costs of their loans, as well as about the borrowers’ own credit-worthiness.” She commented that often lenders use pressure tactics at closing to get applicants to accept the loan and one of these tactics is “encouraging default on previous debt.”
- “The problem is not that borrowers on subprime loans are less sophisticated. We simply face an entirely different market. We are frequently not approaching a mortgage transaction any differently from applicants in middle- and upper-income areas. The difference is they can generally trust their bank not to rip them off with junk fees, credit insurance, or hidden prepayment penalties. People in low-income neighborhoods primarily marketed to by subprime lenders don’t fare so well. When we place that same trust in their lenders or brokers, we become victims.”
- “The pricing on subprime loans seems to be driven most often not by the credit risks of the borrowers, but by how much the lender or broker can get away with. This should come as no surprise when so many lenders pay their employees, or the brokers from whom they buy loans, large bonuses for charging higher rates and fees. . . .According to Freddie Mac’s detailed analysis of a pool of subprime loans, there was an average of 100 extra basis points on the interest rates charged that could not be accounted for when looking at the financial characteristics of the borrower. . . . [W]e believe the average overcharge in the subprime market is even higher than that, as so many borrowers are convinced to pay rates unrelated to their risk.”
- Predatory practices include: financing of fees on high-cost loans, single-premium credit insurance, prepayment penalties, refinancing without benefit (or loan flipping), asset-based lending, balloon payments, yield-spread premiums, mandatory arbitration clauses, racial steering, failing to pay off all of the debts which the borrower of a debt consolidation loan has been led to believe will be paid off, failing to provide borrowers with the money needed for home repairs or other purposes, which was their main reason for refinancing, using inflated appraisals and falsification of information on loan applications.
- “Credit life, disability, unemployment, and health insurance policies range from overpriced at best to a complete rip-off at worst. While we would advise borrowers to avoid all such policies, there is absolutely no justification for charging such policies as a lump-sum premium at the outset of a loan, rather than having borrowers pay them monthly like any other insurance policy. Financing credit insurance policies into home loans is another way subprime lenders strip equity from borrowers. Any credit insurance policies that are paid off monthly should also be conducted as separate transactions from home loans.”
- “Prepayment . . . penalties are used in the subprime market to trap borrowers in rates above what is appropriate for their risk by preventing them from refinancing. Prepayment penalties are profoundly

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anti-competitive measures which prevent the market from working for the benefit of borrowers. While only around 1% of A loans contain these penalties (in exchange for a slight reduction on standardized interest rates), industry analysts estimate that up to 70% of subprime loans contain prepayment penalties. Fannie and Freddie could perform a valuable service for future borrowers on subprime loans by pushing lenders away from their reliance on prepayment penalties.”

- “Yield-Spread Premiums. . . [are]. . . kickbacks [that] explicitly reward mortgage brokers for jacking up interest rates, a practice which is copied by some lenders in directly rewarding employees for increasing the costs of subprime loans. The higher the interest rate, the higher the kickback. Brokers often go to great lengths to build trust in their clients but then abuse that trust by convincing them to take out loans at higher interest rates.”
- “Racial Steering. Minority applicants at banks are often steered down to subprime affiliates while white applicants with similar financial situations are placed in prime loans. Few subprime affiliates, which predominantly serve minority communities, take steps to ensure that applicants with ‘A’-level credit are referred up to banks for ‘A’ loans.”
- Subprime lenders engage in predatory practices during the “post-transaction” period. During this time, “many subprime lenders do not report positive payment information to the credit bureaus.” Also, lenders or servicers “trap” customers who are behind on payments to refinance at high cost. Lastly, consumers are often denied the right to rescind a loan, even though federal law allows three days.
- To help protect consumers, HOEPA’s “high cost thresholds need to be lowered and some protections need to apply to all loans.” HOEPA should be modified to change “the exemptions for certain prepayment penalties and the requirement that a pattern or practice of making loans that a lender knows borrowers cannot repay must be shown for such loans to be prohibited above the thresholds.” Applicants for high-cost loans should be required or encouraged to have counseling, current law needs to be more strongly enforced, and consumers need to have better legal recourse.
- Expressed concerns over “extremely high foreclosure rates” and high rates and fees.
- OTS should change its rules under Alternative Mortgage Transaction Parity Act.
- Federal agencies need to be more proactive in enforcement, consumer education, etc.
- “The intention of the Affordable Housing Goals for the GSEs is properly to lower the costs of homeownership for low- and moderate-income families. Entry of the GSEs into the subprime market could help accomplish that goal if standards are in place to ensure that Fannie and Freddie do not provide liquidity to lenders engaged in deceptive and abusive practices. However, at this time HUD should not grant the GSEs credit toward the goals for the purchase of subprime loans. Instead, HUD should wait until the impact of Fannie and Freddie’s entry into the subprime market is better understood. An appropriate compromise in the interim might be to exclude subprime loans from both the numerators and the denominators in the calculations of goals performance. The one exception we would make to that compromise is that the purchase of loans with certain predatory terms should be counted negatively toward the calculation of the goals.”
- Wall Street is contributing to the predatory lending problem because many of its institutions either own predatory lending companies or are responsible for “bankrolling these predators by scrutinizing their mortgages and selling them to investors.”

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- “The role that Wall Street has played in the rapid growth of subprime lending underlines the need for Community Reinvestment Act responsibilities and enforcement to keep pace with the changing nature of the financial services industry, and for meaningful community reinvestment standards to apply to all sectors of the industry.”

PANEL IV- Industry

Steve Bartlett, President, The Financial Services Roundtable

- “Let me begin by stating clearly for the record that illegal ‘predatory lending’ exists and should be stopped. Sadly, there are lenders and brokers who use illegal and unethical techniques to prey on homeowners. Such individuals use high pressure sales techniques, provide incomplete or incorrect information, and use other deceptive practices that lead to consumers losing some or all of the equity in their home, and in some cases, to eventual foreclosures. . . .The Financial Services Roundtable strenuously objects to predatory practices and supports appropriate policy changes and regulatory efforts that will help protect homeowners from abusive lending practices.”
- “[P]redatory lending and subprime lending are not one and the same. It is important for the Committee to know that several of the legislative proposals to address the problem of predatory lending will have unintended consequences on the millions of American homeowners who have better housing due to the subprime market.”
- “Subprime lending has contributed not only the rate of home ownership, but also to the quality of homeownership. . . .[F]or certain consumers, subprime borrowing serves as an important tool, and sometimes the only tool, for improving the quality of their housing and their credit. . . .Subprime loans allow individuals that several decades ago may not have been considered creditworthy to achieve the dream of homeownership, provide opportunities consumers to improve the quality of their housing and provide sufficient and appropriate flexibility for homeowners to meet many of their financing needs. . . . It’s ordinary Americans that benefit from subprime lending. And, ordinary Americans will be closed out of credit markets and homeownership if legislation or regulation shuts down legitimate subprime lending activities by responsible lenders.”
- “The Roundtable strongly supports efforts to identify, investigate, and prosecute abusive individuals and companies. However, the Roundtable is concerned that some proposals that have been put forward have the potential to limit or even prohibit many legitimate lending practices that allow millions of Americans to achieve their financial dreams.”
- “Let me provide several examples of practices that some have identified as ‘predatory’ but, in practice, provide borrowers with the flexibility to receive loans that meet their needs. One example, is ‘balloon payments.’ . . . Another example involves proposals to limit or prohibit the sale or financing of optional credit insurance. Credit insurance, like other types of insurance, protects policyholders who face adverse circumstances in the event they lose their job or have a run of bad luck. Responsible lenders make this product optional and clearly state that it is not a condition of the loan. Under current laws, customers must sign a separate request for this insurance before it can be sold. Some lenders also allow a ‘free-look’ period during which the borrower can cancel their policy and receive a full refund of their premiums. Some have questioned whether this product should be paid up front and financed over the life of the loan, but the Roundtable believes that there is a good reason for this approach. . . . Other proposals would limit financing of points and fees into the

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principal balance of the loan. While I was Mayor, I heard from many constituents that the biggest obstacle to homeownership was closing costs. Many borrowers simply cannot afford to pay upfront the necessary and routine closing costs that are required for all borrowers, not just subprime borrowers, to enter into a real estate loans. These costs including appraisal fees, title insurance, discount points and origination fees. To prohibit lenders from financing these costs would simply deny access to credit to many otherwise qualified borrowers.”

- The FSR is against predatory lending and advocates stopping the abuses through better enforcement of existing laws. In particular, HOEPA, TILA, RESPA and ECOA. Provided several examples of FTC regulatory authority and laws to bring action against predatory actions by subprime lenders.
- “Limiting points or fees to a percentage of the loan amount could hurt lower income borrowers seeking small loans.”
- “Negative amortization” can be beneficial.
- “As the examples I have just provided demonstrate, many of lending practices that some may identify as ‘predatory’ are actually innovative and flexible methods that, when used properly, help segments of society that several decades ago were denied access to credit markets.”
- “The good news is that regulators and prosecutors already have widespread tools available to combat predatory practices. . . . First and foremost, the Roundtable encourages the Congress to work with the FTC and other regulators to ensure that federal agencies have appropriate monetary and staff resources to enforce existing laws. . . . Additionally, the Roundtable encourages the Federal Reserve Board to use its broad authority granted under HOEPA to take appropriate steps to crack down on abusive lending practices. Further, the Roundtable encourages the agencies to help educate consumers to identify and protect themselves from predatory lenders. . . . The Roundtable also suggests that further research be undertaken to better understand the scope and causes of predatory lending as well as the benefits that have accrued from subprime lending. This information can then be used to devise a targeted solution to predatory lending that will not limit subprime borrowers access to credit from responsible lenders.”

David Bochnowski, Chairman, President and CEO, Peoples Bank, Munster, Indiana, First Vice Chairman, America’s Community Bankers

- “We deplore the actions of unscrupulous lenders who prey upon uninformed borrowers in an effort to make a fast buck.”
- ACB has been working to stop the bad practices through various means including, adoption of the “Housing Opportunities Statement of Principles,” working as a “founding member of the National Partnership in Homeownership, which helped increase the nation’s homeownership rate to a record 67 percent,” working as a “founding member of the American Homeowner Counseling and Education Institute that supports national standards for homeownership counseling” and because ACB “participates in Social Compact, a voluntary organization that promotes and honors non-profit/corporate alliances that help low-income communities.”
- “Unlike federally insured depository institutions that are subject to regular and rigorous examinations, predatory lenders are often effectively beyond the reach of federal laws.”
- “Subprime lending allows individuals with some credit blemishes to qualify for loans, though at somewhat higher rates or under stricter terms than are available to the best borrowers.”
- Subprime borrowers pay more because they have “poorer records.”

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- Subprime borrowers are able to “repair” their credit histories. ACB supports reporting “good performance” and Mr. Bochnowski states, “After ACB took this stance, Fannie Mae and Freddie Mac changed their servicing instructions to implement the same policy.”
- “Defining ‘predatory lending’ presents a difficulty similar to that faced by the Supreme Court in a pornography case. In that instance, Justice Potter Stewart said, ‘I shall not today attempt further to define [pornography],...but I know it when I see it.’ So it is with predatory lending.”
- “ACB is concerned that sharply lowering the HOEPA thresholds could affect a number of non-predatory subprime loans. This could impose additional burdens on legitimate subprime lenders without effectively dealing with the predatory lending problem. We are also concerned that certain rates and terms might be defined as ‘predatory,’ even though in some circumstances they would be appropriate. It could depend on the facts and circumstances of each transaction. Moreover, predatory lenders will eventually find loopholes in the law or shift to lending types that are not covered.”
- “Tightening HOEPA and adding paperwork and stronger disclosures is not likely to help. It may even give predators more opportunities to confuse. . . .And, . . . many predatory lenders are not subject to the same strict supervision as our members. By further tightening HOEPA and other laws, there is a risk of discouraging insured depository institutions from making responsible subprime loans, which would effectively open the door even wider to unregulated predators.”
- Supports providing more resources for consumer educations and credit counseling.
- Stronger regulation and enforcement of existing laws is needed instead of additional legislation.
- “We envision continued efforts by mainstream lenders to offer responsible products; increased reluctance of financing sources to provide funding, directly or indirectly, to predatory lenders; tougher regulation and supervision to prevent abuses; and a more educated public that can tell the difference between a fair deal and a bad one. Unlike legislation, these actions can be tailored and adjusted to deal with diverse and changing circumstances. . . .We think this approach is better than legislatively reducing the HOEPA thresholds and making the required disclosures ever more strongly worded and frequent. For the reasons indicated, ACB does not believe that a stricter statute would be effective. In fact, it could be very damaging. Over-tightening the statutory definitions risks tainting some legitimate loans. Regulators are planning to deny CRA credit for HOEPA loans, a step ACB supports. The secondary market, at least as far as the government-sponsored enterprises are concerned, will not now accept HOEPA loans. These are helpful steps under the current HOEPA limits, but could be perversely damaging if the current trigger values are significantly tightened.”
- “If Congress, despite these concerns, still attempts to tighten the thresholds, ACB strongly urges that it recognize that changes in the marketplace have already tightened them. Under current law, a HOEPA loan is defined, in part, as one that carries an interest rate more than 10 percentage points above ‘the yield on Treasury securities having comparable periods of maturity’. . . .As a result of the steadily falling federal deficit. . . .fewer long-term Treasury securities are available. . . . As the supply of Treasury securities falls, or even dries up, HOEPA’s Treasury benchmark will become lower. Whether or not Congress decides to change the existing HOEPA triggers, you may wish to consider providing the regulators with the flexibility to adjust them so that they continue to reflect your intent.”
- ACB feels that balloon payments, arbitration agreements, credit insurance, prepayment penalties, negative amortization, etc. can all be beneficial to the consumer and the proposed bills before Congress may have unintended consequences. ACB noted that while some of these items have the potential for abuse; they also can help consumers when properly used. ACB observed that credit

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insurance “is one loan feature that predators can abuse,” but explained, “when properly structured and fully disclosed, financing credit insurance can benefit consumers.”

- ACB is not supportive of the language in Rep. Ney’s Bill which refers to “prohibition on profits.” Also, ACB commented within the context of discussion that they “doubt that many lenders actually profit from foreclosures; it is more likely that excessive upfront fees and other loan terms provide the bulk of the profits.”
- ACB “vigorously opposes” many of the provisions in pending bills [e.g., Schakowsky’s H.R. 3901 and Schumer’s S. 2405] that “would impose unprecedented restrictions on non-HOEPA mortgages.”
- Supportive of the Parity Act of 1982, and stated “The Act’s purpose was to put state-licensed institutions on the same footing as federally chartered institutions, not to provide a less restrictive regulatory environment.” ACB believes that under it, OTS “should apply every regulation that imposes conditions that affect a federal savings institution’s ability to make alternative mortgages” and should not apply “only those rules that apply exclusively to alternative mortgages.”
- Closed testimony with the following points:
 - “Federally insured depository institutions are not a major part of the predatory lending problem, they are a key component of the solution;
 - Subprime lending has helped many, many homeowners;
 - Expanding HOEPA coverage by statute and banning certain terms from all loans could be both harmful and ineffective;
 - Borrower education is an essential bulwark against predatory lenders;
 - Uniform national rules are good for the mortgage market, provided they are fairly, effectively, and consistently enforced;
 - ACB pledges to work with Congress, the agencies, and – most importantly – our customers, to eliminate predatory lending.”

Ralph Rohner, Professor of Law, Catholic University, on behalf of Consumer Bankers Association

- Described subprime lending as “risk-based” mortgage lending.
- The subprime industry has helped grow our economy and had provided the needed access to credit for consumers with credit problems.
- “The past decade has witnessed a virtually unprecedented economic boom. In particular, credit to low and moderate income borrowers and to minorities has exploded in recent years, and this expansion has been shared by all sectors of the economy. It has been called by some the democratization of credit. . . . That expansion has been due in part to a good economic run, innovative alternative credit products, and other factors. Certainly, much of the credit goes to banks for their outreach efforts in lower-income communities. But all the evidence suggests that much of the increase is also the result of the dramatic growth in risk based lending.”
- “CBA also agrees that there are continuing problems in segments of the mortgage market, instigated by unscrupulous lenders or brokers who through deception, distortion or fraud imposed on mortgage borrowers obligations that are simply unconscionable. This recognition, however, ought not surprise anyone. Deceptive and heavy-handed lending practices are not new; there have always been rogues or out-riders willing to skirt the boundaries of the law to take advantage of consumers who are vulnerable, out of lack of sophistication or out of sheer desperation.”

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- Explained that most of the predatory lending abuses reported involved “deceptive and hard-sell practices, distortion and ignoring of existing rules on disclosure and documentation, and outright fraud,” which “do not need new law.” Thus, to stop these problems, enforcement of existing law is essential. These laws include TILA, HOEPA, FHA, RESPA, ECOA and the FTC Act.
- CBA “would consider supporting an efficient [national system of licensing for loan originators and brokers] created by federal law or industry-wide collaboration.”
- “[P]art of the opportunity for over-reaching comes from the intricate structures of disclosure and documentation under existing law.” Therefore, CBA supports disclosure simplification.
- Briefly mentioned CBA’s involvement in the “Mortgage Reform Working Group.” Mr. Rohner stated, “CBA suggests that a critical part of addressing unfair mortgage practices is to improve the ‘transparency’ of the mortgage process as a whole, so that from the borrower’s perspective ‘what you see is what you get,’ without surprises or unexpected or hidden terms and costs.”
- CBA is extremely supportive of increased “public education.” Mr. Rohner commented, “Banks, of course, are actively engaged in this process.” He further noted that according to a CBA survey of its members “almost 90% of banks had mortgage counseling programs in place in 1995, and the percentage had been rising annually.”
- “CBA questions whether new federal *legislation* is necessary at this time, or whether reform options might not better be developed at the agency level rather than by statute. Every federal agency with jurisdiction over mortgage lending has begun an examination of unconscionable practices. . . . [HOEPA, TILA, etc.] are adequate authorizations to permit the agencies to develop regulatory restraints that draw on the agencies’ technical expertise and continuing access to information through their investigative and examination powers. This approach — law reform by regulation rather than statutory dictate — is preferable for two reasons: (1) it permits more flexible and nuanced rules that are more easily adjusted as circumstances dictate; and (2) it allows the agencies to assess, on a continuing basis, how much preemptive effect the federal rules should have on state lawmaking on the same topic.”
- “The thrust of the bills currently before the Congress is to target specific loan terms or circumstances and either curtail or prohibit them. . . . [W]e are very apprehensive about direct limitations on a lender’s pricing strategies. . . . [T]he frustration in trying to identify ‘predatory’ loans is that they contain features that may be quite appropriate individually, or in the credit markets in general, or in some contexts, but when combined and marketed in a certain way become overbearing. Arbitrary prohibitions of certain terms affecting the lender’s yield and risk assessment may superficially protect consumers from that particular perceived abuse. But the lender may have other options. . . . Each term or practice that is ‘limited’ in the pending bills may be defended under some circumstances in the larger market. . . . Our major concern about the pending bills, therefore, is that they target certain provisions and practices as unlawful without any apparent empirical base for knowing what the effect will be on covered transactions, whether those transactions are the predatory ones in the first place, and what other unintended consequences the restrictions may produce. All of our experience since 1968 (TILA) or 1994 (HOEPA) suggests that piling legal restraint on top of legal restraint does not work very well on scofflaws. New disclosures or prescriptions on certain loan terms, will do little to deter or prevent the true ‘predator’ from ensnaring its prey through misrepresentation, guile or fear. It would be tragic, we believe, if a well-intentioned effort to deal with a fringe of fraudulent practices inhibited the ability or willingness of mainstream lenders to continue to engage in subprime, or risk-based, mortgage lending, or exposed

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those lenders to a new range of litigation and class action exposure for technical violations if they did so.”

George Wallace, Partner, Eckert Seamans Cherin & Mellott, LLC, on behalf of American Financial Services Association

- AFSA “strongly opposes” predatory lending which is different than subprime lending.
- “To the extent information is available, primarily through anecdotes, predatory lending seems confined to the so-called practice of equity skimming or stripping. If the facts surrounding the anecdotes of predatory lending are as alleged, it seems to consist primarily of a criminally fraudulent practice in which a consumer is intentionally induced into a series of transactions intended to result in the loss of the consumers principal residence. Most equity stripping examples seem to involve home improvement scams where the loan is not originated directly by a lender. AFSA is not aware of any concrete information or statistics on the number of cases of equity stripping, but we can provide information as to legitimate subprime lending practices that indicate why the two are mutually exclusive. why the two are mutually exclusive.”
- “Without subprime lenders, millions of Americans would not have participated in the credit markets over the past 10 years. These same credit markets are a major stimulus to the U.S. economic expansion while at the same time home equity is a more affordable and flexible form of credit for both prime and subprime borrowers. Subprime home equity loans frequently enable a borrower to reduce their overall level of debt and lower their overall rate. Subprime lenders, like prime lenders, do everything they can to avoid foreclosure, which almost always results in a substantial loss to the lender. Foreclosure rates among legitimate lenders are very low.”
- “AFSA urges the Subcommittee to consider any additional home equity regulation with caution and avoid letting a limited number of lowest common denominator practices drive additional legislation that forces subprime lenders to limit credit risk and exclude worthy borrowers . It is clear that the practice of equity stripping is already illegal and in fact criminal, and the Home Ownership and Equity Protection Act (HOEPA) has a whole regimen of stringent protections for certain home equity loans. There is no information available as to why enforcement of existing laws is inadequate and there is no better deterrent to this type of behavior than successful prosecution.”
- AFSA’s statement gives background summary on development and nature of subprime mortgage market, consumer understanding and satisfaction with home equity loans, customer demographics, how customers use loans, etc.
- Foreclosure “almost always results in a substantial loss to the lender” and “No subprime lender extends credit with the intent of subsequent foreclosure.”
- “Charge off rates for subprime loans are 1.4% Some portion of these charge offs are recovered. . . .The charge off percentage is the maximum universe for foreclosures, and in reality, foreclosures are a much smaller percentage.”
- “AFSA is currently working to develop consistent and accurate foreclosure statistics for its members that engage in subprime lending.”
- Responsible lenders have served that market well and did so according to the laws set forth by Congress (FHA, ECOA, TILA, CRA, etc.).

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- “Customer satisfaction with home equity loans is extremely high--94 and 98 percent respectively for the two main types of home equity products, closed end and open end loans.”
- “Basic customer knowledge about home equity loans is also extremely high.”
- The median age of subprime borrowers is 48 and their median income is \$34,000.
- Home equity loans primarily allow people to refinance or consolidate debt, and “[l]ess than 20 percent of these loans are used for other purposes such as home improvement or education.”
- “Subprime lending is a specialized, difficult business...” and while “portrayed by opponents simply as overpriced loans that provide excessive profits, the facts are to the contrary.”
- “AFSA believes that predatory lending cases, while not widespread, are actually cases of illegal fraud and misrepresentation, frequently involving ‘home improvement loans’ originated by third parties. AFSA strongly opposes predatory lending and urges the Committee to carefully consider remedies under existing law and examine whether enforcement of these laws is adequate. AFSA also urges the Committee to obtain hard factual data on the actual frequency of these alleged abuses.”
- Critics have identified 32 practices which they claim are “predatory.”
- “Many of these are clear violations of existing deceptive and fraudulent practices laws, whether criminal fraud statutes like the federal mail fraud statute, the Federal Trade Commission Act, state deceptive practices acts, RICO or common law fraud. Many of the practices they describe, however, involve legitimate business responses to the special risks which higher risk loans present. If these practices were made illegal or significantly regulated, reduction in credit availability or increase in the costs consumers pay for credit would follow.”
- AFSA’s testimony then highlights 15 of these practices and gives a brief defense of each, including: high annual interest rates, high closing costs, prepayment penalties, credit insurance, refinancing, loan underwriting, balloon payments, negative amortization, brokers fees, mandatory arbitration clauses, co-signers, open end mortgages, permitting borrowers to apply loan proceeds as they wish, making loans in excess of 100% loan to value (LTV) and force placed insurance.
- For example, the statement supports credit insurance by noting: “Credit insurance permits borrowers to insure themselves against the risk of death or disability which could make it difficult or impossible to make the required loan payments. Many people benefit from this form of insurance, and they value its convenience and availability. Surveys show that people strongly favor the option of purchasing credit insurance. Restricting the availability of credit insurance is clearly not desirable.”
- AFSA concluded: “Each of these practices is an entirely legitimate business practice. It is possible that some lenders may nonetheless incorporate one or more of them into a scheme to defraud or trick the debtor. However, it is the fraud, not the practice itself, which is the appropriate target of governmental intervention. Present law provides a formidable arsenal to attack and control fraudulent conduct, and neither consumer advocates nor governmental officials lack the tools to control abusive practices when they occur. While no one seriously condones predatory lending practices, additional regulation is not only not needed, it is likely to seriously restrict the market forces which have made low cost, affordable credit widely available to the American consumer.”
- “At the core, the practices advocates of increased regulation focus upon are common garden variety fraudulent practices that have been with us for a long time. State and federal governments have already developed elaborate laws to prevent and penalize the kinds of fraudulent practices which have been listed. In addition to common law fraud, extremely powerful anti-fraud statutes are available to attack abusive lending practices.”

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- More resources for enforcement of existing laws should help curb abuses.
- “AFSA urges Congress to move carefully in this area to avoid collateral damage to legitimate lending.”

Martin Eakes, President and CEO, Self-Help Credit Union and the Coalition for Responsible Lending

- Described his involvement in Self-Help (www.self-help.org), which consists of a credit union and a nonprofit loan fund, and the Coalition for Responsible Lending. “CRL (www.responsiblelending.org) is an organization representing over three million North Carolinians through eighty organizations, as well as the CEOs of 120 financial institutions. CRL was formed in response to the large number of abusive home loans that a number of lenders and housing groups witnessed in North Carolina. We found that the combination of the explosive growth in subprime lending, the paucity of regulation of the industry and the unsophisticated nature of most subprime borrowers have created an environment ripe for abuse. We discovered that too many families in our state - over 50,000 - have lost their homes, as well as the wealth they spent a lifetime building, because of harmful home equity lending practices.”
- “Although a small percentage of mortgage brokers and lenders are responsible for these practices, the problem is large and growing.”
- Mr. Eakes’ group is focused on stopping three “loan-level abusive lending practices.” He urged:

“1. Credit insurance premiums should not be financed into the loan up-front in a lump-sum payment. . . .2. The borrower should not be charged fees greater than 3% of the loan amount (4% for FHA or VA loans). . . .3. Any loan that has a higher than conventional interest rate should not include a prepayment penalty.”

- Eakes was especially critical of prepayment penalties, contending:
 - “Prepayment penalties trap borrowers in high-rate loans, which too often leads to foreclosure. The subprime sector serves an important role for borrowers who encounter temporary credit problems that keep them from receiving low-rate conventional loans. This sector should provide borrowers a bridge to conventional financing as soon as the borrower is ready to make the transition. High interest rate loans become abusive, however, when they prevent borrowers from escaping once credit improves, which is precisely what prepayment penalties are designed to do.
 - Prepayment penalties are the "glue" that enables broker-based racial steering. Lenders will pay a "premium" to mortgage brokers who sell unsuspecting borrowers higher-than-justified interest rates on loans, but only if they can lock the borrowers into the loans through prepayment penalties long enough to recover the premium. Recent studies have shown that minority borrowers in particular are steered into high-rate subprime loans when they in fact qualify for lower cost loans. And borrowers in predominantly African American neighborhoods are **five times** more likely to be subject to a prepayment penalty than borrowers in white neighborhoods. The marketplace will help enforce fair lending principles and police steering if borrowers can get out of bad loans

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as soon as they realize they are harmed, but prepayment penalties prevent this from happening.

- Borrower choice cannot explain the prevalence of prepayment penalties in subprime loans. Only 2% of borrowers accept prepayment penalties in the competitive conventional market, while, according to the Mortgage Information Corporation, 67% of subprime loans charge them.”

- “CRL spearheaded an effort that resulted in the overwhelming passage of the North Carolina predatory mortgage law in 1999. The bill was supported by associations representing the state's large banks, community banks, mortgage bankers, credit unions, mortgage brokers and realtors, as well as the NAACP, AARP, consumer, and community development and housing groups.”
- “HOEPA has manifestly failed to stem the explosion of harmful lending abuses that has accompanied the recent subprime lending boom.” Furthermore, Mr. Eakes stated that HOEPA gave the Federal Reserve Board authority that it has not used.
- In the absence of Board action, HOEPA should be expanded and the current bills offered by Rep. LaFalce and Senator Schumer are two “excellent” bills.
- “Parenthetically, Representative Schakowsky's bill has many outstanding features, while the bill sponsored by Representative Ney would result in more abusive lending rather than less and would represent a substantial step back from existing law.”
- “A simpler step for Congress to take than to modify HOEPA at this point would be to repeal an obscure law -- the Alternative Mortgage Transaction Parity Act of 1982 (the "Parity Act")-- that has outlived its usefulness yet results in thousands of homeowners losing the equity in their homes.”
- Charged that the “most significant home lending abuses have been perpetrated by non-depository, largely unregulated finance companies and mortgage brokers. These lenders are able to structure their loans as ‘alternative mortgage transactions’ and therefore take advantage of the Parity Act to preempt state protections.”
- “The best solution to the legacy of problems caused by the Parity Act is simply to repeal the legislation. It serves no good purpose anymore, and in fact, many unregulated non-depository institutions are taking advantage of federal preemption without any corresponding regulatory obligations. If the Parity Act were repealed, state housing creditors would not be able to use the federal law to avoid meaningful regulation by states.”
- The Federal Reserve Board has the “most existing authority to address predatory lending practices.”
- The following actions were suggested for the Federal Reserve Board:
 - 1. The Board should use its authority under HOEPA to prohibit certain specific abusive lending practices. Specifically, it should: “(1) prohibit the financing of credit insurance premiums for all loans; (2) prohibit prepayment penalties for loans with interest rates greater than conventional; (3) prohibit lenders from ‘flipping’ borrowers through repeated fee-loaded refinancings; (4) outlaw balloon payments altogether for HOEPA loans; and (5) outlaw mandatory arbitration for HOEPA loans.”
 - 2. The Board should add certain charges to the HOEPA definition of "points and fees." In this regard, “the Board should include the costs of financed up-front credit insurance; . . . should include back-end lender payments to mortgage brokers; . . . and. . . should

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include prepayment penalties, since a higher interest rate plus a prepayment penalty is exactly the same as up-front discount points.”

- 3. The Board also “should exercise its discretion under HOEPA to reduce the interest rate trigger for high-cost loans from 10% over comparable treasury rates to 8%.”
 - 4. The Board should improve HMDA disclosures, removing “the HMDA reporting exemption for non-depository lenders whose mortgage lending is less than 10% of total loan originations. . . . should add two data codes to the loan type field -- subprime and manufactured housing -- and add two data fields -- interest rate and HOEPA points and fees or total settlement charges.”
 - 5. “Lenders should receive unfavorable CRA consideration for their or their affiliates' purchase, origination or facilitation of loans with harmful characteristics -- those with prepayment penalties if the loan's interest rate exceeds conventional rates, financed credit insurance premiums/debt cancellation or suspension fees, or ‘points and fees’ of more than 3% (4% VA/FHA) as defined by HOEPA.”
 - 6. In addition, the Board “should provide more scrutiny over the subprime lending operations of bank holding company subsidiaries and bank affiliates.”
- HUD should increase its affordable housing goals for Fannie Mae and Freddie Mac.
 - “[T]he GSEs have an unparalleled opportunity to reduce harmful lending practices by enforcing positive standards on the industry. In fact, strong GSE subprime lending standards are one of the best hopes we have for reforming an industry that strongly needs reformation.”
 - “For example, Fannie Mae's Timely Payments Reward product provides a superb model for how subprime lending should occur: upfront fees are limited, financed credit insurance and prepayment penalties are prohibited, the interest rate is reasonable given the slightly higher risk, and the loan provides a bridge to a lower conventional-type rate as credit improves and payment performance becomes proven. GSE products of this type provide a service to borrowers, significantly improve the subprime industry and justify GSE involvement in subprime lending, since subprime, as well as prime, borrowers should be allowed to reap the benefits of GSE activities.”
 - “If, however, the GSEs simply provide greater liquidity to subprime loans that strip equity from vulnerable consumers, then their efforts will have done far more harm than good, even if subprime interest rates fall slightly as a result of their work. HUD should ensure that establishing higher affordable housing goals does not inadvertently provide the GSEs an incentive to increase their participation in subprime loans that may have harmful characteristics.”
 - “CRL therefore recommends that HUD give the GSEs full affordable housing goal credit for subprime loans that adhere to wealth-preserving lending standards. The GSEs should be encouraged to fund responsible loans to families that fall outside of prime standards. . . . Conversely, however, CRL believes that HUD should not allow the GSEs to purchase loans with harmful characteristics at all. If HUD determines that it lacks the authority for such a requirement, at a minimum, HUD's final rule should disallow goals credit for loans that include harmful, wealth-depleting terms, defined as loans that violate one or more of CRL's three principles. . . . In addition. . . ., the GSEs should be required to disclose all harmful loans that they become involved in. Disclosure of information regarding prepayment penalties, financed upfront credit insurance or DCAs, total HOEPA-defined points and fees, and interest rates would provide valuable data on the pervasiveness of these practices in the subprime mortgage industry, as well as GSE support for these activities. Finally, as the safety and soundness regulator for the GSEs, HUD, through OFHEO, should recognize that loans

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with harmful characteristics are inherently risky loans. When borrowers have equity stripped away, their loans are at significant risk of default and the actual collateral value may often be less than the loan amount. Therefore, HUD should impose higher risk-based capital requirements for loans with harmful characteristics.”

Laura Borrelli, President, Barrister Mortgage and Investment, on behalf of National Home Equity Mortgage Association

- “Let me begin by noting that ‘subprime lending’ is not ‘predatory lending’ as some parties seem to believe. Subprime lenders are performing an extremely important service by making affordable credit available on reasonable terms to millions of Americans who otherwise could not easily meet their credit needs. Before the subprime lending industry became well-established over the past decade, consumers in many underserved markets often found it difficult, if not impossible to obtain credit. Today, virtually every American has the opportunity to get a mortgage for a home, or to use their home equity to pay for important credit needs. We are very proud that our industry has played a key role in democratizing the mortgage credit markets and helping so many consumers.”
- “We also are strongly opposed to abusive lending practices that some unscrupulous mortgage brokers and lenders engage in, and NHEMA commends you for having an oversight hearing on this important issue. . . NHEMA believes that three immediate steps should be taken to address the problem of predatory practices, including voluntary self-policing actions by the industry; greater consumer education efforts by all interested parties; and, most importantly, tougher enforcement of existing laws which already cover most of these abusive practices.”
- “‘Predatory lending,’ which refers to certain abusive lending practices, can and do occur to some extent in almost all types of consumer credit transactions. In the mortgage industry, predatory or abusive practices, such as charging highly excessive brokers’ fees, can arise in either the prime or subprime segments of the marketplace. We abhor such practices, and NHEMA is working to make sure that those involved stop such abuses. However, we do not subscribe to the views of some parties who contend that there is a ‘crisis’ level of predatory practices occurring in our market segment. Quite frankly, we think that the level of predatory lending abuses has been seriously overstated by some industry critics. We also believe that many of the practices that are being termed as ‘predatory’ are not necessarily abusive.”
- “Nevertheless, there clearly are instances of real abuse, and concerted actions must be taken to prevent them. Great care must be taken, however, in crafting any regulatory and legislative changes so that credit availability is not unintentionally sharply curtailed and rates increased for consumers who have serious credit needs.”
- There is no clear definition of subprime lending. However, Ms. Borrelli stated that “subprime” tends to include all loans that do not meet the underwriting standards of the so-called “prime” or “A” mortgage market that is controlled by Fannie Mae and Freddie Mac.” Additionally, subprime loans are typically made to people “who have at least some credit impairments” and who “may be new to the job market,” who “may temporarily be between jobs” or who “may be looking for a higher loan than is standard for the value of the house, etc.”
- Presented the following “background data” on characteristics of the subprime industry:

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- “There are around 5 million outstanding subprime loans, with roughly 1.5 million +/- being made last year.
 - The subprime industry is highly competitive, with thousands of banks, thrifts, finance companies, mortgage bankers and other institutions offering loans to customers who do not qualify for "prime" grade loans. Many of the top subprime lenders are now major banking institutions or their subsidiaries.
 - Mortgage brokers, who typically are independent small businessmen and businesswomen, originate over 50% of the subprime loans. Brokers typically are compensated for their services in helping consumers obtain their loans by receiving a fee from the borrower and/or from the lender.
 - The vast majority of subprime mortgages are not for home purchases, but are either refinances of an existing loan or are a second lien on a home.
 - When most consumers obtain subprime mortgages, they draw upon the equity in their homes to obtain cash to meet a variety of consumer credit needs. Industry data suggests that only about 25% of the loan proceeds are used for home improvement. The overwhelming majority of the equity that is taken out is used for debt consolidation (e.g., paying off higher interest credit cards), educational or medical expenses, buying a car, or other general personal credit needs.
 - Borrowers in the subprime mortgage market typically are not senior citizens, but are younger or middle-aged. About 50% are between 35-49 years old; 25% are between 50-65 years old; and only 10% are over 65 years old.
 - Subprime loans are more expensive than prime loans because they involve higher levels of risk. Servicing costs, which typically run 30%-50% or higher than servicing prime loans, also cause subprime rates to be somewhat higher. Nevertheless, most subprime lenders charge very reasonable and fair rates.
 - SMR Research, which is one of the industry’s leading independent research and data analysis firms, reports that subprime note rates now only average about 2.5% higher than prime note rates.
 - Most subprime customers pay their bills and do not default. Over 90% stay current in making their monthly mortgage payments.
 - Subprime foreclosure rates are only about 2%, considerably less than FHA/VA foreclosures, and compare favorably with those for prime mortgages, which run around 1%. (Contrary to the allegations of some critics, subprime lenders rarely make money on foreclosures. In fact, just the opposite is true. Studies have shown that the lender loses a significant amount of money in over 90% of their foreclosures.)”
- “Mr. Chairman, some parties have created the false impression that subprime lenders generally target their lending in a discriminatory manner and lend primarily to African-Americans and other potentially vulnerable minorities. This is simply not the case, and the data proves it. NHEMA strongly disputes this mischaracterization. Because some critics have been claiming that HMDA data shows subprime lenders are targeting minorities, NHEMA recently asked SMR Research to do an independent analysis of what is shown by the 1998 HMDA data.”
 - “We believe that this 1998 HMDA data clearly shows that the subprime mortgage industry is not disproportionately targeting African-Americans or other minorities. For example, according to the U.S. Census Bureau, African-Americans in 1998 composed about 13% of our population. The

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HMDA data breakdown shows subprime loans were made as follows: 17.5% to African-Americans; 71.2% to Whites; 7.8% to Hispanics; and 3.5% to other racial/ethnic groups. Subprime lending basically reflected our nation's racial/ethnic breakdown."

- "The HMDA data also confirms what anyone in our industry would also tell you: subprime lenders make significantly more loans to lower and moderate income Americans than do prime lenders. This is hardly surprising because many less economically fortunate people do in fact have impairments on their credit records and cannot qualify for "prime" credit rates. The 1998 HMDA data shows subprime borrowers as having annual incomes approximately as follows: about 30% made less than \$30,000; 30% made between \$30,000 and \$50,000; another 30% were between \$50,000 and \$100,000; and only 10% made over \$100,000. The average median income of borrowers according to the 1998 HMDA data was approximately \$70,000 for prime customers as compared to \$55,000 for subprime borrowers. (Also, according to the U.S. Census Bureau, racial/ethnic groups' 1998 per capital incomes were – Whites = \$21,394; African-Americans = \$12,957; and Hispanics = \$11,434.)"
- "Another interesting point that was shown in the SMR's HMDA data analysis is that subprime lenders have relatively high denial rates."
- As a whole, subprime customers "pay on time, and foreclosures average only about 2% as compared to 1% in the prime market."
- "Congress and regulatory officials have a difficult task and should be very careful in addressing the abuses because there is a great danger that new restrictions would limit practices that are generally helpful and desirable for most consumers."
- Certain practices that the subprime industry engages in are deemed "predatory by critics. However many of these practices are not necessarily abusive and are beneficial to the consumer. These include: prepayment penalties, balloon payments, arbitration and charging high interest rates than the prime market.
- Ms. Borrelli defended prepayment penalties, for example, as follows:
 - "Many subprime loans contain terms that impose a prepayment fee or penalty if the borrower pays off the loan before the end of the agreed upon loan period. Some critics are strongly attacking prepayment fees as predatory and unfair, and some legislators have proposed prohibiting such fees. Are prepayment fees abusive? Most of the time, absolutely not. Prepayment fee clauses actually provide a benefit to most consumers because they allow the borrower to get a significantly lower rate on the loan than they would get without the clause. Prepayment provisions are very important in keeping rates lower and helping make more credit available in the subprime market. The reason that prepayment fees exist is that lenders incur significant costs (frequently several thousand dollars) when they make a loan, and they generally do not recover those costs until the loan has been on their books for several years. If a loan is prepaid quickly, the lenders cannot recover these up-front costs unless they address this issue in the terms of the loan. Instead of charging a higher interest rate or higher initial fees, many lenders feel it is fairer and better for the borrower to provide an early-payment fee to protect against losing these up-front costs. On the other hand, it is certainly possible to have an abusive prepayment clause that imposes too much of a penalty and/or applies for too long a time. The point here is most of the time the consumer benefits and the provision is not abusive.

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Sometimes, however, this otherwise wholly legitimate provision can be applied in an abusive manner. Again, the challenge for all of us is to find ways to prevent the abusive applications of such provisions without denying the consumer the benefit of the provision which applies in most cases.”

- “Although NHEMA does not believe that abusive or predatory practices are pervasive in the subprime mortgage sector, and we know that many alleged problems are not necessarily real abuses, we do feel that there are certainly some legitimate areas of concern. For example, “loan flipping,” which involves repeated refinancing of a mortgage in a relatively brief period of time with little or no real economic benefit to the borrower, does occur to some degree, and it should be stopped. Likewise, some borrowers are victims of home improvement lending scams. Others are required to pay excessive loan origination fees to mortgage brokers. Industry, regulators and legislators must work together to find effective ways to stop such abuses. In doing so, however, we must be very careful not to over-react and adopt inappropriate restrictions that raise the cost of subprime mortgage credit, or curtail credit availability to those who need it.”
- “Quite frankly, we are confident that there is no simple “silver bullet” remedy here. Our association has been working actively to help address these problems for several years, and NHEMA believes that a multi-pronged approach must be taken to deal with these questions.”
- Most predatory lending practices “involve fraud and deception that are clearly illegal.”
- “First, and foremost, we feel that these laws, and related regulations, need to be enforced more vigorously. Most abuses could be handled quite effectively by better enforcement.”
- “NHEMA urges this Committee and the Congress generally to support making whatever additional appropriations are reasonably necessary to help these agencies enforce the current laws and regulations more effectively. In addition, we encourage the agencies to request additional funds if they need them.”
- “In particular, we also recommend that the Federal Reserve Board review whether it should utilize its existing authority under HOEPA to issue regulations to help define and control improper practices.”
- Current state laws are “important to remember” as a means to stop predatory lending abuses.
- Consumer education is also a key. NHEMA has taken steps towards better education through development of consumer brochures, etc.
- “NHEMA also supports the concept of urging mortgage borrowers, especially those who are only likely to qualify for the highest cost loans, to consider going to an independent, professional credit counselor to help ensure they understand their proposed loan contract before they enter into the loan.”
- “Voluntary actions” are another important means for stopping abuse. NHEMA has adopted a Code of Ethics, Home Improvement Lending Guidelines, Credit Reporting Guidelines and Fair Lending and Best Practices Guidelines.
- Mentioned NHEMA’s participation in the “Mortgage Reform Working Group.” In this group no final consensus was reached because of the complexity of the issues. One clear point agreed to is that current laws are too complex for “borrowers and lenders.”
- “State and federal legislators who have introduced legislative proposals are undoubtedly all acting sincerely and in good faith to address what they think are problems. Yet, we believe that these various legislative proposals generally miss the mark. Most are drafted in such a way that they would cause credit availability to be greatly reduced and/or the rates to be increased for many

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borrowers. For example, one of the main Congressional bills would severely limit the financing of loan fees and closing costs. The practical effect, however unintended, of this would be discriminatory and would prevent hundreds of thousands of needy Americans, who lack the up-front funds to pay these costs, from obtaining the loan they need. Most also fail to address the fundamental fact that consumer confusion is at the heart of much of the problem, and it is largely the current RESPA/TILA requirements that produce much of this confusion.”

- “Licensing is a key matter of regulatory concern, and better licensing laws would be a significant help in controlling unscrupulous operators.”
- “Mr. Chairman, these are difficult and complex issues that clearly need further study and analysis. . . . NHEMA believes that this Committee and your Senate counterpart need to give careful consideration to these issues and to review the immense amount of work and thinking that has already been done. . . . One of the central goals of any reform package that may be eventually considered should be to provide for much greater consistency and uniformity in mortgage lending laws, including those addressing abusive practices. . . . Ultimately, we hope that agreement can be reached on a broad package of reforms that will include simplification and streamlining of current disclosure requirements, preemption of conflicting state laws and, in any areas where it can be shown to be truly necessary, that provide carefully targeted legislative reforms to help stop abuses without restricting credit availability. ‘Loan flipping’ and home improvement lending scams are two areas where such targeted proposals might be appropriate. . . . Given the very limited remaining time in this Congress, and the great complexity of these issues, we do not believe that it would be prudent for Congress to try to legislate this year.”
- “We believe that this Committee and other interested parties should pursue greater enforcement of current laws, enhanced consumer education and industry self-policing now and should continue studying the mortgage reform issues and seek to address this matter in a comprehensive way in the next Congress.”

Neill Fendly, President Elect, National Association of Mortgage Brokers

- Credited mortgage brokers as a “principal” factor in the national increase in homeownership and the “decline in mortgage interest rates and closing costs.” Specifically, Mr. Fendly stated, “Mortgage brokers have brought consumers more choices in loan programs and products than they can obtain from a branch office of even the largest national retail lender.”
- Stated “mortgage brokers originate more than sixty percent of all residential mortgages in America.”
- Explained efforts by NAMB to work on reform. Listed work on the “Negotiated Rulemaking convened by HUD in 1995,” with the “Mortgage Reform Working Group in 1997 and 98,” with a HUD “initiative that yielded Policy Statement 1999-1 on mortgage broker compensation” and currently with HUD/Treasury “joint task force.”
- NAMB believes “the abusers generally are non-mainstream companies and individuals that ignore the laws that apply to them. They routinely ignore state licensing and consumer protection laws, and they routinely flout the federal Home Ownership and Equity Protection Act (HOEPA), all of which apply to them. We therefore believe that the best solution is twofold: increased enforcement of existing laws and industry self-regulation.”
- “Our chief concern is that any new legislative remedy be finely tuned to address specific problems as narrowly as possible. Further law in this area, such as overly expansive restrictions on certain types

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of loan terms and burdensome disclosure and other affirmative obligations, can have unintended consequences. These include reducing competition in the marketplace by driving participants and investors away and elimination of consumer access to mortgage financing, both because of reduced capital in the market and through reduction in available loan feature and product options. We caution this Committee and Congress against acting too hastily with additional legislation, without considering the twin alternatives of increased enforcement and self-regulation we propose.”

- “Most, though perhaps not all, abusive practices occur in the subprime market. At the same time, however, only a tiny percentage of the subprime loans made are abusive. The great majority of subprime lending in the nation today results in benefits to consumers at reasonable, appropriately risk-based prices.”
- “[A]mbiguity exists for many loan terms or conditions associated with subprime loans that frequently are decried as abusive, including negative amortization, prepayment penalties, financing of closing costs, and even arbitration clauses. In certain circumstances each of these may be abusive, but in the majority of cases they provide the consumer with a feature that especially fits his or her unique circumstances, offers a reduced interest rate, or both. . . .For this reason, few loan terms are always abusive. Rather, whether they are abusive is a question that turns on context and circumstances, from case to case.”
- “[W]e do not favor extensive new legislation to expand the body of law governing our industry, including the danger of overly broad restrictions that may prevent a few abuses but also would prevent many beneficial transactions for consumers. Instead, we support enhanced enforcement of existing law and the further development of industry self-regulation efforts.”
- **“Nevertheless, if there is to be legislation despite our views, we support certain targeted restrictions on certain types of loan terms. For instance, we would support elimination of HOEPA’s current pattern or practice requirement for actions alleging the making of a loan without regard to repayment ability. We also would support new restrictions on charging of closing costs on HOEPA-to-HOEPA refinancings, within a certain initial period after the origination of the first HOEPA loan, unless the new loan has a substantially reduced rate. We would support a flat prohibition of selling single-premium credit life insurance policies, which is not addressed at all under current HOEPA. And we would support prohibiting entirely prepaid installments on HOEPA loans, instead of the current limit of two. Each of these steps would be an example of what we urge in addressing loan terms that sometimes may be abusive but usually are not: narrowly targeted restrictions that address specific terms or behaviors under well defined circumstances. Each of these examples may be found in the provisions of Congressman Ney’s bill, H.R. 4213, and for that reason we support it.”** [Emphasis added]
- “...These consumers understand what they are getting and choose the products they do, with the loan terms and features that they have, because they have examined the options and, often, received the advice of knowledgeable loan originators.”
- “Although the incidence of abuse is small relative to the whole industry, we believe that any abuse committed against mortgage consumers, however rare, is too much. We therefore support efforts to address the bad acts of our unfair competitors, even though we see no evidence that their numbers are growing or that their abuse is expanding.”
- Explained that abuses are committed by all “types of entities” and that “not all abusers are mortgage brokers.”

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- “Another misconception we would dispel is the belief that those committing the abuses operate outside existing regulatory frameworks. To the extent this is true, it is not because they are not subject to existing laws. Rather, they choose to ignore laws that properly apply to them. There is a small minority of institutions that do not obtain state licensure as required. They ignore state consumer protection laws. They do not observe the existing restrictions in the federal HOEPA.”
- “When we urge increased enforcement, however, we do not intend to suggest that those making a good faith effort to comply with all the rules deserve still greater regulatory scrutiny than they already are bearing. We as an industry already are regulated very thoroughly. Rather, we mean increased enforcement against those that choose consciously to evade existing laws. . . .”
- NAMB also “strongly” believes “in the power of industry self-regulation.” Mentioned NAMB efforts to promote its “Best Business Practices (BBP) initiative since 1997, when we worked together with the Mortgage Bankers Association of America (MBA) to develop the Model Loan Origination Agreement.”
- NAMB will seek to promote “Phase Two” of BBP. Accordingly, Mr. Fendly stated, “Phase Two envisions a universal registry of individual loan originators and companies, each uniquely identified by a permanent registration number.”
- “[W]e do not believe that new laws are the best answer. Rather, we urge increased enforcement of existing laws, and industry self-regulation along the lines of NAMB’s BBP initiative. For those that already work hard to comply with existing laws at the state and federal level, additional legislation will represent increased regulatory burden. For those that do not, however, it will represent only new restrictions and requirements to be ignored, along with what is already in place. . . .Existing laws, at the state and federal levels, already provide enough protection against abuse by unfair loan originators. What they do not provide is automatic enforcement. It still remains up to those charged with enforcement to ensure that abusive operators are brought to justice under existing laws.”
- “The civil action arena, however, also has spawned its own form of abuse: A cottage industry has arisen, consisting of plaintiffs’ lawyers that seek only to churn out lucrative class actions against our industry, enriching themselves with little or no benefit to consumers. These lawyers prey on bona fide brokers, lenders, and servicers, taking advantage of the complexity and compliance burden of existing consumer protection laws.”
- With respect to the “impact” of the secondary market on predatory lending, Fendly stated: “[M]ost abuses appear to take place in the subprime market, even though most of the subprime market is legitimate and beneficial to consumers with impaired credit records. **It is the prime mortgage market that has the best established secondary market, where government sponsored enterprises provide liquidity, stability, and pricing discipline. There seems to be, therefore, a strong correlation between the absence of these factors and the overwhelming prevalence of consumer abuse in the subprime market.**” [Emphasis added.]
- “Certain state restrictions on balloon payment and prepayment penalty provisions are preempted by the AMTPA. The purpose of the Parity Act, however, was to eliminate overly broad state restrictions on certain ‘alternative mortgage’ products that are beneficial to consumers. When applied correctly, balloon payments and prepayment penalties benefit consumers through wider and more flexible loan product availability and lower interest rates. We therefore hope the OTS will exercise caution in its proposed revisiting of the implementing regulations under the Parity Act. . . .Because not all balloon payment and prepayment penalty provisions are abusive *per se*, we believe it is simplistic to say that all state laws that restrict such provisions necessarily “address predatory lending practices.” Such

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state laws should be preempted, for the reasons that underlay the Parity Act in the first place. That is, many such state laws do not address abuse so much as they restrict the efficient operation of the legitimate mortgage credit market. This was the considered judgment of Congress in 1982, and we believe it remains correct today.”

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