Testimony of the

National Community Reinvestment Coalition
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Ending Mortgage Abuse: Safeguarding Homebuyers

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Introduction and Executive Summary

Chairman Schumer and Ranking Member Crapo, it is an honor to be here today as the voice for over 600 community organizations from across the country that comprises the National Community Reinvestment Coalition (NCRC). NCRC is the nation's economic justice trade association dedicated to increasing access to credit and capital for minority and working class families. NCRC and our member organizations have been at the forefront in the war against predatory lending. I testify this morning on behalf of NCRC and John Taylor, President and CEO of NCRC.

NCRC has advocated before Congress and the regulatory agencies over two decades for stronger CRA, fair lending, and anti-predatory lending laws. NCRC enforces the nation's fair lending laws as a private attorney general through complaints and lawsuits combating discrimination and redlining. NCRC has filed and settled precedent-setting cases against lenders and brokers in cases involving steering and refusal to lend to rowhomes, Indian reservations, and to other protected classes. We also operate nationally renowned programs including the Consumer Rescue Fund, a foreclosure prevention program, and the Center for Responsible Appraisals and Valuations, which features an alternative dispute mechanism for allegations of fraudulent appraisals.

We are on the precipice of a mortgage tsunami of foreclosures unless immediate intervention occurs. The industry has flooded the market with exotic mortgage lending such payment-only Adjustable Rate Mortgages (ARMs), and "hybrid" 2/28 and 3/27

ARMs. These exotic subprime mortgages overwhelm borrowers when interest rates shoot up after an introductory time period. According to the FDIC's testimony at a previous Senate hearing, interest rates are due to rise for borrowers of one million subprime loans in 2007 and another 800,000 next year.[1] As a result of the abusive lending, the nation is experiencing record foreclosure rates and more than 14% in outstanding subprime loans were delinquent by the end of 2006.[2]

Market failure is rampant and all stakeholders, industry and government alike, are collectively responsible for this failure. The lending industry has created a system in which no one is accountable when the tsunami hits borrowers. Brokers and lenders quickly sell loans into the secondary market. The secondary market has precisely diversified risk to the point where no one investor loses significant amounts, even when foreclosures spike. Too many servicers, appraisers, and foreclosure legal specialists have also figured out how to profit from abuses in the dangerous game of mortgage monopoly.

The federal government holds ultimate responsibility for allowing the mortgage market to spin out of control. The government's traditional role in a market economy is to establish rules that ensure fairness and basic protections for consumers. In the case of the lending industry, the government needs to establish requirements for financial institutions to deal fairly with consumers or face stiff financial penalties for failing to do so. Currently,

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

financial institutions escape with minimal financial penalty for abusive lending practices which inflict massive financial pain and ruin for families and communities.

In this testimony, NCRC will describe in detail how unscrupulous brokers, appraisers, and financial institutions profit at the expense of families and communities. We will explain how S.1299, the Borrowers' Protection Act of 2007, will effectively address the systematic abuses committed by financial institutions at various stages in the lending process.

In addition to the provisions in S. 1299, NCRC's testimony will describe the need for additional protections such as requirements imposed upon servicers to engage in good faith dealings with borrowers. Recently, we have become focused on the issues of law firms that act as foreclosure mills, profiting from consumer hardship and rushing consumers to homelessness, even as we try to negotiate forbearance agreements for consumers who can afford to stay in their homes. This greed in the legal system as attorneys represent investors or servicers is one of the reasons that we support stronger servicing protections.

Brokers – The Point of Entry to the American Dream or Financial Ruin

Mortgage brokers are the point of entry for most families seeking to buy a home or refinance a mortgage. Brokers facilitate up to 70% of loans made in this country, and many honest brokers serve an important role in the marketplace. Unscrupulous and abusive brokers, however, set up borrowers for failure the moment they submit

applications and sign loan documents. Unfortunately, NCRC has documented through a nationwide testing project that too many brokers engage in steering and discriminatory practices.

From 2004 to 2006, NCRC conducted mystery shopping of mortgage brokers, both large and small. Posing as loan seekers, both White testers (the control group or Comparison group) and Black or Hispanic testers (the protected group) met with and called local brokers to inquire about their loan options. NCRC's fair lending testing of mortgage brokers recently uncovered a 46% rate of disparate treatment based on race and national origin.

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

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

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

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

Our results documented the following disturbing patterns:

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

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

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

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

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

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

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

Pricing Disparities Cannot Be Explained Away

NCRC's civil rights enforcement suggests that steering and discrimination are not isolated events but widespread throughout the industry. Data analysis of a national database, the Home Mortgage Disclosure Act (HMDA) indicates that predatory lending is a national epidemic.

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

In 2003, NCRC released a path-breaking study, entitled the *Broken Credit System*, documenting price discrimination on a national level.[3] We found that after controlling for creditworthiness and housing characteristics, the amount of subprime refinance loans increased as the number of minorities and elderly increased in neighborhoods in ten large

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

metropolitan areas. In addition to the NCRC report, two studies conducted by Federal Reserve economists found that subprime lending increases in minority neighborhoods after controlling for creditworthiness and housing market conditions.[4] The Center for Responsible Lending also recently used HMDA data with pricing information to reach the same troubling conclusions that racial disparities remain after controlling for creditworthiness.[5]

NCRC has conducted several studies documenting the persistence and stubbornness of pricing disparities. For example, our *Homeownership and Wealth Impeded* report uncovers troubling evidence that racial disparities increase when income levels increase.[6] For example, subprime loans made up a high 41.9 percent of all refinance loans to low- and moderate-income (LMI) African-Americans. In contrast, subprime loans were 19.2 percent of refinance loans to LMI whites in 2004. LMI African-Americans were 2.2 times more likely than LMI whites to receive subprime loans. Even for middle- and upper-income (MUI) African-Americans, subprime loans made up a large percentage (30.2 percent) of all refinance loans. Moreover, the subprime share of loans to MUI African-Americans was 2.7 times larger than the subprime share of loans to MUI whites. The same pattern of disparities increasing with income occurred when the report

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

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

[6] To access NCRC's report, *Homeownership and Wealth Building Impeded*, please go to http://www.ncrc.org/policy/analysis/policy/2006/2006-04-20_NCRC-OA-PRRACReport.pdf

examined lending to females compared to males or in immigrant neighborhoods compared to predominantly white neighborhoods.

Federal Reserve economists have found that the incidence of high-cost lending is less when banks issue loans through their branches than when banks originate loans through brokers. The Federal Reserve studies do not conclude that brokers are steering minority borrowers to high-cost loans, but the studies mention steering as a possibility. NCRC's mystery shopping suggests that steering is indeed a real possibility. Also, since more than one study has found that high-cost lending is higher for minorities after controlling for creditworthiness, the evidence to-date suggests that the burden lies on skeptics who dismiss the likelihood of steering. NCRC believes that anti-steering provision of S. 1299 is absolutely necessary to combat the steering committed by abusive brokers and lenders.

Appraisal Fraud

Predatory loans include several features such as steering that increase costs beyond the point at which borrowers can afford their loans. Another factor that drives up loan costs is appraisal fraud. Appraisal fraud is commonplace in the housing market and is the result of collusion among abusive lenders and appraisers.

Originator sanctioned appraisal inflation is the dirty little secret of the lending industry. We welcome this hearing and commend you Chairman Schumer, for looking into a

problem that nobody likes to talk about but, in many ways, has triggered the subprime time bomb.

Why is it that brokers are allowed to self select valuation professionals?

Why is it that is lenders are forced to rely on AVM's – which are highly inaccurate themselves – due to widespread mortgage fraud in the marketplace?

Why is it that, despite the protections of FIRREA and the requirements of USPAP, appraisal companies are beginning to sanction the "unlocking" of appraisal reports performed by valuation professionals and changing their content – a clear violation of the law?

Their response, when licensed appraisers began to question the legality and impact of this activity – is to threaten or hit the whistle blowers with slap suits. Just ask Pamela Crowley, a Florida appraiser and a signatory member of NCRC's Center for Responsible Appraisal & valuations who created www.mortgagefraudwatchlist.com to expose lender pressure and valuation fraud, She is being wrongfully sued by an appraisal management company for having the integrity to expose this issue. Senator Schumer, your focus on valuation issues is right on point.

When the bottom falls out, borrowers are left in upside down mortgages where they owe more than the home is worth. Many subprime and prime borrowers are finding themselves in just this situation. We must work to stop lenders, mortgage brokers, real estate agents and title companies from pressuring appraisers to inflate home prices.

NCRC has issued a number of white papers on appraisal pressure, broker discrimination, and lending disparities, including the 2005 paper, entitled *Predatory Appraisals: Stealing the American Dream*, which shed sunshine upon a number of appraisal tactics that regulators – including NYS Attorney General Andrew Cuomo - are now investigating. NCRC concluded that appraisal inflation and the breakdown of the appraisal system posed a serious impediment to responsible lending, while placing the safety and soundness of the mortgage marketplace at risk.

NCRC's CRF program is intervening in a significant number of cases where borrowers have been victimized by appraisal fraud. A sample of CRF loans revealed that about one fifth of the homes were overvalued by more than 50% of their true value, and two thirds of the homes were overvalued by 15-50% more than their true value.[7] Inflating appraisals leave borrowers with unaffordable loans that they are unable to refinance because the loan amounts are higher than the true value of their homes, especially as the housing market cools in the next few years. The results are too often theft of homeowner wealth, equity stripping, and/or foreclosure.

NCRC's CRF program and other research reveal that in order to get an inflated valuation, lenders and brokers use a number of tactics. Some apply pressure by withholding their payment, threatening to not do business with the appraiser, or even blacklisting him or her altogether unless the appraiser meets the lender's requested value. They may demand

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

that appraisers guarantee a predetermined value, ignore deficiencies in the property or simply increase the appraisal if the lender is unsatisfied with it. Lenders also "shop around" (also known as "value shopping") by contracting several appraisers to evaluate one property and then use the highest valuation they find.

Industry surveys suggest that intimidating appraisers is widespread. In 2003, a study conducted by October Research Corporation reported that appraisers were feeling pressure by lenders to mark up property values. Of the 500 appraisers surveyed nationwide, an alarming figure of 55% said they felt pressure to overstate values of the properties they appraised. In addition, 99% of the appraisers interviewed believed that their peers give in to lender demands at some point. A more recent October Research report that was released in 2006 found that the incidence of pressuring appraisers increased to 90%.

The CRF cases and other research of widespread abuses lead NCRC and industry partners to establish a Center for Responsible Appraisals and Valuations.[8] Lenders, appraisers, and other industry partners agree to an ethical code and also agree to submit disputes regarding fraudulent appraisals for arbitration. The alternative dispute resolution of the Center promises to expeditiously settle cases of appraisal fraud and to promote industry-wide changes in practices when a critical mass of industry stakeholders participate in the Center.

[8] See http://www.responsibleappraisal.org/.

While NCRC hopes our Center can influence industry practice, we believe that appraiser abuse is widespread enough that it threatens to destabilize entire communities through inflated appraisals as well as victimizing untold numbers of individuals consumers. Appraiser abuse, as a significant contributor to the looming foreclosure crisis, must be reined in by rigorous protections established by S. 1299.

NCRC's Consumer Rescue Fund

Broker and appraisal fraud are just two of the multiple abuses encountered by NCRC's Consumer Rescue Fund (CRF). Unfortunately, we can testify in the strongest terms today that S. 1299 is urgently needed to eliminate the series of abuses experienced by victims of predatory lending assisted by the CRF.

Through the national CRF program, NCRC works with victims of predatory lending so their mortgage payment becomes more affordable and foreclosure can be avoided. We believe that the work of CRF demonstrates the enormous value of Senator Schumer's proposal to fund foreclosure prevention counseling at $300 million annually. As the Senator suggests funding counseling is extremely cost effective, with counseling costing about $1,000 while a single foreclosure costs families, financial institutions, public agencies and other stakeholders about $80,000.

NCRC's member groups and their communities are an integral part of the CRF program. The CRF identifies consumers who are in predatory mortgages and fixes the mortgages

through mediation with lenders or arranging for refinance loans.[9] Consumers contact NCRC member organizations participating in the CRF program. In a number of instances, the NCRC members in the CRF program are counseling agencies assisting consumers experiencing delinquency and default on their loans. NCRC and our members have found that families in desperate circumstances are most likely to view nonprofit community-based organizations as trusted advisors. While distressed families will hesitate to approach their lender or servicer, they have an intuitive sense that nonprofit organizations exist to lend them a helping hand.

NCRC's CRF program offers mediation services or arranges refinance loans through lending institutions participating in the program. When NCRC mediates with lenders, the lenders will often make the loans more affordable by reducing the interest rate, the margin, and sometimes forgives part of the loan. Refinancing is often employed to deal with an abusive term and condition. For example, an abusive term such as a prepayment penalty that matches or exceeds the reset time period is often dealt with through a refinance.

The CRF program will mediate loans made in any state. Refinancing services are currently available in the following 17 states: Alabama, Arizona, California, Florida,

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

Georgia, Illinois, Indiana, Maryland, Massachusetts, Nevada, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, Texas, and Wisconsin.

CRF's Success: At Least $500 million in Equity Saved

The CRF program has saved borrowers and their communities millions of dollars. In a sample of 112 cases, the median principal amount of the loans was approximately $157,000. The mortgage rates of the previous predatory loans ranged between 5.5% and 17%. The median prior mortgage rate was 9.38%.

Analysis of loan terms before and after refinance

	Principal Amount	Prior Mortgage Rate	New Mortgage Rate	% points difference	Old Monthly Payment	New Monthly Payment	$ Savings
Average	$156,986.2	9.58%	5.74%	3.84%	$1,198.4	$922.0	$276.5
Median	$161,280.4	9.38%	6.00%	3.38%	$1,165.8	$941.7	$224.1

The interest rates of the refinance loans were considerably lower than the rates of the previous predatory loans. The new loans had interest rates ranging between 1% and 8%. The median rate of the new refinance loans rate was 6.00%. The difference between the median rate of the previous loans (9.38%) and the new loan (6%) was 3.38 percentage points, which results in substantial amount of equity saved over the life of a loan.

CRF customers have been able to save millions of dollars of wealth by refinancing out of abusive loans. The average monthly payment was $1,198 for the abusive loans. For the new refinance loans, the average monthly payment was only $922. As a result of the refinancing, the average monthly savings was $276.50, which equates to $3,318 annually. Assuming a 30 year loan term, the total savings on an average loan would be $100,000. Given that the CRF program has assisted at least 5,000 victims through either refinancing or loan modifications, the program has saved borrowers approximately $500 million in equity.

CRF Finds that Minority and Working Class Americans Targeted with Loans Containing Multiple Abuses

A NCRC review of CRF cases indicate that abusive lenders are targeting minority and low- and moderate-income borrowers and communities with high cost and exotic mortgages.[10] About 77% of the borrowers in the CRF sample were African-American. Almost half (47%) resided in low- and moderate-income neighborhoods and 83.6% of the borrowers had incomes below $45,000. The findings that CRF customers were mostly minority and low- and moderate-income is consistent with NCRC's research and other studies documenting that a disproportionate amount of high cost lending is directed towards minority and working class communities. Traditionally underserved

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

communities suffer from less product choice and consequently are more susceptible to abusive high cost and exotic mortgage lending.

The CRF cases also reveal that predatory loans do not usually contain just one or two abusive terms and conditions. More often, a toxic loan in the CRF program contains several abusive features including ARM loans with lax underwriting considering only the initial rates, exaggerated borrower incomes, payments that borrowers cannot afford, exorbitant fees and yield spread premiums, piggyback lending adding excessive debt, and abusive servicing.

The 27 specific abuses revealed by the CRF program include the following:

Abuses	**Description**
asset-based lending	Lenders evaluate a loan application by looking only at the quality of the security or equity, and not at the ability of the borrower to repay the loan
forced placed insurance	Servicer assigns hazard insurance to borrower, coverage is usually much more expensive
HOEPA loan	A loan with a very high interest rate and/or fees that is covered by federal consumer protections. Predators violate the legal protections of HOEPA loans.
Mandatory arbitration	Stipulation that a borrower cannot sue a lender in a court of law, but must use an arbiter
prepaid credit insurance	Insurance financed into the loan that would cover mortgage payments in a case of disability, unemployment, death. Much more expensive than paying monthly outside of loan
abuse of right to cancel	Abusive practices that make it hard for a consumer to cancel a mortgage (ie. abusing right of rescission)
abusive collection practices	Aggressive tactics of collecting late payments
default interest rate	Increasing interest rate in case of delinquency
excessive prepayment penalty	Excessive fee for paying off a mortgage before its maturity

insincere co-signers	Adding insincere co-signers to the application in order to inflate the income of the borrowers. Abusive lenders will add children and other insincere co-signers who cannot contribute to loan payments.
loans made in excess of 100% LTV	When the loan amount exceeds the fair market value of the home
negative amortization	Loan product that requires a monthly payment that does not fully amortize a mortgage loan, thereby increasing the loan's principal balance
flipping	Persuading a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced
fraud	Example: Forging signatures on loan documents
lack of TNB	Lack of tangible net benefits that justify the origination of a new, higher-balance and high-cost loan
targeting/discrimination	Cases when lenders specifically market predatory loans to customers based on race, ethnicity, or age
predatory appraisal	Overestimating the market value of the house
balloon payment	A mortgage that has level monthly payments over a stated term but which provides for a large lump-sum payment to be due at the end of an previously specified term
equity stripping	A case when a homeowner's equity is reduced due to repeatedly refinancing, high fees, and other abuses
home improvement scam	Home improvement costs financed into the mortgage usually paid by a lender to a home improvement contractor directly.
misrepresentation	Misrepresentation of loan terms to a borrower
falsified application	Falsifying loan applications (particularly income level or adding insincere co-signers, etc.)
Stated income	Not requiring full documentation of income from tax forms and paystubs. Reduced documentation or stated income loans increase the chances of fraud.
yield spread premium	Fee paid by lenders to brokers for loans carrying interest rates above a par rate
abusive servicing practices	Servicers not recording payments, force placing insurance, applying high late fees, etc.
unfair terms	High interest rates and loan terms not justifiable by risk (consumer's credit score)
fee packing	Charging undisclosed, improper, and high fees

The sum total of the abuses equals loans that are considerably beyond borrower repayment ability. A sample of 69 CRF cases included calculations of the monthly housing payment-to-income ratio (front-end ratio) and the monthly total debt-to-income ratio (back-end ratio). The front-end and back-end ratios of the predatory loans in the

CRF sample were considerably higher than common limits in standard underwriting guidelines. The median front-end ratio was 35.4%. The median back-end ratio was about 50% as shown in the graph below. Standard front-end and back-end ratios for prime loans are 28% and 36%, respectively. The considerably higher ratios of the predatory loans in the CRF sample suggest that the loans were beyond the consumers' abilities to repay, leading to financial distress and/or bankruptcy and foreclosure.

CRF Cases **Unaffordable Loans**

Debt-to-income Ratios

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

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

The case studies in the appendix illustrate the multiple abuses on the CRF loans, and how predatory lenders and brokers take advantage of hard-working Americans who are striving mightily to achieve or preserve their American Dream of homeownership. The

case studies reveal that aggressive "push-marketing" by predators result in consumers receiving loans that are unaffordable and unsuitable, when tragically an appropriate product would have worked fine.

Recommendations

NCRC believes that the Borrower's Protection Act of 2007 is an excellent start in eradicating several of the core elements of predatory lending. We call on Senate Banking Committee to mark-up the bill quickly and we call on the U.S. Congress to pass S. 1299. Distressingly, the abuses associated with predatory lending include a number of abusive practices beyond those addressed in S. 1299. NCRC therefore urges Congress to pass a comprehensive anti-predatory lending bill, building on the foundation of S. 1299 and the strongest state laws.

Opponents and skeptics of anti-predatory laws will assert that more laws and regulations will reduce access to credit for working class and minority borrowers. But when market failure is rampant, government must step in to fix the broken marketplace. In economic jargon, the actors in a broken market do not internalize the negative externalities of their actions. In other words, the actors in the lending marketplace do not face financial penalties commensurate to the harms of predatory lending. The rapid adoption of dangerous exotic and subprime ARM loans as mainstream products indicates that the market has too few self-correcting mechanisms to curb dangerous products and practices. Strong law and regulation that effectively stop abusive practices do not reduce

responsible lending. Instead well-crafted law puts the abusive lenders out of business, benefiting responsible lenders and families alike.

The following elements of S. 1299 are essential:

Fiduciary Duty of Brokers – One essential problem in today's market is that brokers quickly release themselves of any responsibility for abusive loans after their sales and processing of borrowers' applications. Imposing a fiduciary duty on brokers will provide a powerful financial incentive to refrain from deceptive and exploitative practices.

Fair Dealing – A straightforward and powerful method for significantly reducing deceptive practices is to impose an obligation on brokers and lenders to act with reasonable diligence and to engage consumers in good faith and fair dealing. This is also an elastic concept that can effectively curb future abuses not contemplated by anti-predatory bills. While bills can and should curb specific abuses in today's marketplace, a bill cannot anticipate all deceptive practices in the future. A fair dealing requirement will deter the market from constantly changing abusive practices to escape the reach of specific statutory provisions.

Assessment of Ability to Repay – S. 1299 is absolutely correct to require underwriting based on payments for principal, interest, taxes and insurance. All too often, predatory lenders do not underwrite loans considering all of these payments. In addition, lenders

should underwrite based on the maximum possible payment during the first seven years of the loan. Abusive lenders will underwrite at the initial low rate on ARM loans, setting up borrowers for payment shock and financial distress when the loan's interest rate adjusts upwards. Finally, low- and no-documentation loans are dangerous as indicated by NCRC's CRF program and the Comptroller of the Currency in a recent speech. NCRC's supports S. 1299 requirements to use widely accepted income verification documents including pay stubs and bank statements.

Escrow Requirement for High-Cost Mortgages – NCRC documents that most of the high-cost loans in the CRF program lack escrows. Borrowers in high-cost loans often experience financial stress because they did not anticipate tax and insurance payments. The most ironclad assurance that borrowers of high-cost loans can afford tax and insurance payments is to require that lenders establish escrows for high-cost loans.

Lender Liability for Broker Misdeeds – Currently, victims of predatory lending get caught in a game in which the lender and the broker will point fingers at each and do not assume responsibility for abuses. S. 1299 appropriately imposes responsibilities on brokers. It also appropriately imposes liability on lenders who do properly oversee brokers and allow the brokers with which they do business to commit exploitative practices.

Steering Prohibited – NCRC's mystery shopping of brokers, NCRC's data analysis, and a wide body of other research suggests that steering is prevalent. The result is the loss of

substantial amounts of equity in minority and working class communities. We applaud S. 1299 emphasis on prohibiting steering. It is also important to prohibit lenders from miss-representing the credit history of the borrower or the appraised value of the property as S. 1299 does.

Protections for the Appraisal Process – Fraudulent appraisals is a fundamental problem that contributes significantly to unaffordable loans. S. 1299 rightly imposes a good faith and fair dealing requirement on appraisers and also prohibits lenders from pressuring appraisers and communicating any desired estimated value to appraisers.

Additional provisions for a comprehensive anti-predatory bill include but are not limited to:

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

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

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

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

the loan beyond the borrower's repayment ability. Any flipping language in a federal bill must be air tight and supported by a strong definition of a high cost loan.

Pre-Loan Counseling – NCRC supports pre-loan counseling modeled after the successful counseling requirement in the North Carolina anti-predatory lending law. In that state, a consumer is required to receive counseling by a counseling agency approved by public housing departments before a lender can issue a high cost loan to a borrower. The added risks associated with a high-cost loan necessitates counseling so that a borrower can understand and prepare for a high-cost loan. Extra disclosures by themselves have proven to be inadequate in informing and protecting borrowers.

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

Limits on Liability for Secondary Market - Currently, under federal law, a financial institution that purchases a high cost loan from a lender or broker is liable for all claims and defenses arising from violations of law. Applying liability for purchasers of loans is critical because a significant amount of abusive lending has been enabled by the secondary market. Borrowers often have no recourse if the purchasers of loans have no liability.

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

Mortgage Servicers - An anti-predatory bill must apply protections against abuse by servicers of mortgages including force placement of insurance and failure to correct errors relating to payments. Servicers must also be required to work in good faith with borrowers and nonprofit agencies representing borrowers to thoroughly and reasonably consider alternatives to foreclosure.

Foreclosure Prevention and CRA Modernization

National Foreclosure Prevention

NCRC urges policy-makers to adopt a foreclosure prevention bill that provides funding for foreclosure prevention counseling. Senator Schumer has proposed that Congress appropriate $300 million to provide funding through the Department of Housing and

Urban Development (HUD) to nonprofit counseling agencies to engage in foreclosure prevention counseling. Senators Schumer, Brown of Ohio, and Casey of Pennsylvania have also asked major financial industry trade associations to generate a $2 private sector match for every $1 appropriated by the federal government to fund foreclosure prevention efforts like NCRC's CRF program. Based on a report issued in the spring of 2007 by the Joint Economic Committee of the U.S. Congress, the Senators estimate that their public and private sector funding would assist between 300,000 to 900,000 families in danger of foreclosure.[11] Considering that about 2 million families confront ARM high-cost mortgages whose interest rates will increase this year and next, the Senators' approach is cost-effective and promises to prevent financial and emotional stress inflicted upon families losing their homes.

Senator Reed has introduced a similar bill, S. 1386 - the Homeownership Protection and Enforcement (HOPE) Act, that would provide $610 million for non-profit counseling agencies and state agencies to provide forbearance and loan modification services to distressed borrowers. Servicers are required to make reasonable loan mitigation efforts before foreclosing on loans. In addition, Senator Reed's bill would create a database on foreclosures and delinquencies that would be linked with HMDA. This valuable data would help policymakers understand which loan terms and conditions (such as loan-to-value ratios and fixed or ARM) are more likely to be associated with delinquencies and foreclosures.

[11] Joint Economic Committee, *Sheltering Neighborhoods from the Subprime Foreclosure Storm*, April 11, 2007, http://jec.senate.gov/Documents/Reports/subprime11apr2007revised.pdf.

CRA Modernization Must Accompany an Anti-Predatory Bill - At the same time that Congress is enacting an anti-predatory bill, NCRC also believes that Congress must pass the CRA Modernization Act of 2007, or HR 1289. HR 1289 would strengthen CRA as applied to banks and would apply CRA to non-bank institutions including independent mortgage companies. Federal Reserve research has demonstrated that CRA encourages banks to increase their prime lending, particularly in geographical areas in which their branches are located. CRA, therefore, acts to introduce product choice in traditionally underserved neighborhoods, meaning that these neighborhoods are less susceptible to steering and abusive lending.[12]

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

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Testimony Appendix

CRF Case Studies

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

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

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

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

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

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

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

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

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

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

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

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

In August 2001, less than a year after her first refinance, Ms. Smith refinanced a second time. The new loan for $187,500 was adjustable and carried a three-year prepayment penalty. In October of 2003, Ms. Smith refinanced a *third* time, this time a 30-year fixed loan for $240,000. She refinanced for a *fourth* time in July 2004. On this loan, her

income was greatly inflated at $6,000 monthly, when it in fact was only $3,944. Consequently, the monthly payment on this fourth and final refinance was $1,887, which was an overwhelming 47.87 percent of her income.

CRF Encounters Entire Devastated Communities Due to Predatory Loans

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