



**Summarized Testimony Of  
The Coalition For Fair And Affordable Lending (“CFAL”)  
And  
New Century Financial Corporation  
On  
“Subprime Lending: Defining the Market and Its Customers”  
To The  
Subcommittee on Housing and Community Opportunity  
And  
Subcommittee on Financial Institutions and Consumer Credit  
March 30, 2004**

**Introduction**

The Coalition for Fair and Affordable Lending<sup>1</sup> (“CFAL”) and New Century Financial Corporation, the nation’s second-largest non-prime lender, appreciate the opportunity to testify. I am Terry Theologides, Executive Vice President of Corporate Affairs for New Century, one of CFAL’s founding members.

We believe that in today’s nationwide housing finance market uniform federal statutory standards for non-prime<sup>2</sup> lending should be enacted to apply equally to all types of mortgage lenders. These standards must provide strong protections to all Americans while preserving access to affordable non-prime mortgage credit. New Century and other CFAL members look forward to continuing to work with you to help craft legislation that can be passed with very broad bipartisan support. We commend Chairmen Ney and Bachus for holding today’s hearing to further Members’ understanding of the non-prime market and the Americans who rely on it.

**The Non-Prime Mortgage Market**

**Non-Prime Market Size** - Non-prime mortgage lending originations grew to roughly \$325 billion in 2003, representing 10.5% of all mortgage originations.<sup>3</sup> Securitization of non-prime mortgages has been responsible for much of our industry’s dramatic growth. In 2003, non-prime securitizations accounted for about \$215 billion, representing 66% of the originations done in the non-prime market last year.

**Expanded Credit Opportunities, Especially for Minorities** - The non-prime mortgage market’s expansion since the early 1990’s has significantly increased access to affordable credit for millions of Americans who historically have been unable to qualify for credit under so-called “prime” mortgage underwriting standards. The credit provided

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<sup>1</sup> The Coalition for Fair and Affordable Lending (CFAL), launched in January 2003, was formed to advocate uniform federal legislative standards for non-prime mortgage lending. CFAL’s members make around one-third of all non-prime mortgage loans.

<sup>2</sup> This market segment is also sometimes called “sub-prime,” “non-conforming,” or “specialty” lending.

<sup>3</sup> SMR Research, “Subprime Mortgage Loans, 2004” (“SMR”)

by the non-prime lending industry is especially important for many minorities. For example, the African-American and Hispanic populations differ overall in a number of important economic characteristics relative to the White population. As a group, their respective median incomes are lower, wealth is lower, unemployment rates are higher and credit scores lower. This unfortunate economic disparity has been clearly documented in data by the Census Bureau, the Federal Reserve, the Labor Department and a variety of other reports.<sup>4</sup> What this means is that African-Americans and Hispanics therefore are less likely to meet the more stringent economic risk evaluation criteria in the conforming or “prime” market that operates largely through Fannie Mae and Freddie Mac. However, with the emergence of a significant non-prime market, many of these higher risk minority borrowers, as well as similarly situated higher risk White borrowers, now are able to qualify for affordable mortgage credit at only moderately higher costs where heretofore most would have been unable to obtain it.

**Borrower Profiles** – Non-prime borrowers are typically middle-class, in their 40s and 50s and their racial and ethnic mix is representative of the U.S. population as a whole. Non-prime borrowers had an average annual income in 2002 of \$71,509.<sup>5</sup> Often, charges have been made that most non-prime borrowers are elderly or minorities with low incomes. However, this is not the case. For example, an analysis<sup>6</sup> of 2002 HMDA data and 2000 Census data shows that the racial / ethnic breakdown of non-prime borrowers was as shown below:

	White	African American	Hispanic	Asian
<b>Population %</b>	68.2%	11.9%	13.7%	3.7%
<b>Non-Prime Mortgage %</b>	62.5%	13.2%	14.6%	3.9%

**Repayment Ability** - Some people have a misperception that non-prime lenders typically engage in “asset-based lending”. That is, they will lend to anyone who has equity in their home irrespective of their repayment ability just so they can make money by then foreclosing on the loan. This is patently false. In fact, lenders like New Century do a strict credit evaluation and apply a debt-to-income or residual income test to every loan to ensure the potential borrower can repay the loan without having to rely on the equity in his or her home. Companies make money by making loans to people who repay those loans, not by foreclosing and profiting from a borrower’s remaining home equity. Foreclosures are a lender’s worst nightmare, and lenders do everything possible to avoid

<sup>4</sup> CFAL will be soon releasing a report prepared by a major national consulting firm that explains these issues in detail and that highlights some of the basic economic data outlined in a number of these reports.

<sup>5</sup> SMR

<sup>6</sup> SMR Research Corporation, “Predatory Lending” A New Study of Unfair Lending Accusations” (2004). It also is worth noting that after analyzing subprime lending in census tracts, SMR concluded: “Rather than ‘targeting’ the elderly, these data seem to prove the reverse. It would appear subprime lenders focus attention on census tracts where the elderly do not get many loans, and make a lesser share of loans where the elderly borrowers are most plentiful.”

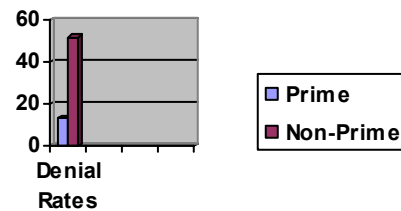
them because they almost always lose money on foreclosures. New Century, for example, loses an average of around \$40,000 per loan when it is forced to foreclose.

Our delinquency and foreclosure rates on our securitized pools of loans, like those of other leading companies, are quite respectable, and delinquent borrowers usually bring their payments current and foreclosures are avoided.<sup>7</sup>

- ✓ Our average foreclosure rate is around 5% - nowhere near the rates claimed by some consumer advocates. Delinquencies and foreclosures track by the credit standing of the borrower.
- ✓ When a foreclosure occurs, we find that it usually is due to an unexpected and adverse change (e.g., job loss) in the borrower’s personal circumstances. We try whenever possible to help borrowers weather such personal crises, but this is not always possible.

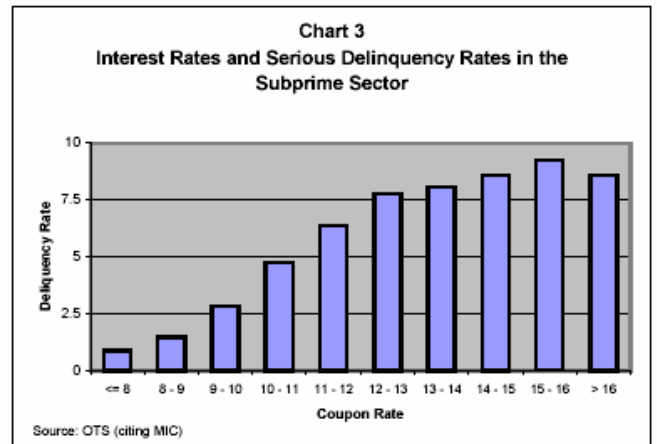
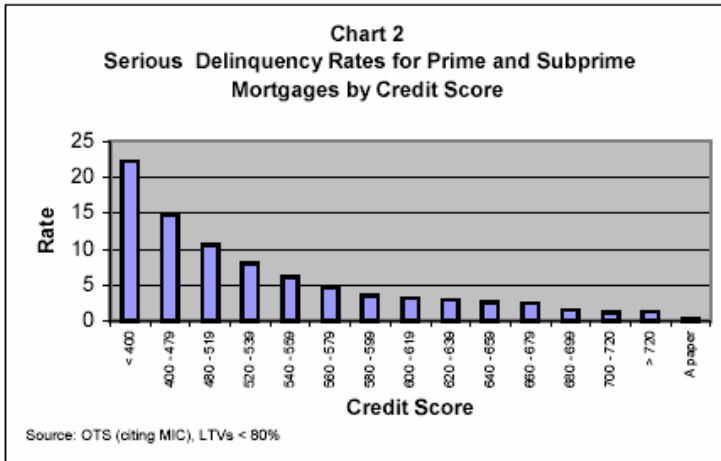
The fact that non-prime lenders do not readily lend to anyone based mainly on their home equity is also indicated by examining average approval versus denial rates. In 2002, HMDA data shows a 52% loan denial rate for non-prime loans in contrast to 13% for prime lenders.<sup>8</sup>

**Non-Prime Rates and Risk-Based Pricing** - The spread in interest rates between prime and non-prime mortgages has narrowed, and now is around 2%. Lenders seek to price based according to risk, and it is well documented that the industry generally now does a relatively good job matching pricing to risk. A helpful illustration of this can be seen in Charts 2 and 3, reproduced from the OCC’s 2003 report on non-prime lending. These charts show how credit scores and interest rates track and indicate risk.



<sup>7</sup> While responsible lenders like New Century are not engaging in lending practices that result in inappropriately high foreclosure rates, it should be pointed out that we understand that in some areas of the country there have been a number of cases of so-called “property flipping” where borrowers have been grossly overcharged for homes due to fraud by unethical appraisers, brokers, lenders and others. Congress should consider whether additional statutory protections are needed to address such property flipping and fraud that often results in borrowers losing their homes in foreclosures.

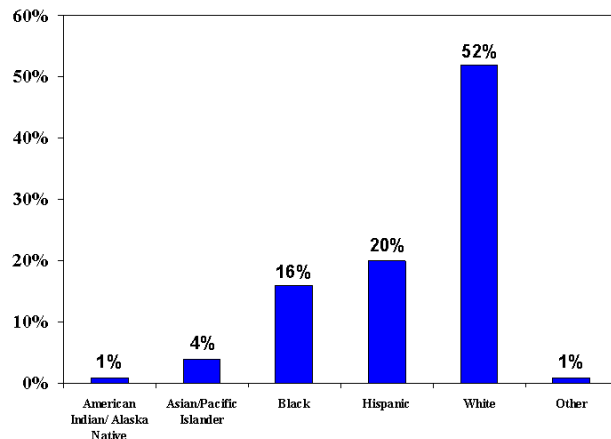
<sup>8</sup> SMR



**Additional New Century Information**

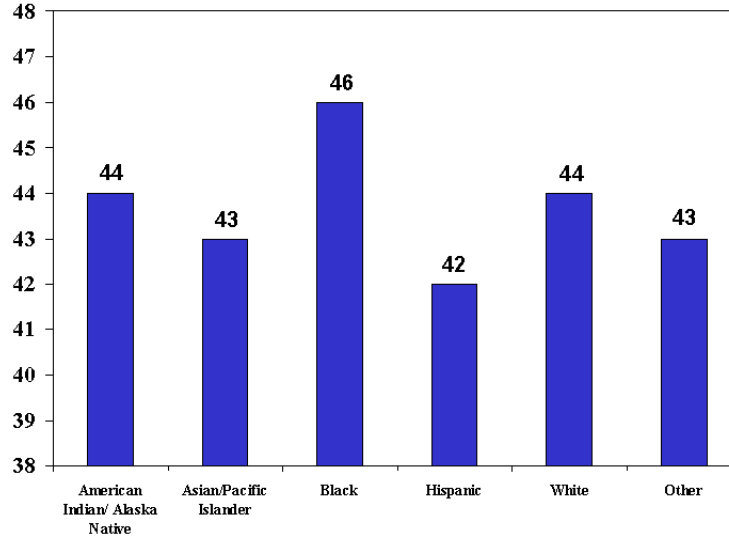
To better explain risk-based pricing and rates, as well as non-prime borrower characteristics, I will now provide summary data from my own company’s records. In many ways New Century is representative not just of the CFAL membership, but of other major non-prime lenders

**Borrowers’ Racial & Ethnic Characteristics** - Like other major non-prime lenders, New Century’s borrowers typically are not poor, nor are they primarily minority or elderly. Instead, they are middle-class, non-minority and in their 40s and 50s. The following charts show New Century 2003 data for funded loans by race or ethnic group, and demonstrate the diversity, age and income of our borrowers. As you can see, substantially more loans were made to Whites than to any other racial group, but our loans roughly track our nation’s racial and ethnic mix as shown in Census data.<sup>9</sup>



<sup>9</sup> Source: HMDA data. 6% of applicants did not provide racial information.

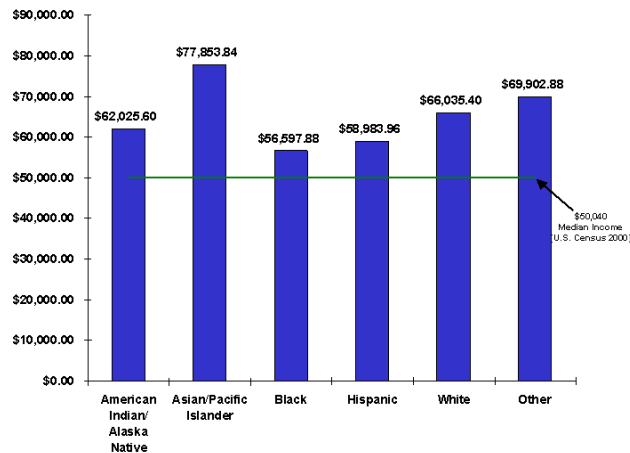
**Borrowers' Ages** - The following chart and table cover 2002 and 2003 data and depict the average age of New Century borrowers in each racial group that received funded loans during that period.



Age Range	Company all	American Indian/ AK Native	Asian/ Pacific Islander	Black	Hispanic	White	Other	Information not provided
20-30	12.54%	12.18%	15.96%	8.98%	15.40%	12.33%	13.48%	12.08%
31-40	31.64%	30.21%	30.12%	28.18%	36.09%	31.23%	29.96%	31.39%
41-50	31.07%	32.44%	28.99%	31.57%	29.69%	31.42%	33.91%	32.11%
51-60	17.55%	16.51%	18.66%	19.90%	14.02%	18.11%	16.18%	17.58%
61-70+	7.20%	8.67%	6.27%	11.37%	4.87%	6.92%	6.47%	6.82%

As can be seen, from the preceding data, our borrowers' average age was well below 65, indicating that New Century is not targeting the older population in any racial group. Less than 7.5% of all of our borrowers are over the age of 60.

**Borrowers' Incomes** – Like those of other leading non-prime lenders, our borrowers typically are middle class with relatively good incomes. The following chart shows New Century 2003 data for funded loans by family income:



**Borrower Characteristics** - As shown by the above information, the average New Century non-prime borrower is as racially diverse as the general population, has an annual family income that is approximately \$72,000 per year, and is under 50 years of age. Other statistics that define “who is New Century’s borrower” in 2003 include:

- ✓ 93.3% lived in the home that they pledged as security for their loans;
- ✓ 6.7% were non-owner occupied;
- ✓ 26.75% of the loans were for purchase of the home;
- ✓ 73.25% were refinances;
- ✓ Average first mortgage loan size was \$170,857;
- ✓ Average second mortgage loan size was \$46,165;
- ✓ Average FICO score was 606;
- ✓ Average Loan to Value ratio was 76.11%; and
- ✓ Average Debt to Income Ratio was 39.25%.

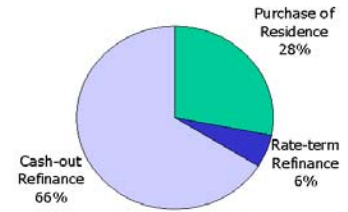
**Current Production Data** - To help you further understand today’s non-prime mortgage lending industry, the following table summarizes other loan characteristics using our February 2004 loan production:

NEW CENTURY’S FEBRUARY 2004 LOAN PRODUCTION			
Loans Originated		Average Loan Size	
Number of loans	15,249	First Mortgage	\$179,000
Dollar Value of Loans	\$2.54 billion	Second Mortgage	\$49,000
Product Types		Averages for First Mortgages	
Fixed Rate	28.0%		
2-Yr. Adjustable*	60.4%		
3-Yr. Adjustable**	2.4%	Debt-to-Income Ratio	40.28
Interest only programs and other niche programs	9.6%	Loan to Value Ratio	78.88%
		FICO score	617

\*fixed for 2 years then adjustable for the remaining 28

\*\*fixed for 3 years then adjustable for the remaining 27

**Loan Purpose** - Borrowers in the non-prime market, just as those in the prime market, have a variety of reasons that serve as the catalyst for seeking a mortgage loan to purchase a home or to refinance. This chart shows the stated loan purposes for our February 2004 loan production. Recent increases in home ownership are in significant part due to the fact that the non-prime mortgage lenders have made credit available to many first time homebuyers. As shown in the chart, 28% of our loans last month were for home purchase.



Fully two-thirds of our business in February involved our customers tapping into the equity in their homes to meet other financial needs. In that regard, we believe that it is important that all borrowers be in a position to make informed financial choices. Therefore, New Century and other major lenders are strong supporters of consumer financial education and counseling programs.<sup>10</sup>

**Prime vs. Non-Prime Underwriting Criteria** - To help illustrate why our borrowers end up with a non-prime loan instead of a prime loan, we took some of our key underwriting guidelines and juxtaposed them to the Fannie Mae Guidelines.<sup>11</sup> We then ran our entire population of 2003 loans – 164,414 in all, through these screening criteria. We found that a full 96.5% of our customers had credit, documentation or loan characteristics that would have precluded them from qualifying for a conforming mortgage based on the published Fannie Mae guidelines. Of the 3.5% that could potentially have qualified for a conforming mortgage, the average interest rate was about 7.14%, the average APR about 7.63%, a majority (58.61%) were White. Only 9.1% of this 3.5%, were African-Americans who might possibly qualify for a prime loan. Thus, it is seriously misleading to contend that 30% to 50% of our borrowers last year (or any year) could have potentially ended up with a conforming or “prime” mortgage.

By looking at credit-scores alone you can see that only a small percentage on non-prime borrowers might qualify. For example, 81% of New Century’s 2003 loans had credit scores below 660, the level below which the major federal banking regulatory agencies consider a borrower to be non-prime. 88% of our African American borrowers, 87% of our Hispanic borrowers, and 81% of our White borrowers were below the 660 score level as illustrated in the following chart:

<sup>10</sup> New Century’s current educational and counseling initiatives, which are expanding, are highlighted in my written testimony.

<sup>11</sup> See my written testimony for additional details.

2003 New Century Originations by FICO Score									
Fico Score Range	ALL	Am Indian/ AK Native	Asian/ Pacific Islander	Black	Hispanic	White	Other	Info not provided	
	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent
<500	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.01%
500-539	17.16%	18.74%	8.77%	23.42%	13.99%	17.03%	15.04%	17.79%	
540-579	20.08%	22.95%	13.19%	24.39%	17.61%	20.28%	17.68%	19.79%	
580-619	21.70%	23.19%	20.48%	22.22%	21.26%	21.83%	21.99%	21.31%	
620-659	21.72%	19.44%	26.52%	17.96%	23.86%	21.75%	23.73%	21.14%	
660-699	11.64%	10.42%	17.71%	7.97%	13.89%	11.42%	13.66%	11.63%	
700+	7.69%	5.27%	13.33%	4.04%	9.39%	7.69%	7.91%	8.33%	
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

Similar results have been noted for the broader non-prime industry. In that regard, let me quote from the earlier referenced OCC study:

*“As discussed earlier, risk plays a dominant role in determining whether or not a borrower ends up in the subprime market. Table 8, which was assembled by OTS, shows the percent of subprime mortgages in the MIC database within specific credit score categories. These data generally support the case that less creditworthy borrowers receive the great majority of subprime mortgage loans, as 81% of subprime loans have credit scores below 660. As discussed earlier, all of the major regulatory agencies use 660 as the cutoff point to denote borrowers that are at high risk of default. In addition, many prime lenders generally regard 680 as the point at which a borrower comes into consideration for a prime loan. Over 88% of the MIC subprime mortgages are associated with credit scores below 680. At the same time, 11.8% of borrowers with credit scores above 680 received subprime mortgage loans.”*

**Table 8**

**Percentage Distribution of Subprime Mortgages by Credit Score**

<u>Credit Score</u>	<u>Percent</u>
Under 400	0.02%
400 to 479	1.1
480-519	6.2
520-539	7.5
540-559	9.9
560-579	11.2
580-599	11.8
600-619	12.1
620-639	11.5
640-659	9.7
660-679	7.2
680-699	4.8
700-719	3.2
Over 720	3.8

Source: OTS (citing MIC); Percent figures based on \$ volumes.

**Risk-Based Pricing** - Our pricing is based on risk. Applicants are categorized into 6 separate risk grades based on a variety of factors including the following: credit score; mortgage or rental payment history; history of paying consumer obligations;

income documentation; loan-to-value ratio; debt-to-income ratio; and history of bankruptcy, if any.

- Our six risk grades are designated as AA, A+, A-, B, C and C-. Almost three-quarters of our production falls in our AA and A+ grades.
- As our underwriting guidelines<sup>12</sup> show, borrowers in our AA credit grade are typically those who have credit quality that is quite close to qualifying for a prime loan. However, they typically have debt ratios, loan-to-value ratios or income documentation limitations that would preclude them from qualifying in the prime market. In contrast, borrowers in our C and C- credit grades, representing only about 4% of our production, have impaired credit through some combination of late mortgage payments, late consumer debt payments, recent bankruptcies or other credit blemishes.

Once an applicant is categorized into a risk grade, his or her interest rate depends on a variety of additional factors including: loan program; loan size; credit score band; loan-to-value ratio; income documentation; property type (non-owner occupied; condominium; single family home; etc.); points paid; whether or not there is a prepayment penalty; and the state in which the property is located.

The assignment of risk grades to our applicants is done through an automated computer program and is not subject to employee discretion. It is also blind with respect to race and age. The following table shows how this system assigned risk grades last year.

2003 New Century Originations by Risk Grade									
Risk Grade	Company All	Am Indian/ AK Native	Asian/ Pacific Islander	Black	Hispanic	White	Other	Info not provided	
	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent
AA	60.82%	57.03%	71.17%	55.89%	64.60%	60.24%	64.29%	59.25%	
A+	19.02%	21.08%	16.05%	19.93%	18.34%	19.19%	18.99%	19.19%	
A-	9.86%	10.54%	6.59%	11.79%	8.68%	10.03%	7.37%	9.76%	
B	6.62%	7.38%	4.25%	8.11%	5.22%	6.82%	5.99%	7.15%	
C	3.05%	3.51%	1.57%	3.65%	2.70%	3.07%	2.82%	3.42%	
C-	0.64%	0.47%	0.39%	0.64%	0.46%	0.66%	0.54%	1.23%	
<b>Total</b>	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	

You can see from this table that 87.6% of African American borrowers, 91.6% of our Hispanic borrowers and 89.5% of our White borrowers have risk grades of “A-” or better.

<sup>12</sup> Attached as Appendix “D” to my written record testimony, for example, is a table summarizing our underwriting guidelines as of March 17, 2004 for our California loans. Such state tables are available to our brokers in all states and anyone else at our website [www.newcentury.com](http://www.newcentury.com).

Only 3.7% of our borrowers (4.3% African American; 3.2% Hispanic; 3.7% White) are in our highest risk grades of “C” or lower.

The table attached as Appendix “A” summarizes how various factors can affect the interest rate of borrowers within a particular credit grade. Our rate sheet and pricing then correspond to both the risk grades and loan characteristics. As to fees, on average the borrower will pay less than 3.5% in origination points and fees, including yield spread premiums but excluding prepayment penalties. Below is a table showing high-level data regarding our February 2004 loans:

Risk Grade	Weighted Avg Interest Rate	Weighted Avg APR	Weighted Avg Points & Fees*	Weighted Avg FICO Score
AA	6.83	7.26	2.47	633
A+	7.06	7.51	2.83	592
A-	7.28	7.74	3.14	575
B	7.80	8.26	3.40	561
C	8.13	8.64	3.32	551
C-	9.58	10.03	3.67	547

\*Includes both New Century and broker points and fees paid by the borrower, but excludes third-party pass-through fees such as appraisal, title insurance and public official fees.

**Prepayment Penalties** - There is no doubt that prepayment penalties can be abusive and harmful to borrowers, especially when they are unduly long, unusually large, poorly disclosed or simply forced on an unwitting borrower. That said, however, proper prepayment penalties can be very beneficial to borrowers. The value and opportunity in prepayment penalties stem from the fact that borrowers can obtain a substantially lower rate if they accept a loan with such a penalty. Like most of the leading non-prime lenders, the longest prepayment penalty we offer is 3 years. The secondary mortgage market will pay significantly more for a loan that is less likely to prepay within the first 2 or 3 years after origination. This enables lenders to offer a lower rate if a loan has a prepayment penalty as part of its terms. For example, on our March 17, 2003 rate sheet, a borrower in our AA credit grade applying for a 30-year fixed rate \$180,000 loan with us with a 595 FICO score and an 85% loan-to-value ratio would get a 6.50% rate. If that borrower were comfortable that he or she was not planning to move or refinance in the next 3 years,<sup>13</sup> he or she could lower their rate by a full 1.00%, to 5.50% with the addition of a prepayment penalty. In practical terms, that would amount to lowering the monthly payment by \$115.70, from \$1,137.72 to \$1,022.70. In the first 3 years the borrower

<sup>13</sup> Although borrowers do not enter into loan transactions thinking they will pay a prepayment penalty, inevitably some do for reasons including the following: (1) an unexpected job relocation; (2) a declining rate environment in which the borrower may conclude that it is economically in his or her best interest to refinance into a lower rate and pay the prepayment penalty than it is to wait until it lapses and risk a change in the interest rate environment---for example, a declining rate environment, combined with improvement in the borrower’s credit profile so that the borrower would qualify in a higher non-prime grade or even a prime grade, may tilt the scale in favor of refinancing even with the additional cost of a prepayment penalty; or (3) a need to refinance to tap into additional equity in the home to meet unanticipated financial needs.

would save \$4,165.20 in interest.<sup>14</sup> But, what would happen if the borrower were to need to refinance within the 3-year penalty period? In the above example, the borrower would have to pay a prepayment penalty of \$3,949.09.<sup>15</sup> The true cost of the prepayment penalty is in fact less since the borrower received a \$115.70 payment reduction for each month of the mortgage until he refinanced. Thus, for example, if the borrower prepaid after 2 years, the actual cost to the borrower after factoring in the interest savings is only \$1172.29.

This illustrates how, in the hands of a well-informed borrower, a prepayment penalty can be a very powerful payment reduction tool. The primary reason so many of our borrowers elect to take the loan with the prepayment penalty is that one of their main considerations is cash flow. They want to be able to keep their monthly payment as low as possible.<sup>16</sup>

Another very important consideration in accepting a prepayment penalty is the fact that this enables many borrowers to qualify for the loan. For many borrowers, lowering the rate by agreeing to a prepayment penalty and obtaining a significantly lower monthly payment enables them to qualify for a loan because it helps them to meet our debt-to-income ratio guidelines.<sup>17</sup>

Despite my confidence that New Century and other responsible lenders are handling prepayment penalties properly<sup>18</sup>, we recognize that not all lenders or brokers do so. Therefore, we have called for additional federal legislative protections to ensure that borrowers are always given the choice of a loan with or without such a penalty and that the length and amount of the penalty be limited.

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<sup>14</sup> After 5 years the borrower would have saved \$6,942.00. If the borrower were to hold the loan for 30 years, the total savings would be \$41,652.

<sup>15</sup> In California, as in most states, the formula we use for a prepayment penalty is 6-months' interest on 80% of the original balance.

<sup>16</sup> A typical borrower has two principal means of reducing his or her monthly payment. One is to pay more points up front to "buy down" the interest rate. This is in effect an upfront prepayment penalty. The borrower must either bring additional cash to the table or borrow additional sums to finance the additional up-front points. The alternative, and often more attractive choice, is to agree to accept a prepayment penalty. If a borrower believes he or she is likely to remain in the home and not refinance for 2 or 3 years, then for no cost the borrower can reduce his or her payment significantly by agreeing to a limited prepayment penalty.

<sup>17</sup> We include a color brochure with our initial borrower disclosure package that contains an explanation of how prepayment penalties work, and our sales associates are trained to explain how the prepayment penalties work. We do not bury the prepayment clause in the middle of the promissory note. Rather, we have a separate, prominently labeled form that covers the prepayment penalty. We have the borrower review and sign that form separately.

<sup>18</sup> While we are always searching for ways to improve how we explain and disclose these potentially confusing concepts, on the whole we think we are doing a good job. Last year we originated over 128,000 loans with prepayment penalties. Our central complaint log shows that we currently have only 29 complaints related to prepayment penalty issues. Now, in my view, even one legitimate complaint is one too many, and you can be sure that we follow through on each one of those complaints to understand the potential causes. However, with such a low complaint rate I am comfortable concluding that there is nothing inherently or systemically wrong with the way we offer prepayment penalties.

**Making Loans That Benefit Borrowers** - We subject each loan to a reasonable benefit test prior to closing. If no reasonable benefit can be achieved, then the loan will be declined. In addition, there are situations where after the loan is closed, a borrower may complain, an investor may raise a question, or we may discover by our own audit of the file as part of a quality assurance review that some aspect of the loan needs to be revisited. In these situations, we will pro-actively rewrite the loan to correct the problem or refund points and fees as appropriate.

Although New Century and other responsible lenders now apply borrower benefit tests before we make our loans, and document our determination, we do have a real concern over the fact that statutory or regulatory benefit tests vary and are in some cases quite unclear, making compliance uncertain. Such tests include wording such as “identifiable” benefit, “tangible net” benefit, or “borrower’s interest” with little or no definition or limitation in most cases. CFAL believes that a uniform national benefit test should be enacted when Congress amends HOEPA, but we feel that it should be clearly defined and contain reasonable qualifications (such as requiring that any violation be “knowing or intentional”) and that safe harbor examples be provided in the statute and implementing regulations.

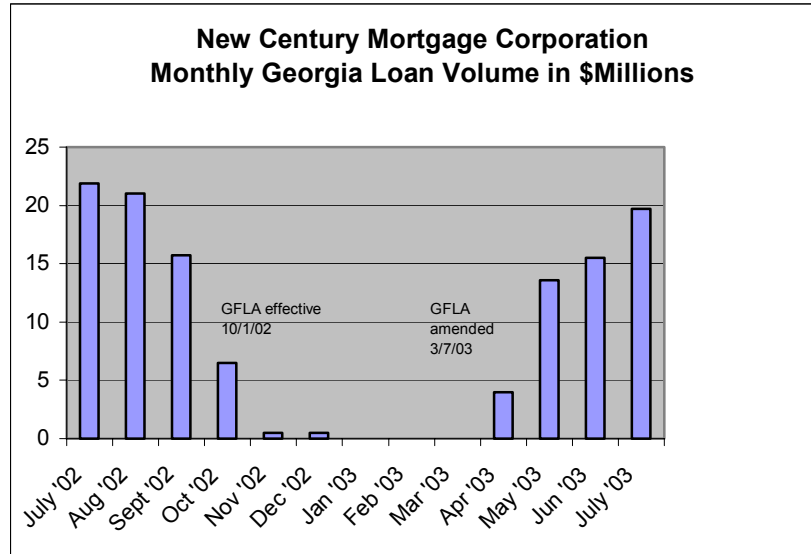
## CONCLUSION

As our testimony has documented, New Century and other major reputable lenders like its CFAL partners are meeting the mortgage credit needs of millions of Americans whose risk profiles prevent them from qualifying under the stricter underwriting standards of the “prime” mortgage market. We are carefully evaluating risks and seeking to make loans only to those who can repay them. We always try to ensure that the borrower receives a reasonable benefit from the loan, which we price as fairly as we can based on our evaluation of each applicant’s risk profile. Only a very small percentage of our borrowers actually might qualify for “prime” rates. We never intentionally engage in or condone improper practices, but when we make mistakes, we seek to correct them and make the borrower whole. Borrowers are not intentionally “targeted” on the basis of race, age or other improper discriminatory factors. The vast majority of all our borrowers receive loans that are only modestly more expensive than “prime” loan costs, and this is due in substantial part to the flow of reasonably priced capital from the secondary market.

At the same time, we recognize that there are some bad lenders and brokers who take unfair advantage of borrowers. We accordingly support strengthening current federal law, as well as enhancing enforcement and consumer financial education opportunities. We also understand that the many state and local legislators who have stepped in to try to fill the gaps in the federal HOEPA law have been well intended. However, the irrational patchwork of state and local “anti-predatory lending” laws that is developing is not workable.

**Uniform National Non-Prime Lending Standards Are Needed** - None of these laws is the same, and requirements vary greatly. Provisions are often arbitrary, unclear and totally impractical for lenders to implement.<sup>19</sup> Well intended, but poorly crafted state and local requirements are having unintended negative consequences for borrowers.

Our earlier experience in Georgia is a good illustration of the problems lenders and borrowers experience due to well-intended but poorly drafted state or local laws. The Georgia Fair Lending Act (“GFLA”) was enacted in 2002 in order to stop predatory lending practices without affecting the availability of credit.



However, the act was so overbroad and contained such ambiguous provisions that mortgage credit was severely impacted. This chart shows the impact on New Century’s loan business in Georgia from shortly before the GFLA went into effect until shortly after the law was amended to correct its major deficiencies. We believe New Century’s experience to be representative of the industry as a whole.

Although our Georgia business has rebounded, the sad fact is that there are still many higher risk Georgians who we cannot lend to because of the law even as it has been amended. Restrictions that still exist under Georgia law with regard to points, fees, prepayment penalties and other issues mean that many borrowers that can no longer qualify for a loan.

I also want to note that currently my company and most others are significantly limiting the types of mortgage products we offer in New Jersey due to that state’s overly restrictive law.

<sup>19</sup> All current and prospective homeowners, regardless of being prime or non-prime borrowers, should be given the opportunity to receive the best possible rate a lender offers based on their financial histories. As various states and cities enact predatory lending legislation, the legislation is impacting the rate and terms that borrowers receive. For example, the State of California has legislation that sets a standard for rates, points and fees throughout the state. Yet, the City of Oakland and the City of Los Angeles have proposed ordinances that will be more restrictive in terms of the interest rates, points and fees that can be charged in those municipalities. Thus, a resident of the City of Los Angeles may be denied access to credit under its proposed legislation but that same borrower who lives in a suburb outside of the Los Angeles city limits may be able to qualify for a loan because they will fall under the less restrictive state legislation. It seems inherently unfair that borrowers should have to deal with these inconsistencies and it makes it extremely difficult for lenders to operate in that patchwork of inconsistent laws and regulations.

Today, nonprime lending is clearly a nationwide, interstate business that is highly dependent on the national capital markets in order to make affordable mortgages available to the millions of Americans who cannot qualify for conventional financing.<sup>20</sup> We need consistent, nationwide requirements to be able to do so effectively and efficiently. Most states also still have no effective borrower safeguards in place. Borrowers need protections not only from abusive lending practices, but also from differing, poorly crafted state and local laws that limit their access to affordable credit and force them to pay more.

New Century and CFAL therefore strongly support prompt Congressional action to provide clear, effective and workable uniform national fair lending standards for nonprime mortgage loans. These standards should provide equal protections for all Americans and apply to all mortgage originators, regardless of how they may be structured or chartered. We also believe that state officials should have an active role along with federal authorities in enforcing these national standards.

Thank you for this opportunity to appear before your Subcommittees. New Century and its CFAL partners look forward to continuing to work with your Members, consumer and community groups, and all other interested parties to help craft a fair, effective and workable legislative measure that sets such national standards and that can be passed with broad bipartisan support.

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<sup>20</sup> Since the advent of the secondary mortgage market, borrowers have been able to take advantage of longer terms and lower rates that are made possible by the free flow of capital. No longer are borrowers in Oklahoma dependent on local financiers. No longer is the condition of the local economy a detriment to securing funding. Today, national and international funds from Wall Street are used to make the dream of homeownership a reality for millions of American families.

## Appendix “A”

<b>FACTOR</b>	<b>Effect on Interest Rate</b>
<b>Loan Program</b>	Our rate sheet displays the rate for our most common product, the 2-28 Adjustable Rate Mortgage. This product is fixed for 2 years and then adjusts every 6 months thereafter. As is typical, our rate for a 30-year fixed-rate loan is higher than for our adjustable product. Our rate for a 30-year fixed-rate loan is 1.00% higher than that for the 2-28 ARM. Our lowest rate for a 2-28 ARM is 4.50% while our lowest rate for a 30-year fixed-rate loan is 5.50%.
<b>Credit Score</b>	Even within our credit grades, we stratify pricing by FICO score. Therefore, for a borrower in our AA credit grade with a high credit score, the rate could be as low as 4.50%. A borrower with the lowest eligible credit score within our AA credit grade could receive a rate no higher than 6.85%.
<b>Income Documentation</b>	Our AA borrowers are eligible for rates as low as 4.50% if they are able and willing to provide full documentation of their income. Borrowers who apply under our Limited Documentation program pay rates that are 0.25% higher. Borrowers who apply under our Stated Documentation program, which has the most flexible requirements regarding income documentation, pay about 0.90% above the Full Documentation rates.
<b>Loan Size</b>	Because so many of the origination costs are fixed regardless of the size of the loan, we are able to adjust the rate depending on the loan size. Borrowers who apply for loans of between \$250,000 and \$500,000 are eligible for a rate typically 0.25% lower than the rate for a corresponding loan of \$100,000 to \$249,999. Likewise, we charge an extra 0.25% for loans under \$100,000.
<b>Loan-to-Value Ratio</b>	All things being equal, a loan with a higher loan-to-value ratio presents a higher risk to a lender if the borrower were to default. Therefore, we offer our best rates within a credit grade to applicants with Loan-to-Value Ratios of 65% or less. Our rate sheet typically provides a rate increase of 0.15% to 0.35% as a borrower moves from a 65% LTV loan to one with an 80% LTV.
<b>Property Type</b>	Our rate sheet provides for rate increases of 0.25% to 0.75% if a property is non-owner occupied, if it is a condominium, if it is a rural property or if it is a 3-4 unit property.
<b>Prepayment Penalty</b>	If a borrower agrees to a prepayment penalty on his or her loan, our rate sheet provides for a rate reduction of up to 1.00%, depending on the loan program and the duration of the prepayment penalty, which can be no longer than 3 years. In some states where prepayment penalties are not permitted, we cannot offer the benefit of such a rate reduction option to our borrowers.
<b>Points</b>	In our retail originations, if a borrower wishes to pay lower points than a particular loan program would typically require, the borrower may be eligible to do so in exchange for a slightly higher interest rate. Likewise, through our wholesale channel we offer our brokers the opportunity to provide the same tradeoff choice to their applicants. If a wholesale applicant either cannot afford to or prefers not to pay the up-front compensation that the broker would typically require for a particular loan program, the broker can offer a higher rate to the borrower and receive a so-called yield spread premium from us.
<b>State</b>	Our rates vary depending on the state in which the property is located. In some states, such as Georgia and New Jersey, state laws constrain our ability to offer loans with prepayment penalties or for us or our brokers to collect as much in points and fees as we would typically collect in another state. In order to make certain that we stay within acceptable risk parameters, we are forced to make fewer loans in those states and, to the extent we are able to make a loan, more of our pricing is driven into the interest rate. All things being equal, our rates in Georgia and New Jersey are 0.50% to 1.15% higher in our AA risk grade than our Southern California rates. We believe that the state laws in Georgia and New Jersey contribute significantly to this pricing differential.

## Appendix “B”

### “Best Practices”

Like other major non-prime lenders, we have a strong commitment to fair and ethical lending. Therefore, not only do we seek to comply fully with applicable laws and regulations, but we also frequently go beyond what the law requires with additional voluntary “best practices.” Here are some of New Century’s best practices that we adhere to in originating mortgage loans:

- We will not underwrite or purchase “high cost” loans as defined by the federal Home Ownership and Equity Protection Act (HOEPA”), or any loans defined as “high cost” under State or local law.<sup>21</sup>
- We do not purchase or offer loans with balloon payments, negative amortization or mandatory arbitration clauses, reverse mortgages, or with loan terms that trigger interest rate increases by borrower default.
- We do not make or purchase loans containing single premium credit insurance or debt cancellation products.
- We offer loans with and without prepayment penalty options.
- We do not originate loans that pay off zero interest rate mortgages provided by charities or government without 3<sup>rd</sup> party counseling for the borrower.
- We only approve loan applications where we have verified the borrower’s ability to repay the loan.
- In evaluating applications, we confirm that our loan represents a reasonable benefit to the borrower.
- We do not solicit our loan portfolio within twelve months of loan origination.

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<sup>21</sup> New Century Mortgage does not originate “high cost” loans due to the reputation risk and legal risk associated with initiating high cost loans. We, like most other companies, do not wish to have our reputation tarnished by being associated with loans that are perceived as being “high cost,” which in turn has for many become synonymous with “predatory”. Additionally, the legal risk of originating high cost loans is enormous.

Under the federal HOEPA, penalties for even an unintentional violation include having the loan rescinded at any time during its first three years and being required to refund all fees and payments made by the borrower. Moreover, under this law, assignees and secondary market purchasers would likewise be liable for this unintentional violation of which they neither knew nor could have known. State and local laws, such as the original version of the Georgia Fair Lending Act and ordinances enacted in Oakland, California and elsewhere, contain even more draconian penalties.

The laws that have been enacted contain requirements for making so-called “high cost” loans are generally unclear and contain overly broad requirements. They lack any meaningful right to cure unintentional errors, provide severe penalties for violation of the law, and in many cases mandate unlimited assignee liability. For these reasons, most non-prime lenders have stopped making “high cost” loans and the secondary market for purchasing or securitizing them has virtually evaporated.