FORECLOSURE, PREDATORY MORTGAGE AND PAYDAY LENDING IN AMERICA'S CITIES

HEARING

BEFORE THE

SUBCOMMITTEE ON DOMESTIC POLICY

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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FORECLOSURE, PREDATORY MORTGAGE AND PAYDAY LENDING IN AMERICA'S CITIES

WEDNESDAY, MARCH 21, 2007

House of Representatives,
Subcommittee on Domestic Policy,
Committee on Oversight and Government Reform,
Washington, DC.

The subcommittee met, pursuant to notice, at 3 p.m. in room 2154, Rayburn House Office Building, Hon. Dennis J. Kucinich (chairman of the subcommittee) presiding.

Present: Representatives Kucinich, Cummings, Watson, Davis of Illinois, Tierney, and Issa.

Also present: Representative Turner.

Staff present: Jaron Bourke, staff director; Jean Gosa, clerk; Nidia Salazar, staff assistant; Natalie Laber, press secretary, Office of Congressman Dennis J. Kucinich; Alissa Bonner, professional staff member, Information Policy Subcommittee; Leneal Scott, information systems manager; Erin Holloway, Office of Congressman Dennis J. Kucinich; Cate Veith, Office of Congressman Dennis J. Kucinich; Jay O'Callaghan and Kristina Husar, minority professional staff members; John Cuaderes, minority senior investigator and policy advisor; and Benjamin Chance, minority clerk.

Mr. Kucinich. The Subcommittee on Domestic Policy of the Committee on Oversight and Government Reform will now come to order.

I first want to begin by thanking all of you for being here and to let you know that we have spent the last hour in a series of votes, and when there is action and votes on the floor that is our first responsibility. So I am sorry that we are starting an hour late, but I am very grateful for the presence of each and every one of the witnesses here.

Today's hearing will examine the subprime mortgage industry and the problem of foreclosure, payday lending industry, and the enforcement of the Community Reinvestment Act. The hearing will also examine alternatives to foreclosure and to payday lending.

Now, without objection the Chair and the ranking minority member will have 5 minutes to make opening statements, followed by opening statements not to exceed 3 minutes by any other Member who seeks recognition.

Without objection, the Members and witnesses may have 5 legislative days to submit a written statement or extraneous materials for the record.

Without objection, the subcommittee is going to recognize and welcome Mr. Turner, who is a member of the full committee, to sit for the purposes of hearing and questioning witnesses' testimony during the subcommittee's series of hearings on the state of urban America.

Again, I bid you good afternoon and welcome. This Subcommittee on Domestic Policy of the Committee on Oversight and Government Reform will come to order for its first meeting. This is the first hearing of the subcommittee, and it is also the first hearing in a series of hearings on the state of urban America. This series intends to take a closer look at American cities, their progress, their problems, and their future. This series is important, not only for the problems it seeks to rectify, but also because I think the last time the U.S. Government took a comprehensive look at American cities was nearly 40 years ago when the Kerner Commission concluded "Our Nation is moving toward two societies, one black, one white, separate and unequal." Today's hearing will examine the subprime mortgage industry and the problem of foreclosure, the payday lending industry, and the enforcement of the Community Reinvestment Act. The hearing will also examine alternatives to foreclosure and to payday lending.

Next Thursday, March 29th, we will look at urban economic development strategies, and particularly whether taxpayer-financed stadiums and large convention centers fulfill the economic promises made about them. In the coming weeks we will also take a look at the retail and grocery store industries, as well as access to health care in the heart of urban America.

Today we are examining the impact of foreclosures, predatory mortgage, and payday lending in America's cities against the backdrop of a series plunge in the stock market last week. On March 13th the Dow Jones Industrials dropped more than 240 points, its second biggest drop in nearly 4 years, primarily due to the subprime mortgage industry. All three major stock indexes dropped by about 2 percent. The stock market erased $406 billion in wealth. By the end of the week nervous creditors forced New Century Financial Corp., the Nation's second-largest subprime mortgage lender, to stop making new loans.

As the stock market recovers from a bruising week and the anxiety about what is to come, major American cities are bracing themselves. The Center for Responsible Lending projects that one out of five subprime mortgages originated during the past 2 years will end in foreclosure. These foreclosures will cost homeowners as much as $164 billion. The exact cost it will have on urban America is unknown.

I wonder if any of us in Government has a proper understanding of the dimensions of the forthcoming foreclosure crisis and the impact it will have on American cities. It will be severe, it will be prolonged, and it will be very serious.

Today's hearing is meant to examine what has brought us here. What are the motivations and practices of the lending industry that brought them to the verge of a financial crisis and brought American cities to the edge of downfall?

For the record, I have invited leading trade associations for mortgage brokers, payday lenders, and the American Bankers Association to help us answer this question. We thought they were all going to be with us here. I am disappointed to learn that two out of three associations invited reconsidered their participation in the hearing. Now, Cleveland, my home town, is at the epicenter of this national problem.

I want to point to some maps here with the help of staff. If you look at this map you see the sideways line V highlighted in light green. Let me tell you what that geographical area represents. It is the area in the city where depository banks made very few prime loans.

Now this map highlighted in red and orange, look at the same V and the same place. This geographical area represents where the highest number of subprime mortgage loans were made during the same year.

Now, this next map, again, the same V in the same place. Here, the red dots indicate the number of foreclosures.

These maps tell you there is a clear and self-reinforcing correlation between the low number of prime loans, the high number of subprime loans, and the high number of foreclosures.

Finally, the final map, again, the familiar sideways lying "V" shape, but here the foreclosures indicated by blue dots are superimposed on the neighborhoods. Red indicates predominately African American neighborhoods. Again, they match.

Lack of access to prime loans, a high frequency of subprime loans, and a high rate of foreclosures are by no means specific to any racial group, but this pattern certainly carries a whiff of America's dark past.

I started my political career as a representative on the Cleveland City Council. Later I was clerk of courts, and then mayor of the city of Cleveland. During my tenure as mayor, Cleveland became the first city to sign a Community Reinvestment Act agreement pursuant to the then newly enacted Community Reinvestment Act of 1977. But what has happened to my city in the past decade is a story that is reflected nationwide.

Consider a recently published report on seven of the Nation's largest financial institutions, entitled, Paying More for the American Dream. The report found that CitiGroup, Countrywide, GMAC, HSBC, J.P. Morgan, Washington Mutual, and Wells Fargo all originated a substantial volume of both higher-cost subprime and lower-cost prime loans.

The report also found the following: for these seven lenders, the percentage of total home purchase loans to African Americans that were higher cost was six times greater than the percentage of higher-cost home purchase loans to whites. Let me go over that one more time. These seven lenders, the percentage of total home purchase loans to African Americans that were higher cost was six times greater than the percentage of higher-cost home purchase loans to whites. Those percentages were actually 41.1 percent to 6.9 percent.

Next point, the percentage of total home purchase loans to Latinos that were higher-cost loans was 4.8 times greater than the percentage of higher-cost home purchase loans to white, 32.8 percent to 6.9 percent.

In each of the cities examined, the seven lenders combined showed larger African American/white and Latino/white disparities than those exhibited in the overall lending market.

Foreclosure and discrimination in lending practices, these are serious problems for America's cities, but in almost every major city there are significant numbers of hard-working Americans who are working to reverse these problems. Among our distinguished witnesses today are some of those Americans. These are individuals and organizations who have created viable alternatives to payday lenders and the foreclosure and subprime mortgages. These alternatives are the link between where we are now, at the brink of a massive wave of foreclosures, to where we want to be, on the road to the Nation's recovery where American families can live in: security physically, emotionally, and financially.

But even with these alternatives, even if these hard-working Americans worked every second of the day, the tide will not be turned, because the magnitude of the problem outstrips even the best of their abilities and efforts. To turn the tide of foreclosures in America's cities, leadership at the Federal Government level is necessary.

Today we will have the opportunity to examine what the problem is and the steps that can be taken before it becomes bigger and beyond our capacity to resolve.

With that, I would like to recognize the distinguished ranking member of the committee, my friend from California, Mr. Issa, for his presentation.

Mr. ISSA. Thank you, Mr. Chairman. I couldn't help, when you were speaking about being from Cleveland, to want to reach over and remind you that you not only represent most of my family in Cleveland, but I was born and raised there, so it was very insightful to look at the map of Cuyahoga County as we went through this. I appreciate the fact that today we have a number of experts from our hometown—not the town I represent, but our hometown.

Mr. Chairman, I want to thank you again not just for holding this hearing but for allowing Congressman Michael Turner to sit in and participate. For those who don't know, I am sandwiched between two large city mayors from Ohio, and particularly Congressman Turner, who is recently a two-term mayor of Dayton before coming here and who has, since he arrived, concentrated on areas of urban America.

Today's hearing is twofold, though. Today's hearing not only deals with the crisis, if we will, of subprime loans, but it is also dealing with something that affects my Congressional District, payday lending. Payday lending is a major and constant problem for the U.S. military. With over 44,000 Marines and Navy corpsmen who operate from Camp Pendleton within my District, we are constantly dealing with bailouts coming through the USA, the Naval Relief, and so on to try to deal with Marines and Sailors who get behind by utilizing payday programs. These programs have an incredibly high rate, and if not for congressional action would have been completely unchecked. But we may need to do more.

Today I look forward to hearing on both of these subjects, one which is in the news every day and one which is on Camp Pendleton and around military bases every day, including in my District.

I will put the rest in for the record and yield back.

Mr. KUCINICH. I thank Mr. Issa for his participation and also note that we both share a strong interest in each other's communities. I am always grateful for the knowledge that you have about our hometown, so thank you.

Mr. ISSA. My brother is always calling to tell me, too, he's your constituent.

Mr. KUCINICH. Well, thank you very much.

I would now like to yield to the gentleman from Chicago, Congressman Davis, for a statement.

Mr. DAVIS OF ILLINOIS. Thank you very much, Mr. Chairman.

First of all I want to thank you and the ranking member for holding this hearing. I am so pleased and delighted that it is taking place today because it was 30 years ago that the Community Reinvestment Act was born in my District, pushed by an organization called the Organization for a Better Austin, of which a woman named Gail Sincata was the leader, and I was, indeed, a member of that organization. I am very pleased to associate myself with Gail's name and with the tremendous work that she did.

Chicago helped to lead the effort that heightened the obligation of the financial industry to reinvest in their communities. I am, indeed, disappointed that decades worth of efforts are threatened now by the suspect practices of various institutions. This hearing offers a wonderful opportunity to shine light on the problem and discuss specific potential solutions to support our citizens.

The issue of predatory lending is a serious problem throughout the country and, indeed, in Chicago. In 2003–2004 the number of foreclosures in Chicago failed, for the first time in over a decade, particularly on high-cost loans that had been regulated by the city and State after, I might add, a tremendous amount of community pressure.

Many of the communities in my District are communities where, if economically other neighborhoods sneeze, they get pneumonia. Unfortunately, due to the predatory lending practices of various institutions, the rate of foreclosure on subprime loans is 19.2 percent. This is up 37 percent from approximately 5 years ago. In the North Londale community, foreclosures are up 247 percent since 1993, in West Garfield Park they are up 256 percent, and in the Near West Side they have gone up 440 percent—all of which are in the Congressional District which I represent.

These foreclosures have dramatic effects on the surrounding communities. Foreclosures are associated with increases in abandoned properties and decreased property values. Indeed, for every one abandoned home, I understand that the property value of a surrounding home is devalued by $30,000. These effects are particularly harmful to those with the fewest assets. They see the equity that they have worked so hard to put into their homes shrivel up, and they often lack the resources to offset this negative spiral.

Although the number of foreclosures in Chicago increased in both white and non-white neighborhoods, the vast majority of foreclosures on non-Federal Housing Administration loans were in neighborhoods in which 80 percent or more of the citizens were minority. In fact, data from the NCRC shows that African American borrowers in the Chicago area were 2.5 times more likely than whites to receive a subprime loan in 2005, with Latino borrowers being 1.82 times more likely to receive a subprime loan.

These practices have made some obviously wealthy and others obviously poor. Obviously, today provides an opportunity—and I want to add my thanks to all of those who have come to witness, not only for your presence but also for your patience.

Mr. Chairman, I would ask permission to submit for the record documents from the National Community Reinvestment Coalition and the National Training and Information Center that describe some of the problems with banking services and foreclosures in the Chicago area.

Mr. KUCINICH. Without objection, so ordered.

I thank the gentleman from Chicago, and now would like to recognize for the purpose of his statement our colleague from the full committee, Congressman Turner, who is a former mayor of the city of Dayton, OH. Congressman, thank you very much.

Mr. TURNER. Mr. Chairman, I want to thank you for holding this important hearing. Your background as both a mayor and a leading advocate for individuals is very important for this process. You are taking up issues of urban and economic development but also issues that are important to families and individuals, and in that you can make a difference, so thank you very much for that.

I also would like to thank you and Ranking Member Issa for including me in this hearing. I appreciate being included. As you know, I served as the chairman of the Federalism and Census Subcommittee in the last Congress, and we had taken up urban issues that included CDBG, the public housing issues, historic preservation, and brownfields. I am very appreciative of the fact that the chairman and I are working together on the issue of brownfields. It helps to be able to make a difference to neighborhoods that are plagued by abandoned factory sites and environmental conditions.

Today we have before us the incredibly important issue of home foreclosures, predatory lending, payday lending practices. The latest figures from the Mortgage Bankers Association show that home foreclosures are a record high. You can certainly see that both, Mr. Chairman, in what you are experiencing in Cleveland, Cuyahoga County, and what we are experiencing in Montgomery County and in Dayton. These record foreclosures are linked to the mortgage lending practices in the subprime market.

Rising interest rates and weak home prices have made it increasingly difficult for borrowers, especially those that took out subprime loans to meet their obligations. Owning and maintaining a home is a challenge, even under the best of financial circumstances. Owning a home when money is tight or non-existent is virtually impossible. I believe that home ownership is a privilege that everyone should enjoy, but we must not allow for the dream of home ownership to be shattered because of questionable and less than honest mortgage practices that can steal individuals' futures.

Mr. Chairman, I would like to recognize one of our witnesses, Mr. Jim McCarthy, who is the president of the Miami Valley Fair Housing Center of Dayton, OH.

Thank you, Jim.

Jim is going to tell us about how his organization works to combat predatory lending, and I urge the members of this subcommittee to listen closely to his testimony, especially as it relates to how we might be able to address predatory lending at the local level.

His organization has taken an effort to educate homeowners and to also assist those who have gotten into trouble.

Mr. Chairman, one other thing I would like to add is that, as I served as mayor and as we were facing the issue of predatory lending and we would see the individual crises and the price that this would have for homeowners, my community continued to wonder how the financial markets could sustain these types of losses that would be inevitable, because even though individual's lives were being impacted, actual capital was being lost in the market that cumulative one would expect would have an impact. Today we are now seeing the results of that as the headlines are beginning to show concerns in the financial markets over these practices having happened that have impacted industry lives.

So, Mr. Chairman, I thank you for holding this hearing.

Mr. KUCINICH. I thank the gentleman from Ohio.

Mr. Cummings from Maryland will speak next. Thank you, Mr. Cummings.

Mr. CUMMINGS. Thank you very much, Mr. Chairman. I cannot even begin to thank you enough for holding this hearing today.

Mr. Chairman, as I go into my statement, I hope that these hearings will yield some results. I think that so often we hold hearings—and I have said this on other committees that I sit on—but when it comes to results sometimes something happens and we don't get there. I have looked at some of the testimony here today and I know that a lot of the people here will talk about things that they are trying to do to prevent foreclosures and things that stem from predatory lending and trying to address to whole payday loan situation. We in Baltimore have done quite a bit in those areas, too.

So I appreciate your efforts to examine the challenges facing America's cities, and I think the timely issue of predatory lending is an excellent place to start.

News reports surrounding the recent subprime mortgage industry's crisis have shone a national spotlight on a problem that was already known to those of us familiar with our cities. Low and moderate-income communities are being targeted by lenders whose singular concern is making money at the expense of others. For example, subprime loans trapped individuals with poor credit by offering a low introductory interest rate that is followed by dramatic rate increase. This year, mortgage payments on 41 percent of all subprime loans will increase. Additionally, these loans frequently have an interest-only, no principal balloon structure and prepayment penalties. These practices discourage borrowers from paying down their debt and create a series of scenarios that could easily spiral out of control.

To be sure, roughly one in five subprime loans go into foreclosure at least once. This is bad news for individual borrowers, and it is bad news for entire communities, as well. Foreclosures have a domino effect in the community. They depress nearby property values, leading to additional foreclosures. This cycle has devastated far too many low and moderate-income communities in America's cities.

I am disappointed that the problem had to affect the stock market before it really garnered the national attention that it deserved, but I appreciate the opportunity to investigate the larger issue of predatory lending with this one high-profile example as a backdrop.

Today we will also look into the practice of payday lending, which targets low and moderate-income individuals who are strapped for cash. Payday loans offer short-term loans payable in full after 30 days or less with interest and a fee. The typical payday loan borrower is not as financially unstable as you might expect. He or she is likely to have steady employment, a relationship with a bank, and the ability to transfer funds electronically.

As I close, unfortunately the same circumstances that caused the borrower to seek a payday loan in the first place are likely to prevent him or her from paying it off within the allotted time. For this reason, borrowers become trapped in a long-term debt making high interest-only payments. Payday loans can include interest rates higher than 300 percent.

I am seriously concerned that companies are profiting by trapping vulnerable low and moderate-income individuals in cycles of debt.

In 1997 Congress passed the Community Reinvestment Act to prevent this injustice. I am interested to learn what we can do to better protect our low and moderate-income communities, and I appreciate the chairman's attention to this critical issue.

As I close again, Mr. Chairman, there is one interest thing. I don't know whether it happens in Cleveland, but in my community—I live in the inner city of Baltimore—you can go miles and not find a bank in the African American community and poor communities. So I am hoping that we will look into these matters and go beyond the hearing, Mr. Chairman, and try to come up with some results.

[The prepared statement of Hon. Elijah E. Cummings follows:]

U.S. House of Representatives
110th Congress

Opening Statement

Representative Elijah E. Cummings, D-Maryland

"Foreclosure, Predatory Mortgage and Payday Lending in America's Cities"
Subcommittee on Domestic Policy
Committee on Oversight and Government Reform

March 21, 2007

Mr. Chairman,

Thank you for holding this important hearing to investigate the subprime mortgage industry, the payday lending industry, and the enforcement of the Community Reinvestment Act.

I appreciate your efforts to examine the challenges facing America's cities, and I think the timely issue of predatory lending is an excellent place to start.

News reports surrounding the recent subprime mortgage industry crisis have shone a national spotlight on a problem that was already known to those of us familiar with our cities.

Low and moderate income communities are being targeted by lenders whose singular concern is making money at the expense of others.

In my Congressional District in Baltimore, for example, the number of new subprime loans in has risen rapidly, from less than 5 percent of the market in 2003 to nearly a third last year, according to estimates by First American Loan Performance.

That's higher than the share nationwide, which the company estimates at about one in four loans. Baltimore has a particularly high concentration—a Reinvestment Fund study estimates that half of new mortgages made in the city in recent years are subprime.

Subprime loans trap individuals with poor credit by offering a low introductory interest rate that is followed by a dramatic rate increase.

This year, mortgage payments on 41 percent of all subprime loans will increase.

Additionally, these loans frequently have an interest only, no-principal balloon structure and pre-payment penalties.

These practices discourage borrowers from paying down their debt, and create a series of scenarios that could easily spiral out of control.

To be sure, roughly one in five subprime loans go into foreclosure at least once.

This is bad news for individual borrowers and it is bad news for entire communities as well.

Foreclosures have a "domino effect" in the community. They depress nearby property values, leading to additional foreclosures.

This cycle has devastated far too many low and moderate income communities in America's cities.

I am disappointed that the problem had to affect the stock market before it garnered national attention, but I appreciate the opportunity to investigate the larger issue of predatory lending with this one high profile example as a backdrop.

Today we will also look into the practice of payday lending, which targets low and moderate income individuals who are strapped for cash.

Payday loans are offered as short-term loans, payable in full after 30 days or less with interest and a fee.

The typical payday borrower is not as financially **un**stable as you might expect. He or she is likely to have steady employment, a relationship with a bank, and the ability to transfer funds electronically.

Unfortunately, the same circumstances that caused the borrower to seek a payday loan in the first place are likely to prevent him or her from paying it off within the allotted time.

For this reason, borrowers become trapped in long-term debt, making high, interest-only payments.

Payday loans can include interest rates higher than 300 percent.

I am seriously concerned that companies are profiting by trapping vulnerable low and moderate income individuals in cycles of debt.

In 1977, Congress passed the Community Reinvestment Act to prevent this injustice.

I am interested to learn what we can do to better protect our low and moderate income communities, and I appreciate the Chairman's attention to this critical issue.

I look forward to the testimonies of today's witnesses and yield back the remainder of my time.

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Mr. KUCINICH. I thank the gentleman from Maryland.

The gentleman from Massachusetts, Mr. Tierney.

Mr. TIERNEY. Thank you, Mr. Chairman. I add my comments to the others in thanking you for having this important hearing, and thank all of the witnesses for their testimony, both the written testimony, as well as what you will give verbally here today. This is proposed to be a long hearing, and I know some of us have to apologize in advance for being in and out of the room for other commitments, but it doesn't mean that we haven't had an opportunity to read thoroughly what has been provided by this panel, as well as the next panels, and appreciate it.

In my District, in Essex County I note on the chart here from 1998 to 2001, that period up to 2006 has seen an increase in foreclosures of 289.1 percent. It is a huge issue in my community, as well as others on the panel that have spoken here. I look forward to your proposed solutions, because I think we have identified the problem pretty well. I am looking forward to hearing your comments on how we might be of assistance to people to stop this from snowballing out of control worse than it has now.

Again, thank you, Mr. Chairman, for attending to this matter.

Mr. KUCINICH. I thank the gentleman from Massachusetts.

If there are no other additional statements, this subcommittee will now receive testimony from the witnesses before us today.

I would like to begin by introducing our first panel.

From my left, Mr. Jim Rokakis. Jim Rokakis took office as Cuyahoga County treasurer—that is in Cleveland, OH—in March 1997, after serving for over 19 years on the Cleveland City Council. Mr. Rokakis has brought sweeping reform to the treasurer's office. He overhauled the Cuyahoga County's property tax collection system and significantly improved Cuyahoga County's investment function. Mr. Rokakis revolutionized the way Ohio counties collect delinquent property taxes by working successful to pass Ohio House Bill 371 that allows county treasurers in Ohio's largest counties to sell their property tax liens to private entities. Mr. Rokakis spearheaded House Bill 294, which streamlines the foreclosure process for abandoned properties, and was instrumental in creating Cuyahoga County's don't borrow trouble foreclosure prevention program. Mr. Rokakis developed nationally recognized link deposit loan programs that have helped revitalize the county's housing stock and reduced urban sprawl. Additionally, he worked to pass Ohio House Bill 293 that allows senior citizens to defer property tax payments. Our new Governor and former colleague Ted Strickland has appointed Mr. Rokakis to Ohio's recently formed Task Force on Foreclosures in Ohio.

The next witness will be Ms. Inez Killingsworth, who is the president of the East Side Organizing project, as well as co-chairperson of the National People's Action, which is a coalition of hundreds of grassroots organizations. She is a national leader in the fight for reform of the Federal Housing Administration, predatory lending, and advocating neighborhood safety. The East Side Organizing Project was founded in 1993 to create organized leadership around issues that impact neighborhood life in Cleveland. ESOP works with community residents, schools, businesses, churches, and other neighborhood institutions to identify issues and take actions that create safe, economically strong, and stable communities for our residents. Decisions about strategy and organizational direction are made by ESOP members. Since 1998, much of ESOP's work has focused on predatory lending, divestment of capital, and quality loan services for low income and minority communities, and the foreclosure explosion in Cuyahoga County and the city of Cleveland. ESOP's aggressive approach toward predatory lending has been nationally recognized for its effectiveness in fighting loan industry abuses and setting up better loan services in low income communities.

We will hear from Mr. William Rinehart, who has served as vice president and chief risk officer of Ocwen since April 1999, where he is responsible for internal audit, information security, quality assurance, Sarbanes-Oxley compliance, credit policy and administration, community relations, regulatory compliance, and Six Sigma. He joined Ocwen in 1998 as director of Credit Policy. Ocwen Financial Corp. formed in 1988 as a public company—it is on the New York Stock Exchange—headquartered in West Palm Beach. Ocwen derives the majority of its revenues from the servicing of residential mortgage loans for third party institutional investors. Ocwen currently services approximately 480,000 mortgage loans with unpaid principal totaling $55 billion.

The next witness will be Mr. Josh Nassar, vice president of Federal affairs for the Center for Responsible Lending [CRL]. CRL is a nonprofit, nonpartisan research and policy organization that promotes responsible lending practices and access to fair terms of credit for low wealth families. CRL is dedicated to protecting home ownership and family wealth by working to eliminate abusive financial practices. CRL has conducted or commissioned landmark studies on predatory lending practices and impact of State laws that protect borrowers. CRL has also supported State efforts to combat predatory lending and worked for regulatory changes to require responsible practices among lenders nationwide.

The next witness is Professor Dan Immergluck. Professor Immergluck teaches courses, including real estate finance, housing policy, research methods at Georgia Technology. He has also taught courses in policy analysis, urbanization, and nonprofits and public policy. He conducts research on real estate and housing markets, economic development, community development, community reinvestment, fair housing, and urban and regional planning and policy. Professor Immergluck previously taught at Grand Valley State University in Grand Rapids, MI, and was for almost a decade a senior researcher with the Woodstock Institute in Chicago, which is a nonprofit research organization focused on community and economic development. At the institute he served as the primary deputy to the president, authored dozens of reports, advised Federal, State, and local government, as well as nonprofit agencies. The professor has also worked as an economic development planner for an industrial development organization in Cleveland and for the State of Ohio. His most recent book, Credit to the Community, examines the history of lending discrimination and red-lining, fair lending policy, and the Community Reinvestment Act.

Finally, Mr. Harry Dinham, president of the National Association of Mortgage Brokers, has served in leadership roles for both the

Texas Association of Mortgage Brokers and the National Association of Mortgage Brokers. Established in 1973, the National NAMB is the only national trade organization representing the mortgage broker industry. Fifty State affiliates, more than 27,000 members, the NAMB promotes the industry through programs and services such as education, professional certification, and government affairs representation.

I want to thank each and every one of the witnesses for appearing before the subcommittee today.

It is the policy of the Committee on Oversight and Government Reform to swear in all witnesses before they testify.

[Witnesses sworn.]

Mr. KUCINICH. The record will reflect that the witnesses answered in the affirmative.

I will ask that each of the witnesses, beginning with Mr. Rokakis, now give a brief summary of their testimony, and to keep this summary within 5 minutes duration. I want you to bear in mind that the complete written statement that you present will be included in the hearing record.

Mr. Rokakis, you are our first witness. I welcome you as not simply as the distinguished treasurer of Cuyahoga County, but as someone who I have served with in public life for decades. You have been an exemplary public servant and you honor us with your work and your presence. Thank you very much for being here. Please proceed.

STATEMENTS OF JAMES ROKAKIS, CUYAHOGA COUNTY TREASURER, CLEVELAND, OH; INEZ KILLINGSWORTH, PRESIDENT, EAST SIDE ORGANIZING PROJECT, CLEVELAND, OH; BILL RINEHART, VICE PRESIDENT AND CHIEF RISK OFFICER, OCWEN FINANCIAL CORP., WEST PALM BEACH, FL; JOSH NASSAR, VICE PRESIDENT, CENTER FOR RESPONSIBLE LENDING, WASHINGTON, DC; DAN IMMERGLUCK, GEORGIA INSTITUTE OF TECHNOLOGY, ATLANTA, GA; AND HARRY DINHAM, PRESIDENT, NATIONAL ASSOCIATION OF MORTGAGE BROKERS, MCLEAN, VA

STATEMENT OF JAMES ROKAKIS

Mr. ROKAKIS. Thank you, Mr. Chairman. Thank you, Chairman Kucinich and Ranking Member Issa, for allowing me to speak today on the topic of subprime lending and the harm that it has caused to so many communities all over America, particularly communities in Ohio. The damage to the Buckeye State has been enormous, but, sadly, the news of the past few months convinces me that the worst is yet to come.

My name is Jim Rokakis. I am the county treasurer for Cuyahoga County, OH, a county of over 1.3 million people that includes Cleveland and 59 suburban communities.

For at least the past 7 years, urban leaders in cities like Cleveland, Dayton, Toledo, and other older, more mature cities throughout America have been decrying the explosion in foreclosure filings in their communities. They have complained of abandonment, of property flipping, and of a lending industry that we thought was behaving so irresponsibly we were convinced that some day a segment of that industry, the subprime sector, would implode.

We complained of no document loans and of adjustable rate mortgages that would reset at a rate higher, that would be well beyond the means of the borrower. We complained of borrowers known as NINJAS, no income no jobs no assets, who were often buying multiple properties, very often with no down payments. We complained of fraud on an unprecedented scale that involved buyers, sellers, brokers, bankers, and appraisers.

Mr. Chairman and members of the committee, these tactics have devastated Cleveland and its neighborhoods. The most obvious example, Chairman Kucinich, is a neighborhood in Cleveland that you once represented, known as Slavic Village, where 900 homes have been abandoned in just the past several years.

We pleaded for help at the State level, but we were no match for the lobbying team assembled by the mortgage brokers, the bankers, and financial services industries that have come to view securitization and the use of collateralized debt obligations as a foolproof way to finance mortgages in this country, not just for people with good credit but for people with bad credit or no credit at all.

You have heard this before, but it bears worth repeating. The American dream of home ownership has become, for the hundreds of thousands of Americans who have been foreclosed or who are being foreclosed or who will be foreclosed this year, for those Americans it has become a nightmare. For older, struggling American cities like Cleveland this promise of the American dream has become a nightmare, burdening these communities with vacant properties and maintenance costs these cities cannot afford.

For the millions of Americans who live next to one of these properties or on a street with a vacant home or many vacant homes, who have witnessed a precipitous decline in the value of the most valuable asset, their home, this foreclosure disaster has become a nightmare for them, too.

Last March we began a foreclosure prevention program in our county that asked our residents who were facing foreclosure to call 211-hotline where operators referred them to foreclosure counseling specialists. The director of that program, Mark Wiseman, is seated behind me. I am proud to say we saved approximately 600 homeowners from foreclosure during that period, but I am sobered by the fact that for every mortgage we saved, 20 more foreclosures are filed with our clerk of courts. We have gone from 3,500 private mortgage foreclosures in 1995 to 7,500 private mortgage foreclosures in 2000, to over 13,000 in 2006, with no end in sight. These increases coincide perfectly with the growth of the subprime lending industry.

What are we asking for this Congress to do? Don't fall for the argument that some on Wall Street are starting to voice, that this is a market problem that the market will correct, that the market is already doing so by tightening credit standards. Mr. Chairman, we have already talked about it, but I have read various reports that estimate anywhere from 1.4 to 2.4 million mortgages will go into default. The losses suffered as a result of these defaults will run into the hundreds of billions of dollars. On a daily basis we read reports of mortgage banks that are filing bankruptcy or are facing bankruptcy. Does anybody really believe this is all caused by a little hiccough in the market, one that we should trust the market to correct?

There are two areas where this Congress can be of great help. Certain loan products must be abolished and loan officers must be held to fiduciary duty. No document loans have no place in the home mortgage industry. These loans, which are unapologetically referred to as liar's loans among brokers, are an invitation to fraud and should be outlawed. If your borrower can't prove beyond doubt what their income is, why are you lending them money in the first place?

As far as loan officers are concerned, Mr. Chairman, the loan officer knows with a considerable degree of certainty whether the borrower he is working with will be able to repay that loan, yet they reject the notion that they should be required to have that borrower's best financial interest at heart when driving the decisionmaking. This is the most important financial decision these borrowers will ever make, and it is critical that these mortgage brokers be held to the highest fiduciary standards.

There has been talk in this Congress of a suitability standard. Does the borrower have the income to make a monthly loan payment, not only next month's payment but the payment when the loan rate resets? Selling somebody a loan they don't need or can't afford should cost that mortgage broker his or her license.

When the industry testifies before this panel, please ask yourself one question: why are we here to address what has become a national crisis? They will blame the foreclosure disasters on a slow economy and rising unemployment, on rogue brokers and bankers who have misbehaved.

I am going to tell you we have enough laws and regulations. We just need to do a better job of enforcing the ones we have. Ask them if lax or non-existent underwriting standards haven't played a role in this disaster, or if high fees and bonuses totaling billions of dollars to brokers who are ordered to write mortgages with higher interest rates and excessive fees haven't contributed to this foreclosure tsunami.

Mr. Chairman, you will never be able to put a dollar amount on the heartbreak, the pain, and the distress caused to these families. Never. Please reject the argument that if Congress reigns in the abuses of the subprime industry, that it will dry up credit for the millions of Americans with less than perfect credit.

There is unquestionably a place for subprime lending in this country. Subprime loans can provide opportunity for people to own a home who might not otherwise have that chance. But, Mr. Chairman and members of the committee, to say that you must accept these abusive practices as part of the solution, well, that is just plain wrong.

Thank you for this opportunity.

[The prepared statement of Mr. Rokakis follows:]

TESTIMONY OF CUYAHOGA COUNTY JIM ROKAKIS BEFORE THE CONGRESSIONAL SUBCOMMITTEE ON DOMESTIC POLICY COMMITTEE ON OVERSITE AND GOVERNMENT REFORM

WEDNESDAY MARCH 21, 2007
2:OOPM

Mr. Chairman and members of the community these tactics have devastated Cleveland and its' neighborhoods. The most obvious example Mr. Chairman is the neighborhood in Cleveland known as Slavic Village where you once served as its councilman, where 900 homes have been abandoned in just the past several years.

We pleaded for help at the State level Mr. Chairman but were no match for the lobbying team assembled by the mortgage brokers, the mortgage bankers and financial services industry that has come to view securitization and the use of collateralized debt obligations as a fool proof way to finance mortgages in this country, not just for people with good credit, but for people with bad credit—or no credit at all.

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My name is Jim Rokakis and I am the County Treasurer for Cuyahoga County, Ohio, a county of over 1.3 million people that includes Cleveland and 59 suburban communities. I have held that position for 10 years and served as a member of Cleveland city council for 19 years before that.

First I would like to thank the committee for allowing me to speak on the topic of predatory lending and the damage it has done to communities all over America, but particularly to communities in Ohio. The damage has been enormous, but sadly the news of the past few months convinces me that the worst is yet to come.

For at least the past seven years urban leaders in cities like Cleveland, Dayton, Toledo, Cincinnati, and other older, more mature cities throughout America have been decrying the explosion in foreclosure filings in their communities. They have complained of abandonment, of property flipping and of a lending industry that was behaving so irresponsibly that we were convinced that someday that a segment of that industry—the sub prime sector—would implode. We complained of no document loans and of Adjustable Rate Mortgages that would reset at a rate that would be well beyond the means of the borrower. We complained of borrowers known as NINJA's-No Income-No Job-No Assets—who were buying properties, often multiple properties, often with no down payments. We complained of fraud on an unprecedented scale that involved buyers, sellers, brokers, bankers and appraisers.

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What are we asking this Congress to do? Don't fall for the argument that some on Wall Street are starting to voice—that this is a market problem that the market will correct, and that the market is already ~~doing~~ that by tightening credit standards. Mr. Chairman I have read various reports that estimate that anywhere from 1.4 to 2.4 million mortgages will go into default and that the losses suffered as a result of these defaults will run into the hundred of billions. On a daily basis we read reports of mortgage banks that are filing bankruptcy or are facing bankruptcy. Does anybody really believe that this is all caused by a little hiccup in the market, one that we should trust them to correct?

There are two areas where congress can be of great help: Certain loan products must be abolished and loan officers must be held to a fiduciary duty. No document loans have no place in the home mortgage industry. These loans

Mr. KUCINICH. Thank you very much, Mr. Rokakis.

Now the Chair will recognize Inez Killingsworth, the president of East Side Organizing Project. Thank you very much, Ms. Killingsworth. You may proceed.

STATEMENT OF INEZ KILLINGSWORTH

Ms. KILLINGSWORTH. Thank you, Mr. Chairman, and to the subcommittee. I am especially honored today to tell you that I was beside Gail Sincata, known as the mother of CRA, during the fight over a decade ago on CRA, that law that allowed banks and confined banks that they must be accountable to all people. When Gail passed, I kind of stepped up to the plate, not to fill Gail's shoes, but to challenge people to get the crooks. I am national co-chairperson of the National People's Action. Again, I would like to thank you for convening this meeting and allowing ESOP to be a part of this.

What I like to call is the Perfect Storm of how it happened. I live in a community that has been destroyed by all levels of government, with the exception of our county treasurer, who you just heard from today. Without question, cities in Cleveland were ripe for the picking. The steel industry was leaving. The secondary industries went belly up. And we continue to have what I call a brain drain. Indeed, the banking industry would like you to believe that they pulled out of Cleveland because of the economy. Well, I would like to say that is not true. They pulled out because they could get more money in the subprime with their subprime affiliates than they could with their regular loans. They did not pull out. That was no mistake. They did not do what they were supposed to do in terms of the CRA.

Consider National City Bank, whose headquarters is in Cleveland. Until very recently, National City owned First Federal Finance. I encourage you to read the Plain Dealer article of March 15, 2007 where National City Bank has put $50 million in reserve because it foolishly invested in First Franklin Financial, but now has to foot the bill for that company's abusive practices as they are stuck with all of those loans.

National City is not alone. Consider Key Bank, who also learned the parting of their ways when they decided to sell their subprime affiliate, Champion Mortgage, late last year. Had National City Bank, Key Bank, and other banks not chosen to cut their lending practices in the low and moderate-income communities over the last 10 years, we would not be here today. We would have better service in our community. Of course, had the banking regulators did their job, also, we would not be here.

I live in the Union Miles community. I have lived in there for more than 30 years. I remember when we had banks in our neighborhood, but one by one they all disappeared. The subprime industry will tell you that they acted based on the economics of supply and demand. That is probably one of the things that I kind of agree with them on, but the fact is, as the banks abandoned low and moderate-income neighborhoods, the subprime industry moved in, and moved in fast.

For example, in 2002 Argent Mortgage Co., the wholesale lending arm of ACC Holding, which also owns Ameriquest Mortgage, had no presence in the city of Cleveland, but since 2003, however, despite only offering a subprime loan product, they have been the largest lender in the Cleveland area. I guess you can figure out why.

I would suggest to you that Argent's surge in Cleveland is the result of years of local banks turning their banks on low and moderate income.

I would like to spend a minute and give you some sense of how devastating this has been in Cleveland. Ohio foreclosure rate is three times the national average, and the highest in all of the States. This data says that 12 out of 13 largest Ohio counties indicate that 2003 foreclosure filings increased by an estimate of 25 percent over 2005 in the year of 2005. Despite representing less than 5 outstanding mortgages, subprime loans account for 70 percent of all the foreclosures.

In the Cleveland community where I live, I remember going past houses that were very vital, having barbecue meals in the back yard. This one particular lady, Mrs. McCoy—I bring her name up because she was very dear to me, and she was always talking about the subprime lender and how they were taking advantage of our neighborhood. Well, today Mrs. McCoy is no longer with us, but before she passed on she lost her home.

ESOP has a model that we work with in terms of our hot spot cards and how we approach that in terms of trying to help people to save their home and not be homeless. We worked along with National People's Action NTIC a few years ago, to get an agreement with CitiFinancial. CitiFinancial, as you know, is a part of the CitiGroup, the largest bank in the world. CitiFinancial acquired the associates a few years ago, and we were going after them because in our community we were hearing complaints of people about their loans.

We finally got an agreement with CitiFinancial after years of wrangling over what it was. We developed out of that agreement what we call our hot spot card. Our hot spot card allows us to gather information that we may be able to use to help people to refinance or get a forbearance or even a resolution to that loan. That is one of the things that has gone national with ESOP is our hot spot cards, and we work very closely with the county.

We also have an agreement with Select Portfolio, better known as Fairbanks. We also have an agreement with Ocwen. Mr. Rinehart is to my left here today to talk about how we work together to save people's homes in Cleveland.

I could go on and on and on, but I see my time is up. I thank you very much.

[The prepared statement of Ms. Killingsworth follows:]

3631 Perkins Ave.
Cleveland, Ohio 44114

Phone: 216 361-0718

ESOP

East Side Organizing Project

a member of SHARES

Testimony of Inez Killingsworth
President, East Side Organizing Project

Provided to the Subcommittee on Domestic Policy, Committee on Oversight and Government Reform

March 21, 2007

Introduction

Good afternoon. My name is Inez Killingsworth. I appear before you today as the President of the East Side Organizing Project (ESOP), a community organization whose roots are in the southeast side of Cleveland, Ohio but whose growth has been fueled by abusive lending and now includes the entire Northeastern Ohio region as ESOP's work is widely recognized and requested.

I have been involved with community organizing and development for more than 30 years. I am the co-founder of the Union-Miles Development Corporation and served as its president for many years. I am also President of the Trustees Board for Mt. Olive Missionary Baptist Church.

I am especially honored to tell you that I was at the side of Gale Cincotta, the "Mother of CRA", during that fight and the fight over the last decade to make CRA a law all banks must follow and one that all regulators are held accountable to. When Gale passed, I stepped up to her challenge to "get the crooks" and, today, serve as the Co-Chair of National People's Action (NPA) and I am on the Board of the National Training & Information Center (NTIC).

I want to thank Congressman Dennis Kucinich for holding this hearing. As you may know, ESOP is a convening partner of the Ohio Fair Lending Coalition. We sent Congressman Kucinich a letter several weeks ago about our concerns with respect to the proposed merger of Huntington/Sky Bank and the much larger issue as it relates to depository institutions meeting the credit needs of their service area. Congressman Kucinich's office, in conjunction with fair housing experts Charles Bromley, Paul Bellamy and ESOP, worked very hard to make this hearing possible.

Th Perfect Storm: How his happened

This hearing was scheduled before the news broke about "sub-prime worries on Wall Street" and before the New Century melt down. It was scheduled before Ohio's AG Marc Dann won an injunction that stops New Century in its tracks from abusing any more Ohio residents. While the above is good news, I fear it may be too late as, until recently, the Ohio Legislature has done everything in its power to make sure predatory lenders knew Ohio was open for business.

ESOP predicted what is happening today more than seven years ago. Indeed, we saw our neighbors losing their home before the term "predatory lending" was even coined. We were dismissed by all as some crazy community organization who doesn't understand lending.

I live in a community that has been destroyed because all levels of government failed to respond to this issue sooner because they dismissed the voice of groups like ESOP.

Without question, cities like Cleveland, were "ripe for the picking". The steel industry was leaving, their secondary industries went belly up and we continue to have a brain drain. Indeed, the banking industry would like you to believe they pulled out of the Cleveland communities because of the economy.

Ladies and Gentlemen, they pulled out because they could make MORE money vis a vis their sub-prime affiliates. And make no mistake: THEY DID. Consider National City Bank whose headquarters is in Cleveland. Until very recently, National City Bank owned First Franklin Financial. I encourage you to read the Plain Dealer article that was published on March 15, 2007 (http://www.cleveland.com/business/plaindealer/index.ssf?/base/business/117394899598200.xml&coll=2) where NCB has put $50 million in reserves because it foolishly invested in First Franklin Financial but now has to foot the bill for that company's abusive practices as they are stuck with those loans.

National City is not alone. Consider Key Bank who also sensed the party is over when they sold their sub-prime affiliate, Champion Mortgage, late last year.

Had NCB, Key and Cleveland's other banks not chosen to cut off lending in low to moderate income communities over the last ten years, we would not be here today. Of course, had the banking regulators done their job, we wouldn't be here either.

I have lived in the Union-Miles neighborhood for more than 30 years. I remember having banks in my neighborhood. One by one, however, they disappeared.

As they left, others set up shop. A visit the corner of E. 93rd St. and Union makes my point. Twenty years ago, that intersection had three bank branches. Today, it has three check cashing stores. My neighborhood does not have ONE bank in our community.

The sub-prime industry will tell you that they acted based on the economics of supply and demand. That is probably the only thing they and I agree on. The fact is, as the banks abandoned low to moderate income neighborhoods, the sub-prime industry moved in and moved in fast.

For example, in 2002, Argent Mortgage Company (the wholesale lending arm of ACC Holdings which also owns Ameriquest Mortgage company) had no presence in the city of Cleveland. Since 2003, however, despite only offering a sub-prime loan product, they have been the largest lender in Cleveland. I guess we are supposed to believe that, almost overnight, the credit rating of Cleveland residents tanked and they no longer qualified for a prime rate mortgage.

I would suggest to you that Argent's surge in Cleveland is the result of years of local banks turning their back on low to moderate income, often minority, residents.

The Aftermath Of The Storm

My good friend, Dr. Calvin Bradford, will shared with you how the banks, with the full support of the federal regulators, were allowed to leave places like my neighborhood.

I want to spend a few minutes and give you a sense of just how devastating the last decade has been due to the regulators abdicating their responsibility and abusive lenders entering the market place. The following statistics were put together by Paul Bellamy, a fair housing expert in Cleveland. They paint a very grim picture. Consider:

- Ohio's foreclosure rate is three times the national average and the highest of all states.[1]
- Data from 12 of the 13 largest Ohio counties indicate that 2006 foreclosure filings increased by an estimated 25 percent over 2005, with an estimated 80,000 foreclosure filings.[2]
- The volume of foreclosures is expected to grow much faster in 2007 and 2008 because of the number of subprime ARM loans

[1] *Mortgage Bankers Association, National Delinquency Survey, Third Quarter 2006*

[2] *Data for the last 10 years was originally obtained from the Ohio Supreme Court and are republished in Policy Matters Ohio reports over the past several years. See:* http://www.policymattersohio.org/Foreclosure_Growth_2006.htm

that will be reset at much higher rates. In 2005, subprime loans accounted for about 13 percent of the mortgages issued nationally, compared to almost 28 percent (more than double) of the mortgages issued in Ohio. Subprime loans account for 18 percent of all outstanding Ohio mortgages currently held by the secondary market and other loan servicers. Despite representing less than one of five outstanding mortgages, subprime loans account for 70 percent of all foreclosures.[3]

- The most common type of Ohio subprime mortgage is a "2/28" loan. These loans are sold with low initial "teaser rates" that are fixed for the first two years. Beginning in year three, the interest rate increases as often as every six months, so the monthly payment grows dramatically. Often, these loans are not underwritten to anticipate the inevitable rate escalation. In 2007 and 2008, roughly $14 *billion* of these 2/28 subprime loans are going to reset in Ohio, impacting some 150,000 to 200,000 mortgages.[4]

- Many borrowers with 2/28s and other ARMs can't refinance or sell to avoid default because their property is not worth what is owed. All too often, their original mortgage was based on an inflated appraisal. In 2006, six of Ohio's eight major metropolitan areas experienced depreciating real estate values between 3.5 and 7.7 percent - well above the US average of 2.7 percent.[5]

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[3] *The Subprime Market's Rough Road," Wall Street Journal, 2/17/07.*

Home Mortgage Disclosure Act data - Reported subprime loans (generally considered an undercount) show that subprime increased from 16% of Ohio's mortgages in 2004, to just over 28% of the Ohio loan market in 2005.

Mortgage Bankers Association, National Delinquency Survey, Third Quarter 2006 (most recent available).

[4] *"Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners," The Center for Responsible Lending, December 19, 2006. Figures from databases maintained by lending industry trade groups actually suggest that over $20 billion 2-28 subprime loans will reset in Ohio during 2007 and 2008.*

[5] *First two sentences are based on reports of staff of foreclosure prevention projects around the state. Third sentence is from "National housing market declines," Cleveland Plain Dealer, 2/16/07 based on home price data for 2006 from the National Association of Realtors.*

While the above numbers are staggering, what I see in my neighborhood is even more tragic. I can't walk down any street in my neighborhood without seeing a vacant, often un-boarded, home. Many of these homes used to belong to my friends. I remember visiting them not that many years ago to celebrate the holidays or have a cook out during the summer. Today, those fond memories have been replaced by the stark reality that the lending industry ripped off my friends and me. As I peek inside some of these homes, I see the remnants of what was once a stable family. I can see where the kitchen sink used to be and remember helping Ms. McCoy wash the dishes there after a neighborhood cook out. Today, the sink has been ripped from the wall and sold for scrap.

Today, I notice more sirens from firefighters going to put out yet another fire caused by squatters trying to keep warm in a vacant house and am reminded to tell my grandchildren, once again, to stay out of vacant houses lest they step on a needle or encounter a molester.

That is my reality. While I don't wish ill on anyone, I must tell you that the losses investors on Wall Street are facing today pales in comparison to the losses I have faced on E. 93rd Street for the last 5-7 years because of their abusive greed.

Cleaning Up The Mess: ESOP's Model

ESOP has a well earned reputation for loading up buses with ripped off homeowners and armed with 2500 plastic sharks and traveling to the home of CEO's and managers of local predatory lenders and throwing sharks at these loansharks until they agree to meet with us to negotiate a written agreement to fix their bad loans. Some tell us that doing this isn't nice. I suppose they are correct but we don't think what these lenders have done to our neighborhood is very nice either.

Each of ESOP's agreements contain two sections. The first is "prohibited practices" going forward and the second part of all of our agreements is the "review and repair process."

ESOP, working with National People's Action (NPA) and our national affiliate, National Training &Information Center (NTIC) helped lead a national campaign against Citifinancial about six years ago when they acquired the Associates. It was a long and, sometimes bitter, campaign that eventually led to a national agreement and is where we first introduced the Hot Spot Card (HSC) which we have gone on to use with other agreements. It is a complaint form that the homeowner completes and ESOP then sends to a designated person at Citifinancial who is empowered to make decisions about changing the terms of the loan.

The agreement with Citifinancial also immediately stops any foreclosure efforts until both sides have had an opportunity to review the loan and find a better alternative. To date, hundreds of homes have been saved as a result of this agreement.

It is also important to note the impact these agreements can have on changing industry practices. For example, when negotiating our agreement with Citifinancial, we pushed them to drop single premium credit life insurance. At first, they refused to budge. Finally about six months into the negotiating process and hearing dozens of horror stories about how this product was packed into loans and often never paid off, they began to listen. Finally, they relented and agreed to drop the product. Within a year, every major lender that I am aware of did the same thing.

At about the same time we were concluding our agreement with Citifinancial, ESOP members began reporting concerns about a company called Fairbanks Capital Corp. At first we dismissed their concerns as that of some older people who didn't really know what they were talking about. After all, we mistakenly thought, what would a company from Alaska be doing in Cleveland?

The complaints kept pouring in, however, and we finally decided there must be something to the stories people were telling us. After some research, we quickly learned that Fairbanks (now called Select Portfolio Servicing) was among the nation's largest sub-prime loan servicers just a few years ago. Their problems were well chronicled in papers throughout the nation. ESOP spearheaded what started as local fight that became national in the course of a few months. It resulted in an agreement that not only kept them in business, but it made it taboo to do things like not apply payments properly, force placing insurance on accounts without first determining if the homeowner had their own policy...all things that were common in the industry.

While it took some time, Fairbanks' CEO finally came to the table and met with us after being barraged with bad press and a lawsuit by the FTC. We went on to meet several more times to hammer out an historic agreement that immediately stops a foreclosure when a Hot Spot Card is submitted, creates a list of prohibited practices going forward and has saved hundreds of families from foreclosure. Today, a number of the reforms contained in that agreement are now standard operating procedure for sub-prime loan servicers across the nation with respect to applying payments, forced placed insurance, company ombudspersons, etc. Equally important, while SPS openly admits it still "has a problem in Cleveland," their foreclosure filings dropped by about 43% between 2003 and 2005. That is because ESOP is working with them to keep folks in their home AND because they banned the practices we called them out on that were putting people in foreclosure in the first place. Indeed, while we didn't start off on the best foot, ESOP is proud to be in partnership with SPS today as we work together to keep our residents and their customers in their home.

Three days after signing the SPS agreement, Ocwen Financial called our national affiliate, NTIC, and indicated they wanted to talk. I and key ESOP members and leaders from organizations around the country began meeting with my friend next to me, Bill Rinehart and the CEO of Ocwen, Ron Faris. In just a few months, we put together an agreement without a single plastic shark ever being lobbed! We just celebrated the two year anniversary of this agreement a couple weeks ago. To date, well over 100 homeowners in the Cleveland area have been assisted by this agreement.

While we are proud of all of our agreements, we consider this agreement to be one of, if not, the best agreements we have simply because Bill and Ron are not afraid to think outside the box and think with us about new ways to keep people in their home. For example, I mentioned earlier that resetting ARM's over the next year or so will result in, according to the experts, an unprecedented wave of new foreclosure filings.

We are working with Ocwen to try to get out ahead of this issue. Ocwen provided us with a list of about 500 Cleveland area homeowners who will see their rate adjust in the coming months. We sent a mailing to those homeowners whose rate will reset in the next two months, many of whom may not even have a clue that they are about to see their payments increase significantly, and invited them to a meeting where Ocwen will have a representative present to discuss their options and, where it is clear they will not be able to meet their mortgage obligation, begin the process to see if there is a way their loan can be modified.

Finally, on the national level, working with NPA and NTIC, we also have a national agreement with JP Morgan Chase. It is not quite the same as the other agreements we have but it has allowed us to employ the Hot Spot Card with great success.

The above are examples of ESOP's involvement to secure national agreements. Over the last few years, we have been pretty busy locally as we have negotiated written agreements with Charter One Bank, Ameriquest (includes Argent and AMC Servicing) and we just signed an agreement with Litton Loan Servicing on February 28, 2007 that has already assisted more than two dozen families who were facing foreclosure. During the signing of this agreement, Larry B. Litton, Jr., the CEO of Litton, commented that ESOP's Hot Spot Card program and our commitment to preserving homeownership is a "model" that he wants to replicate across the country.

While we don't have a written agreement (yet) we also have a very good relationship with Third Federal Savings & Loan (as an aside: I wish to amend my earlier remarks to note that Third Federal is the ONLY bank in Cleveland that has really stepped up to the plate to take people out of bad loans and put them in good loans), Homecomings and Wilshire Credit Corporation.

All combined these agreements resulted in rescuing about 400 families from foreclosure in 2006. Based on numbers YTD, ESOP expects that we will assist more than 700 families by the end of this year.

The secrets to these agreements and our success is:

1) They are based on mutual respect and an understanding that everyone loses when a home goes into foreclosure.
2) An understanding that a group like ESOP can often be less threatening for the borrower to speak with than someone who is calling them from a thousand miles away.
3) We have one and only one point person for each of our lender partners who is empowered to make decisions about reworking the loan or some other resolution to keep the homeowner in their home.
4) We have regular face to face dialogue with top officials (usually the CEO) at least twice a year and conference calls when needed.

Hopefully, you are asking yourself 'why, if this is so successful, aren't more lenders and servicers reaching out to partner with local organizations?' I wish I had a good answer but I don't. It is beginning to change but many lenders and servicers, even despite the last few weeks, don't really believe we have a crisis on our hands.

That, ladies and gentlemen, is where you come in. If left to correct itself, I have no doubts that the lending industry will continue to tighten up on its lending standards. That is fine going forward. But what about yesterday and today. The industry would like you to think that they have learned their lesson and are cutting off the really bad guys. And that is happening to some extent. The problem is they don't want to be held accountable for the abuse and damage they caused over the last decade. Congress has a chance to hold them accountable going forward AND for their past abuses and I implore you to do so.

I thank you again for the opportunity to speak before you today and welcome any questions.

Mr. KUCINICH. I want to note that all witnesses' testimony will be included in the record. If you would like to confine your remarks to 5 minutes I can assure you that the record of the committee will reflect your full remarks, but I can understand, in reading the full text of all of your presentations, and notably Ms. Killingsworth and Mr. Rokakis who have just testified, you know, it is good for us to hear this, and I am so grateful that you are here to make the presentation.

I want to note that we have been joined by Mr. Murphy of Connecticut and Ms. Watson of California. Thank you for being here.

The next witness, Mr. Rinehart. Mr. Rinehart is vice president and chief risk officer of the Ocwen Financial Corp. Thank you for being here. Please proceed.

STATEMENT OF WILLIAM RINEHART

Mr. RINEHART. Thank you, Mr. Kucinich, Ranking Member Issa, and members of the committee, for giving me and Ocwen Financial Corp. the opportunity to share our thoughts with you today.

We—and I mean that in the broadest sense to include the mortgage industry, Congress, regulators, consumer advocates, and State officials—have two issues to address. The first is what changes are needed to ensure that all participants in the origination of subprime mortgages act responsibly. The second, what do we do to assist borrowers who are already facing difficulty.

Insofar as Ocwen is a loan servicer and not an originator or broker, my remarks today will focus primarily on the second point; that is, what Ocwen is doing to help our servicing customers who are currently having trouble repaying their loans to stay in their homes.

As I indicated in my written statement provided to you, foreclosure is a lose/lose/lose proposition for the homeowner, for Ocwen as servicer, and for the investor who owns the loan. Foreclosure should be pursued only when all other options have failed.

Regardless of the type of loan the borrower has or how it was underwritten, subprime borrowers often have little financial cushion to withstand any financial shocks. Any change in their income level through job loss, reduction in hours, death or disability of a wage earner, or unexpected expenses. A leaky roof, broken hot water heater or furnace, new transmission for their car, or medical expenses can cause an immediate crisis for these homeowners.

Borrowers already facing difficulty in repaying their mortgage who are then impacted by an interest rate increase because they have an adjustable rate mortgage have a high likelihood of experiencing financial default. Because foreclosure is a bad economic proposition for all parties, Ocwen has worked hard to develop processes to help defaulting customers find alternatives to foreclosure. Ocwen is proud of our industry-leading loss mitigation programs that avoid foreclosure for more than 80 percent of our customers who become 90 days or more past due. In the small percentage of cases that do go to foreclosure, the primary root cause is our inability to open a line of communication with our customer.

Despite our repeated attempts to reach out to our customers through telephone calls and letters, some customers, due to shame, fear, and a lack of knowledge, tune us out. We also make available to borrowers an instructional DVD that explains the various solutions available to them. If the committee would like a copy, I would be happy to provide one.

Mr. KUCINICH. We would.

Mr. RINEHART. OK.

Mr. KUCINICH. Thank you.

Mr. RINEHART. But, again, if the customer won't talk to us, we can't help them.

To close the communication gap, Ocwen has partnered with non-profit housing advocacy groups, including the National Training and Information Center in Chicago and their affiliate, the East Side Organizing Project in Cleveland, to reach out to Ocwen customers to try to find alternatives to foreclosure. We provide lists of our customers who we have been unable to contact to these housing advocacy groups. Receiving contact from a local trusted community group such as ESOP may spur the Ocwen customer to make a call and take that critical first step to avoiding foreclosure.

Through these partnerships, we have helped many Ocwen customers stay in their homes. Substantial changes in how subprime mortgages are granted have already occurred, and more are likely to occur. These changes have resulted from market factors—that is, investors and investment banks are requiring product and underwriting changes—and from recent regulatory guidance. These changes will reduce the number of new borrowers finding themselves in trouble only months after receiving their loan. These changes, however, will make it more difficult for borrowers already in a loan to fix their current problems.

Ocwen and other servicers, groups like NTIC and ESOP, investors, and investment banks must work together to help these homeowners already facing difficulties.

Thank you.

[The prepared statement Mr. Rinehart follows:]

Testimony before Subcommittee on Domestic Policy, Committee on Oversight and Government Reform by William E. Rinehart, Vice President and Chief Risk Officer, Ocwen Financial Corporation on March 21, 2007

Chairman Kucinich, Ranking Member Issa, and Members of the Committee, it is a pleasure to have been invited by the Committee to provide insights into the nature of the subprime lending problem as faced by borrowers. In addition, I have also been asked for my views on the effectiveness of federal regulators, the industry and on the ways in which cities are affected by the rise of foreclosure, and my views on the ways in which consumers and the stock market are affected by the proliferation of the subprime mortgage industry.

Let me start with some background on my employer, Ocwen Financial Corporation. Ocwen is a publicly traded company (NYSE: OCN) headquartered in West Palm Beach, Florida, specializing in the servicing of subprime residential mortgage loans. We currently service approximately 480,000 loans totaling $55 billion in unpaid principal. Ocwen neither originates nor owns the loans we service; rather, we provide loan servicing for various investors who own the loans, typically large fixed-income institutional investors. Most of the loans we service are considered subprime and they are part of REMIC Securities.

I think it is important to stress at the onset that foreclosure is clearly a lose/lose/lose proposition for all parties involved in lending. It is especially most painful on families that lose their homes. As Members of this Committee know all too well, as do all the witnesses that will appear before this Committee today, homeownership is not only an American dream, but many times the first step in financial security for millions of Americas. We must do all we can to ensure this for today and tomorrow's homeowners. As I will discuss, Ocwen is always looking for ways to make this so.

In order to better understand what Ocwen does, it would be helpful to provide an overview of the subprime mortgage industry and put in context our role in that process.

Most subprime loan transactions start with a mortgage broker who has direct contact with the consumer. The mortgage broker is responsible for understanding the consumer's requirements and helping the consumer complete the loan application. The broker then submits that application to one or more lenders or originators. The lender is responsible for underwriting the loan by reviewing the loan application, a credit report on the applicant, an appraisal on the property and other information.

The lender will base the credit decision on the applicant's credit history, income, assets and liabilities and the value of the property. The interest rate offered will reflect the overall risk of the transaction as determined by the underwriting process and the type of product requested. Certain loan characteristics (income documentation type, prepayment penalty, loan to value) and applicant characteristics (credit score) will determine the offered rate.

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When the loan is funded and closed, the lender will either hold the loan in its portfolio or sell the loan. Most subprime loans are originated by lenders that are not operating under federal charters or federal regulation. These lenders are sometimes referred to as "non-depositories" as they are not banks or thrifts that accept deposits as a means of financing their loans. As these non-depositories rely on lines of credit to finance the closed loans, they typically sell the loans as quickly as possible to avoid both interest costs on carrying the loan and interest rate risk.

Most of these loans are sold to an investment bank. The investment bank purchases loans from multiple lenders, assembles the loans into a loan pool, creates a security and sells the security (or securities) to various investors. The investors are large institutional investors, hedge funds, pension funds and other fixed-income investors. The investment bank also sells the servicing rights to a servicer such as Ocwen through an auction process. Ocwen buys the right to service the loans in the security and collect a servicing fee for its work.

This is a critical element of the economics of subprime mortgages. Ocwen only collects that servicing fee as long as the loan is outstanding. If a loan goes through foreclosure, Ocwen loses the servicing fees that it already paid for.

This is an important fact because it explains why foreclosure it not a good economic proposition for Ocwen as servicer. We lose the servicing fee if the loan goes through the foreclosure process. It is also important to note that foreclosure is not an event that benefits the investor who owns the loan. Our experience is that the investor sustains a loss on 97% of foreclosures. And, of course, the consumer loses his/her home and the neighborhood has another vacant property for some period of time until the property is resold.

Foreclosure is clearly a lose/lose/lose proposition for all parties. Under the contracts that spell out our duties as servicer, we are required to take actions to return the maximum amount of contractual principal and interest to the investor. In the vast majority of cases, finding a way to keep a customer in their home and continuing to pay their mortgage is the best economic proposition for the customer, the servicer and the investor.

Ocwen is proud of our industry-leading loss mitigation efforts. During 2006 we were able to resolve the loans of more than 80% of severely delinquent customers in a way that avoided foreclosure. We do this through a consultative approach with each customer to determine the optimal resolution to their delinquency. We first determine if the customer wants to stay in their home. In some cases they do not, and we work with them to dispose of the property in the most timely and value-maximizing manner. If the customer wants to stay in the home, we review their financial situation to determine their ability to pay, and work hard to find a payment plan that will accommodate their situation.

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In the less than 20% of the cases where we are unable to avoid foreclosure, the reasons are varied. In some cases the customer has abandoned the property. In a small number of cases the customer just does not have the income to be able to stay in the home. In about half the cases of foreclosure, we are unable to make contact with the customer. Despite repeated telephone calls and letters, several of which are certified, we are unable to talk to the customer to try and work out an arrangement. To clarify this, we may attempt to contact a customer multiple times over many months and still make no contact. We even send our customers a DVD that explains to them why it is so important that they speak with us so we can help them. I have brought copies of this DVD to for the Committee Members and staff to review.

We consider foreclosure to be a failure. In fact, our incentive compensation plan for our late-stage loss mitigation employees includes a deduction for every loan that completes the foreclosure process. This is why we do everything we can to contact the customer to find an alternative to foreclosure.

One of the innovative approaches we take is to partner with non-profit housing groups in various cities to help us contact our customers. Groups like the East Side Organizing Project (ESOP) in Cleveland, Ohio reach out to Ocwen customers who have otherwise not made contact with us. Our hope is that a contact from a local, trusted consumer-advocacy group will be successful where our efforts have not been successful. If ESOP is successful in making contact with the customer, they will often meet face-to-face with the customer, collect financial information, understand their situation, and bring the customer to Ocwen to negotiate a non-foreclosure resolution.

Currently we have this program in place with nine affiliates of the National Training and Information Center (NTIC) based in Chicago. In addition to ESOP in Cleveland, we work with other NTIC affiliates in Chicago, Cincinnati, Pittsburgh, Indianapolis, Kansas and Iowa and the St. Ambrose Housing Aid Center in Baltimore. We are currently discussing this program with other national and local consumer groups. While we can only count our successes with this program in the hundreds so far, each success preserves homeownership for a family and helps maintain some stability in their neighborhood.

Our experience in this program and our daily loss mitigation efforts reveals many of the problems faced by subprime borrowers. The most common cause of delinquency and default is a change in borrower circumstances. The most prevalent cause is job loss or reduction in hours. Many subprime borrowers live from paycheck to paycheck. A reduction in income is critical to these borrowers. Death or disability of a wage earner in a household is another primary reason for repayment difficulties. Additionally, as many subprime borrowers have little or no savings, any unexpected expense can cause a financial crisis for these households. A broken hot water heater, leaky roof, or even a transmission repair on a vehicle is enough to put these families in crisis. Medical bills for a household member can also force borrowers to make painful decisions as to how to prioritize their limited resources.

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An all too-frequent problem we see in our servicing business is the borrower who is unable to pay their annual bill for property taxes and hazard insurance. While most prime mortgage loans involve monthly escrow payments toward these major outlays, only 47% of the subprime first lien loans we service come to us with escrows in place. These are the borrowers who most need the discipline of contributing to these amounts each month. Ocwen makes an effort to communicate to all new servicing customers the importance and benefits of escrow accounts, but for many of them the additional monthly amount on top of their principal and interest cannot be accommodated.

I have been asked to address the effectiveness of federal regulators. It is important to reiterate that most subprime loans are originated by non-depositories, companies that are not federally regulated. The largest specialty subprime lenders are generally state-licensed and not subject to oversight by the Federal Reserve, the Office of Thrift Supervision, the Office of the Comptroller of the Currency or the Federal Deposit Insurance Corporation. Notwithstanding their lack of direct supervision, these regulators do influence all mortgage lenders. An example is the FFIEC guidance released in the fall of 2006 pertaining to interest-only and option ARM loans. Only months after this guidance was released, it was quickly adopted by most state regulatory bodies. Even without the force of law, it quickly became an industry standard.

However, as many consumer advocates and others observed, interest only and option-ARM loans are not as prevalent in the subprime industry as "regular" ARM loans, including "2/28" loans and "3/27" loans. These loans generally have a lower rate than similar fixed rate loans, but the introductory fixed rate of these ARM loans resets to a spread over an index after either 24 months or 36 months. Generally, the first rate reset with be in the range of 2.5% to 3.0% above the introductory rate, and subsequently reset every six months thereafter. So, a loan initiated at 7.0% could increase to 10.0% within two to three years after origination.

In addition to the rate resets, these loans were underwritten with the assumption that the borrower was repaying a 7.0% loan, not a 10.0% loan. With the proposed new federal guidance now including regular ARM loans, underwriting standards for the subprime industry will likely change just as they did with the prior guidance.

In the recent past, borrowers facing these rate resets could simply get a new loan to avoid paying the higher reset rate. Coupled with steadily increasing property values, many borrowers not only refinanced but also pulled out more of this newly-created equity and used the cash for other personal purposes. Even borrowers facing some difficulty in repaying their current loans were able to borrower more money in a new loan to help stave off financial crisis (for a little while, anyway).

However, this game of musical chairs, borrowers getting a new loan and more money to pay out the prior loan, is over. The music has stopped. Property values are no longer increasing. In many overheated markets, property values are dropping. Moreover, more rational underwriting standards now in place or proposed will preclude these borrowers from qualifying for a new loan. These tighter underwriting standards will reduce the number of new borrowers receiving a mortgage loan they can't repay, but it locks out many current borrowers who are now stuck in a loan with increasing interest rates. These borrowers who qualified for a loan only months ago will no longer have access to mortgage credit and will have to find a way to deal with their current loan.

What is the impact of these issues? As discussed, many borrowers who currently have loans will no longer qualify for a new loan to help solve their current problems. Many of these borrowers may experience delinquency, default and foreclosure. Relaxed underwriting allowed many of these borrowers to buy a home with no cash down payment. In some cases, as a result of cooling property values, many of these borrowers now have loans with balances in excess of the value of their homes. With no investment in the property, many of these borrowers will walk away from their homes and their obligations.

Unfortunately, those who do walk away from their obligations further tarnish their credit histories, potentially eliminating any future opportunity at homeownership. Their effort to participate in the American dream of homeownership has, for some, become a bad dream.

Foreclosures result in vacant properties. These vacant properties, if not properly secured and maintained, can quickly become a blight on their neighborhoods and depress surrounding property values. There is some evidence that the "easy credit" offered by some subprime lenders fostered property flipping where unsuspecting borrowers were sold inner-city properties at greatly inflated values. Clearly neighborhoods and cities are impacted by an increasing number of foreclosed properties.

I have also been asked to comment on the impact of subprime mortgages on the stock market. We have all read the recent impact on the stock prices of specialty subprime lenders. Some of these companies may not survive the current dislocations in the industry. Moreover, the stock prices of many companies with even modest subprime exposures are down. I am not an expert in the machinations of the stock market, but some who are suggest that investors are overreacting to the current negative news of subprime lenders. Perhaps with the exception of home builders, it is difficult to conceive that the stock prices of other businesses or industries will be affected by the poor performance of some subprime loans.

The cooling of real estate markets is not a result of issues in the subprime industry, but rather a result of rising interest rates and hyper-speculation. The increase in property values did not reflect normal supply and demand factors but irrational demand. Markets are returning to a more rational equilibrium. Will the removal of some number of potential homebuyers due to changes in subprime underwriting aggravate the downturn in the housing industry? Quite possibly. But market corrections are inevitable, particularly a market that was heavily influenced by speculation and not true buyer demand.

Changes in the subprime industry are appropriate and necessary. In their zeal to maintain their growth rates, many subprime lenders forgot (or ignored) the basic tenet of lending- the borrower should be able to repay the debt. Market forces have already brought about change. The high delinquency of many subprime loans in mortgage-backed securities has caused investors and investment banks who buy the loans to impose tighter underwriting requirements. Regulation and, perhaps, legislation may bring about additional changes in how new loans are granted.

In the meantime, Ocwen and other servicers, investors, investment banks and groups likes NTIC and ESOP in Cleveland will have to continue to work hard and work together to help borrowers try and keep their piece of the American dream.

Respectfully submitted by:

William E. Rinehart
Vice President and Chief Risk Officer
Ocwen Financial Corporation
1661 Worthington Road
West Palm Beach, Florida 33409
Telephone: 561-682-7041
Email: william.rinehart@ocwen.com

Mr. KUCINICH. I thank the gentleman.

We will next hear from Josh Nassar, who is with the Center for Responsible Lending.

Please proceed.

STATEMENT OF JOSH NASSAR

Mr. NASSAR. Thank you, Chairman Kucinich, Ranking Member Issa, and members of the committee for having this important hearing today, and thank you for inviting me to testify on this important topic.

As has been mentioned, we estimate that, of the subprime mortgages made in the past 2 years, 20 percent will fail, not just enter foreclosure, but the person will actually lose their home. The impact on urban communities is absolutely profound. Keep in mind that over half of African American homeowners have subprime mortgages and 40 percent of Latino homeowners.

When looking at the practices in the subprime industry, it really should come as no surprise that we are seeing such high rates of foreclosures. The dominant loan product in the subprime market that most homeowners in subprime market have is called a 2/28 or a 3/27 hybrid ARM. That simply means that for the first 2 or 3 years the person has a fixed-rate loan. Then it enters an adjustable period.

But here's the problem: these loans have a built-in payment shock of at least 30 percent, meaning that if you have a $2,000 monthly payment, it is going to jump to $2,600, at least. Generally these loans are only underwritten. The lender is only providing a loan based on the person's ability to afford the loan for the fixed rate period, not for the adjustment period, so it really shouldn't come as a surprise that we are seeing these problems.

The other thing is that many times, as has been mentioned, people are receiving no-doc and low doc note loans, which make it extremely difficult for someone to actually afford the cost of the loan and generally costs more money.

Lenders also frequently do not escrow for taxes and insurance, meaning that a person has a major bill due in addition to the payment shock. And most subprime homeowners have a prepayment penalty. Over 70 percent of subprime homeowners have prepayment penalties on their loans. Less than 5 percent of prime borrowers have prepayment penalties. This means that most homeowners have a terrible choice. They get hit with the prepayment penalty, or they have to pay the adjusted rate. It is a lose/lose situation. They are between a rock and a hard place.

Another thing that should be taken into account is that many people in the subprime market actually qualify for prime loans. It has been estimated by Freddie Mac that at least 20 percent of people in the subprime market who receive subprime loans could qualify for a prime loan, and the reason why is because there is massive steering going on in the subprime industry.

We have shown in our research, which I attached to the testimony, that African American and Latino homeowners are 30 percent more likely to have a subprime loan, even when they have the same credit score as their white counterparts. So it is not just about credit risk. There is a lot more going on here.

So what should be done? That is the natural question. Well, first of all Congress should pass a comprehensive anti-predatory lending law that not only holds lenders and brokers accountable but also allows States and localities to add additional protections down the road.

We should also have a return to sound underwriting where a person is qualified for a loan not just for the initial period but also when the loan adjusts upward. Without that, it is going to be ineffective.

In addition, brokers really need to have more duties, a fiduciary duty to homeowners. Over 70 percent of subprime loans are made by mortgage brokers, and so if we are going to attack this problem we have to deal with the role of mortgage brokers who have a financial incentive to put people in a higher rate loan than what they qualify for through the payment of yield spread premiums.

In addition, the Federal regulators, bank regulators, have proposed new guidance which calls on institutions to underwrite loans to the adjusted rate. We hope that those regulations are, in fact, finalized, and then the Federal reserve makes sure that it is applied to the entire market, not just to national banks and to federally regulated banking institutions.

And we encourage lenders and servicers to reach out to homeowners now to try to avoid what we will perceive is a much bigger problem as far as people entering foreclosures.

Finally, we call on the GSEs to play an increased role. Recently Freddie Mac announced that they were going to require from the loans they buy that lenders are actually going to underwrite to the adjusted rate, to after the teaser rate. Fannie Mae, unfortunately, has not followed their lead and has not taken the same action. We would hope that Fannie Mae would take the same action.

The impact of these issues on communities and wealth, it is difficult to overstate. I would just say to keep in mind that African American and Latino households have only 17 percent of the wealth of white households, so the impact and abuses in subprime industry are just absolutely devastating.

Thank you. I would be happy to answer your questions.

[The prepared statement of Mr. Nassar follows:]

Testimony of Josh Nassar
Center for Responsible Lending

Before the U.S. House Committee on Oversight and Government Reform

"Foreclosure, Predatory Mortgage and Payday Lending in America's Cities."

March 21, 2007

Chairman Kucinich, Ranking Member Issa, and members of the Committee, thank you for holding this hearing to examine the problems of foreclosures and predatory lending in the subprime market and their impact on urban America, and thank you for the invitation to speak today.

My name is Josh Nassar and I serve as the Vice-President for Federal Affairs for the Center for Responsible Lending (CRL) (www.responsiblelending.org). CRL is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL began as a coalition of groups in North Carolina that shared a concern about the rise of predatory lending in the late 1990s.

CRL is an affiliate of Self Help (www.self-help.org), which consists of a credit union and a non-profit loan fund. For the past 26 years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans. Self-Help has provided over $5 billion of financing to over 50,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across the country, with an annual loan loss rate of under one percent. We are a subprime lender. In fact, we began making loans to people with less-than-perfect credit in 1985, when that was unusual in the industry. We believe that homeownership represents the best possible opportunity for families to build wealth and economic security, taking their first steps into the middle class.

In my remarks today, I will focus on subprime home loans—the development of the market, its characteristics and consequences, particularly for families in urban areas. As I will discuss in more detail, inequities in the market and massive foreclosures are having a devastating effect all over the nation, including urban areas with high concentrations of minority residents.

The performance of the subprime market and subprime foreclosures matter because homeownership is by far the most important wealth-building tool in this country. For millions of families, it ultimately makes the difference between merely surviving between paychecks or building savings for a better future. Nearly 60 percent of the total wealth held by middle-class families resides in their home equity—the value of their home minus the amount they owe on it. For African-American and Hispanic families, the share is much higher, topping 88 percent for both groups.[1]

Another reason the performance of the subprime market matters: Americans are carrying more debt, and today we owe more on our homes than ever before. Even with lower interest rates in recent years, homeowners have been dedicating more of their disposable income (the amount left after paying all essential expenses) to paying their mortgages. In March 2001, the average household spent about nine percent of its disposable income to pay its mortgage. During the third quarter of 2005, households were spending nearly 11 percent.[2]

In a nation where homeownership is so important to financial security, and where so many families are burdened with high debt, it appears that subprime lending is pushing many vulnerable consumers backward instead of forward.

During the past year, CRL has published two research reports that have highly disturbing implications for families seeking to gain a secure position in the middle class. In a report issued last May, our analysis shows that African Americans and Latinos receive a disproportionate share of subprime loans, even when they have similar credit scores to white borrowers. And in December, we issued a report showing that subprime home loans are resulting in a devastating epidemic of foreclosures. At the time the report was issued, some industry representatives said it was overly pessimistic. Today our projections are looking right on track, or even conservative. In fact, a recent analysis by the investment bank Lehman Brothers projects 30 percent losses over time on subprime loans made in 2006.[3]

Most of the research CRL conducts is nationwide in its scope, but our research findings have particular implications for communities concerned about wealth-building. For most Americans, buying a home is the most accessible path to financial security, but today there are serious questions about whether expanded lending in the subprime market has been helpful or harmful. At least one point is clear: subprime lending is having a huge impact on communities of color. It is well established that African Americans and Latinos are paying higher costs for mortgages.[4] In CRL's research, we show that these mortgages are <u>not</u> resulting in sustainable homeownership, and may actually be pushing minority homeowners backward financially instead of helping them build wealth and security.

Under typical circumstances, foreclosures occur because a family experiences a job loss, divorce, illness or death. However, the epidemic of home losses in today's subprime market is well beyond the norm. Subprime lenders have virtually <u>guaranteed</u> rampant foreclosures by pushing risky loans on families while knowing that these families will not be able to pay the loans back. There are several factors driving massive home losses:

- **Risky products**. Subprime lenders have flooded the market with high-risk loans, making them appealing to borrowers by marketing low monthly payments based on low introductory teaser rates. The biggest problem today is the proliferation of hybrid adjustable-rate mortgages ("ARMs," called 2/28s or 3/27s), which begin with a fixed interest rate for a short period, then convert to a much higher interest rate and continue to adjust every six months, quickly jumping to an unaffordable level.

- **Loose underwriting**. It is widely recognized today, even within the mortgage industry, that lenders have become too lax in qualifying applicants for subprime loans.[5] These practices are especially troubling: qualifying borrowers without any verification of income; qualifying borrowers without considering the costs of required property taxes and hazard insurance; and failing to account for how borrowers will be able to pay their loan once the payment adjusts after the teaser period expires.

- **Broker abuses**. Today's market includes perverse incentives for mortgage brokers to make high-risk loans to vulnerable borrowers. Brokers often claim that borrowers engage them for their knowledge and generally believe that brokers are looking for the best loan terms available. Yet brokers also claim they do not need to serve the borrower's best interests.

- **Investor support**. Much of the growth in subprime lending has been spurred by investors' appetite for high-risk mortgages that provide a high yield. The problem is that the investor market reaction occurs only after foreclosures are already rampant and families have lost their homes.

- **Federal neglect**. Policymakers have long recognized that federal law—the Home Ownership and Equity Protection Act of 1994 (HOEPA)—governing predatory lending is inadequate and outdated. Although the Federal Reserve Board (hereinafter, the "Board") has the authority to step in and strengthen relevant rules, they have steadfastly refused to act in spite of years of large-scale abuses in the market. For the majority of subprime mortgage providers, there are no consequences for making abusive or reckless home loans.

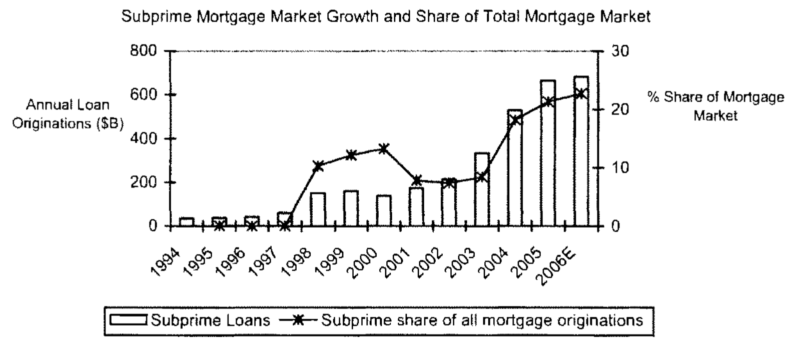
While there is a strong need for comprehensive reforms of the subprime mortgage market, including weeding out abuses in how mortgage servicers handle monthly payments, my primary focus in these comments will be on loan origination practices and how high-risk loans in the subprime market are supported and regulated.

I. The Subprime Market and the Evolution of Predatory Lending[6]

The severe downturn in the subprime markets has been prominent in the media recently, but problems on subprime mortgages are not new. Before discussing the current problems, I would like to provide a bit of context on the growth of the subprime market and the evolution of predatory lending.

The subprime market is intended to provide home loans for people with impaired or limited credit histories. In addition to lower incomes and blemished credit, borrowers who get subprime loans may have unstable income, savings, or employment, and a high level of debt relative to their income.[7] However, there is evidence that many families—a Freddie Mac researcher reports one out of five—who receive subprime mortgages could qualify for prime loans, but are instead "steered" into accepting higher-cost subprime loans.[8]

As shown in the figure below, in a short period of time subprime mortgages have grown from a small niche market to a major component of home financing. From 1994 to 2005, the subprime home loan market grew from $35 billion to $665 billion, and is on pace to match 2005's record level in 2006. By 2006, the subprime share of total mortgage originations reached 23 percent.[9] Over most of this period, the majority of subprime loans have been refinances rather than purchase mortgages to buy homes. Subprime loans are also characterized by higher interest rates and fees than prime loans, and are more likely to include prepayment penalties and broker kickbacks (known as "yield-spread premiums," or YSPs).



Source: Inside Mortgage Finance

When considering the current state of the subprime market, it is useful to understand how predatory lending has evolved over the past 15 years. When widespread abusive lending practices in the subprime market initially emerged during the late 1990s, the primary problems involved equity stripping—that is, charging homeowners exorbitant fees or selling unnecessary products on refinanced mortgages, such as single-premium credit insurance. By financing these charges as part of the new loan, unscrupulous lenders were able to disguise excessive costs. To make matters worse, these loans typically came with costly and abusive prepayment penalties, meaning that when homeowners realized they qualified for a better mortgage, they had to pay thousands of dollars before getting out of the abusive loan.[10]

In recent years, when the federal government failed to act, a number of states moved forward to pass laws that address equity-stripping practices. Research assessing these laws has shown them to be highly successful in cutting excessive costs for consumers without hindering access to credit.[11] The market has expanded at an enormous rate during recent years even while states reported fewer abuses targeted by new laws.

In spite of this success, no one would say that predatory lending has been eliminated. Prepayment penalties continue to be imposed on 70 percent of all subprime loans,[12] and many other "old" predatory practices are still alive and well in today's marketplace: "Steering," when predatory lenders push-market borrowers into a subprime mortgage even when they could qualify for a prime loan; kickbacks to brokers (yield-spread premiums) for selling loans with an high interest rate higher than the rate to which the borrowers actually qualified; and loan "flipping," which occurs when a lender refinances a loan without providing any net tangible benefit to the homeowner.

A. Pricing Issues

Risk-based pricing made the growth of the subprime market possible, but the market has consistently been plagued with questions about whether pricing on subprime mortgages is actually fair. As far back as 2000, a joint report by the U.S. Department of Housing and Urban Development and the U.S. Department of the Treasury noted that "[i]n predominantly black neighborhoods, subprime lending accounted for 51 percent of refinance loans in 1998—compared with only nine percent in predominantly white neighborhoods."[13] The researchers observed that these differences persisted even when adjustments were made to account for differences in homeowners' incomes. Though disconcerting, these observations were not based on a direct measurement of the cost of mortgages, nor did they account for a broader set of risk factors routinely used to determine loan prices.

In 2005, staff to the Board of Governors of the Federal Reserve System analyzed the distribution of these higher-rate loans.[14] They report pricing disparities between different racial and ethnic groups even after controlling for a borrower's income, gender, property location, and the loan amount. For example, after accounting for these differences, African-Americans who took a loan to purchase a home were 3.1 times more likely than white non-Hispanic borrowers to receive a higher-rate home loan; for Latino borrowers, the same disparity stood at 1.9 times.[15]

While this Federal Reserve analysis confirmed that African-American and Latino borrowers were more likely to receive higher-rate loans than white borrowers, the researchers were unable to broadly explore how these disparities were affected by risk factors such as borrowers' credit score, down payment, or ability to document income. To help advance the debate, my organization, the Center for Responsible Lending, has produced the first full research report that addresses this limitation.[16] (The executive summary of that report is submitted with the paper copy of this testimony.)

Specifically, we developed a database of 177,000 subprime loans by matching loans in HMDA to a private database of subprime mortgages. This step allowed us to bring together detailed information on mortgage pricing, loan terms, and borrower risk characteristics in a single dataset. As a result, our study was able to account for those factors and isolate the effects of race and ethnicity in influencing whether a borrower receives a higher-rate loan in the subprime market.

Our findings were striking. We found that race and ethnicity—two factors that should play no role in pricing—are significant predictors of whether a subprime loan falls into the higher-rate portion of the market. Race and ethnicity remained significant predictors even after we accounted for the major factors that lenders list on rate sheets to determine loan pricing.

In other words, even after controlling for legitimate loan risk factors, including borrowers' credit score, loan-to-value ratio, and whether the borrowers documented their income, race and ethnicity matter. African American and Latino borrowers continue to face a much greater likelihood of receiving the most expensive subprime loans—even with the same loan type and the same qualifications as their white counterparts. Across a variety of different loan types, African American and Latino borrowers were commonly 30 percent more likely to receive a higher-rate loan than white borrowers.

B. The Emergence of Riskier Products

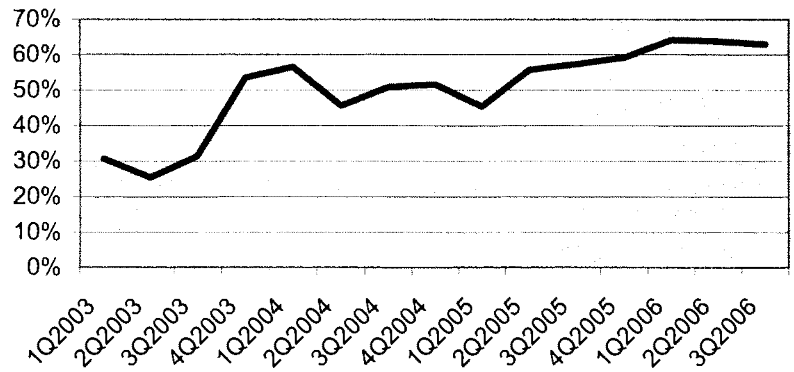
In addition to pricing issues, a more recent concern has emerged in the subprime market: high-risk loan products that were never intended for families who already have credit problems—the 2/28 and 3/27 loans previously mentioned. The risks posed by these loans are magnified further because they are designed to generate refinances. These loans typically begin with a low introductory interest rate that increases sharply after a short period of time (one to three years) and fails to account for escrows for required taxes and insurance. The very design of these loans forces struggling homeowners to refinance to avoid unmanageable payments. In other words, the prohibition against flipping that many states instituted has been defeated by the design of a particular subprime mortgage product that has dominated the market in recent years.

While multiple refinances boost volume for lenders, these transactions often provide only temporary relief for families, and almost inevitably lead to a downward financial spiral in which the family sacrifices equity in each transaction. These dangerous subprime hybrid ARM loan products and the ensuing refinances make a high rate of foreclosures not only a risk, but also a certainty for far too many families. And the likelihood of foreclosure will only increase as housing prices slow and accumulated equity is no longer available to refinance or sell under duress.

C. Foreclosures in the Expanding Subprime Market

In the United States, the proportion of mortgages entering foreclosure has climbed steadily since 1980, with 847,000 new foreclosures filed in 2005.[17] In 2006, lenders reported 318,000 new foreclosure filings for the third quarter alone, 43 percent higher than the third quarter of 2005.[18] In the past 18 months, there have been frequent stories in the media about risky lending practices and surges in loan defaults, especially in the subprime market.[19]

Subprime Foreclosure Starts as a Percent of Total Conventional Foreclosure Starts



Source: MBA National Delinquency Surveys

Figure 2 shows that foreclosure filings on subprime mortgages now account for over 60 percent of new conventional foreclosure filings reported in the MBA National Delinquency Survey. This fact is striking given that only 23 percent of current originations are subprime, and subprime mortgages account for only 13 percent of all outstanding mortgages.

Late last year we published a report that represents the first comprehensive, nationwide research conducted on foreclosures in the subprime market. The report, "Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners," is based on an analysis of over six million subprime mortgages, and the findings are disturbing. Our results show that despite low interest rates and a favorable economic environment during the past several years, the subprime market has experienced high foreclosure rates comparable to the worst foreclosure experience ever in the modern prime market. We also show that foreclosure rates will increase significantly in many markets as housing appreciation slows or reverses. As a result, **we project that 2.2 million borrowers will lose their homes and up to $164 billion of wealth** in the process. That translates into foreclosures on one in five subprime loans (19.4 percent) originated in recent years. Taking account of the rates at which subprime borrowers typically refinance from one subprime loan into another, and the fact that each subsequent subprime refinancing has its own probability of foreclosure, this translates into projected foreclosures for **more than one-third of subprime borrowers**.

Another key finding in our foreclosure report is that subprime mortgages typically include characteristics that significantly increase the risk of foreclosure, regardless of the borrower's credit. Since foreclosures typically peak several years after a loan is originated, we focused on the performance of loans made in the early 2000s to determine what, if any, loan characteristics have a strong association with foreclosures. Our findings are consistent with other studies, and show what responsible lenders and mortgage insurers have always known: increases in mortgage payments and poorly documented income substantially boost the risk of foreclosure. For example, even after controlling for differences in credit scores, these were our findings for subprime loans made in 2000:

- Adjustable-rate mortgages had 72 percent greater risk of foreclosure than fixed-rate mortgages.
- Mortgages with "balloon" payments had a 36 percent greater risk than a fixed-rate mortgage without that feature.
- Prepayment penalties are associated with a 52 percent greater risk.
- Loans with no documentation or limited documentation of the applicant's income were associated with a 29 percent greater risk.
- And buying a home with a subprime mortgage, versus refinancing, puts the homeowner at 29 percent greater risk.

The report also used Moody's Economy.com housing appreciation forecasts to project subprime foreclosure rates in every metropolitan statistical area in the United States. Our research shows that local markets with high housing appreciation in recent years are likely to experience marked increases in subprime foreclosure rates as this appreciation slows or reverses. The data indicate that many urban areas in particular will experience extremely high losses. As one example, here in the greater Washington, D.C. area, projected lifetime foreclosure rates on subprime loans made from 1998 through 2001 are slightly over eight percent, but for subprime mortgages made in 2006, the projected foreclosure rate shoots up to nearly 23 percent. Overall, the greatest jumps in foreclosure rates are clustered in California, where we found 14 of the top 15 largest increases. For example, in the greater San Diego area, foreclosure rates on subprime loans made from 1998 through 2001 were only 3.2 percent, but we project that 21.4 percent of the loans made in that area last year will fail.

A full copy of the "Losing Ground" foreclosure study appears on CRL's website at http://www.responsiblelending.org/issues/mortgage/reports/page.jsp?itemID=31217189. This report includes a chart showing our subprime foreclosure rate projections in 378 metropolitan areas.

D. Disparate Impacts of Foreclosures

The costs of subprime foreclosures are falling heavily on African-American and Latino homeowners, since subprime mortgages are disproportionately made in communities of color. The most recent lending data submitted under the Home Mortgage Disclosure Act (HMDA) show that over half of loans to African-American borrowers were higher-cost loans, a measurement that serves as a proxy for subprime status.[20] For Latino homeowners, the portion of higher-cost loans is also very high, at four in ten. The specific figures are shown below:

Share of Higher Cost Mortgages by Race

Based on 2005 Data Submitted Under the Home Mortgage Disclosure Act

Group	No. of Higher-Cost Loans	% for Group	% of Total
African American	388,741	52%	20
Latino	375,889	40%	19
White	1,214,003	19%	61

Given the projected foreclosure rate of approximately one-third of borrowers taking subprime loans in recent years, this means that subprime foreclosures could affect approximately 12 percent of recent Latino borrowers and 16 percent of African-American borrowers. If this comes to pass, it is potentially the biggest loss of African-American wealth in American history.

However, while the negative impact of foreclosures falls disproportionately on communities of color, the problem is not confined to any one group. In absolute terms, white homeowners received three times as many higher-cost mortgages as African-American borrowers, and therefore will experience a significant number of foreclosures as well.

II. Factors Driving Foreclosures in the Subprime Market

A. Risky Products: 2/28 "Exploding" ARMs

Subprime lenders are routinely marketing the highest-risk loans to the most vulnerable families and those who already struggle with debt. Because the subprime market is intended to serve borrowers who have credit problems, one might expect the industry to offer loan products that do not amplify the risk of failure. In fact, the opposite is true. Lenders seek to attract borrowers by offering loans that start with deceptively low monthly payments, even though those payments are certain to increase. As a result, many subprime loans can cause "payment shock," meaning that the homeowner's monthly payment can quickly skyrocket to an unaffordable level.

Unfortunately, payment shock is not unusual, but represents a typical risk that comes with the overwhelming majority of subprime home loans. Today the dominant type of subprime loan is a hybrid mortgage called a "2/28" that effectively operates as a two-year "balloon" loan.[21] This ARM comes with an initial fixed teaser rate for two years, followed by rate adjustments in six-month increments for the remainder of the term of the loan.[22] Commonly, this interest rate increases by between 1.5 and 3 percentage points at the end of the second year, and such increases are scheduled to occur even if interest rates in the general economy remain constant; in fact, the interest rates on these loans generally can only go up, and can never go down.[23] This type of loan, as well as other similar hybrid ARMs (such as 3/27s) have rightfully earned the name "exploding" ARMs.

One would hope that this type of loan would be offered judiciously. In fact, hybrid ARMs (2/28s and 3/27s) and hybrid interest-only ARMs have become "the main staples of the subprime sector."[24] Through the second quarter of 2006, hybrid ARMs made up 81 percent of the subprime loans that were packaged as investment securities. That figure is up from 64 percent in 2002.[25]

Recently federal regulators issued a proposed statement that explicitly offers greater protections against the risks posed by exploding ARMs. The proposal specifies that depository lenders and their affiliates would be required to consider the potential for unaffordable increases in house payments before approving hybrid ARMs. Specifically, the statement says that an institution's analysis of a subprime borrower's repayment capacity should include an evaluation of the borrower's ability to repay the debt by its final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule.

As regulators receive comments on their Statement, one point some in the industry are likely to argue that consumers demand these types of loans and should carry all the responsibility for receiving unsuitable loan products. Through our experience at Self Help and CRL, we have seen that homeowners with subprime ARMs or other types of risky loans were almost never given a choice of products, but were instead automatically steered to these loans, and were given little or no explanation of the loan's terms. Mortgage brokers and lenders are the experts, and consumers should be able to trust them for sound advice and a suitable loan.

It is not hard to find examples of trust that was betrayed. One example appeared recently in *The Washington Post*, which published an article about a barely literate senior citizen who was contacted by a mortgage broker every day for a year before he finally took an "alternative" mortgage against his interests.[26] Recently we at CRL informally contacted a few practicing attorneys in North Carolina and asked them to provide examples of inappropriate or unaffordable loans from their cases. In less than 48 hours, we received a number of responses, including the cases briefly described in Appendix A. We also are aware of cases in which the borrower requested a fixed-rate mortgage, but received an ARM instead. The industry itself has asserted that borrowers placed in subprime hybrid ARMs could have received fixed-rate loans, and that the rate difference is "commonly in the 50 to 80 basis point range."[27]

B. Loose Qualifying Standards and Business Practices

The negative impact of high-risk loans could be greatly reduced if subprime lenders had been carefully screening loan applicants to assess whether the proposed mortgages are affordable. Unfortunately, many subprime lenders have been routinely abdicating the responsibility of underwriting loans in any meaningful way.

Lenders today have a more precise ability than ever before to assess the risk of default on a loan. Lenders and mortgage insurers have long known that some home loans carry an inherently greater risk of foreclosure than others. However, by the industry's own admission, underwriting standards in the subprime market have become extremely loose in recent years, and analysts have cited this laxness as a key driver in foreclosures.[28] Let me describe some of the most common problems:

Not considering payment shock: Lenders who market 2/28s and other hybrid ARMs often do not consider whether the homeowner will be able to pay when the loan's interest rate resets, setting the borrower up for failure. Subprime lenders' public disclosures indicate that most are qualifying borrowers at or near the initial start rate, even when it is clear from the terms of the loan that the interest rate can (and in all likelihood, will) rise significantly, giving the borrower a higher monthly payment. In fact, it is not uncommon for 2/28 mortgages to be originated with an interest rate four percentage points under the fully-indexed rate. For a loan with an eight percent start rate, a four percentage point increase is tantamount to a 40 percent increase in the monthly principal and interest payment amount.

Failure to escrow: The failure to consider payment shock when underwriting is compounded by the failure to escrow property taxes and hazard insurance.[29] In stark contrast to the prime mortgage market, most subprime lenders make loans based on low monthly payments that do not escrow for taxes or insurance.[30] This deceptive practice gives the borrower the impression that the payment is affordable when, in fact, there are significant additional costs.

A recent study by the Home Ownership Preservation Initiative in Chicago found that for as many as one in seven low-income borrowers facing difficulty in managing their mortgage payments, the lack of escrow of tax and insurance payments were a contributing factor.[31] When homeowners are faced with large tax and insurance bills they cannot pay, the original lender or a subprime competitor can benefit by enticing the borrowers to refinance the loan and pay additional fees for their new loan. In contrast, it is common practice in the prime market to escrow taxes and insurance and to consider those costs when looking at debt-to-income and the borrower's ability to repay.[32]

Low/no documentation: Inadequate documentation also compromises a lender's ability to assess the true affordability of a loan. Fitch Ratings, the international ratings firm, recently noted that "loans underwritten using less than full documentation standards comprise more than 50 percent of the subprime sector . . .." "Low doc" and "no doc" loans originally were intended for use with the limited category of borrowers who are self-employed or whose incomes are otherwise legitimately not reported on a W-2 tax form, but lenders have increasingly used these loans to obscure violations of sound underwriting practices.

Multiple risks in one loan: Regulators have expressed concern about combining multiple risk elements in one loan, stating that "risk-layering features in loans to subprime borrowers may significantly increase risks for both the...[lender] and the borrower."[33]

C. Broker Abuses and Perverse Incentives

Mortgage brokers are individuals or firms who find customers for lenders and assist with the loan process. Brokers provide a way for mortgage lenders to increase their business without incurring the expense involved with employing sales staff directly. Brokers also play a key role in today's mortgage market: According to the Mortgage Bankers Association, mortgage brokers now originate 45 percent of all mortgages, and 71 percent of subprime loans.[34]

Brokers often determine whether subprime borrowers receive a fair and helpful loan, or whether they end up with a product that is unsuitable and unaffordable. Unfortunately, given the way the current market operates, widespread abuses by mortgage brokers are inevitable.

First, unlike other similar professions, mortgage brokers have no fiduciary responsibility to the borrower who employs them. Professionals with fiduciary responsibility are obligated to act in the interests of their customers. Many other professionals already have affirmative obligations to their clients, including real estate agents, securities brokers and attorneys. Buying or refinancing a home is the biggest investment that most families ever make, and particularly in the subprime market, this transaction is often decisive in determining a family's future financial security. The broker has specialized market knowledge that the borrower lacks and relies on. Yet, in most states, mortgage brokers have no legal responsibility to refrain from selling inappropriate, unaffordable loans, or not to benefit personally at the expense of their borrowers.[35]

Second, the market, as it is structured today, gives brokers strong incentives to ignore the best interests of homeowners. Brokers and lenders are focused on feeding investor demand, regardless of how particular products affect individual homeowners. Moreover, because of the way they are compensated, brokers have strong incentives to sell excessively expensive loans.[36]

Experts on mortgage financing have long raised concerns about problems inherent in a market dominated by broker originations. For example, the chairman of the Federal Reserve Board, Ben S. Bernanke, recently noted that placing significant pricing discretion in the hands of financially motivated mortgage brokers in the sales of mortgage products can be a prescription for trouble, as it can lead to behavior not in compliance with fair lending laws.[37] Similarly, a report issued by Harvard University's Joint Center for Housing Studies, stated, "Having no long term interest in the performance of the loan, a broker's incentive is to close the loan while charging the highest combination of fees and mortgage interest rates the market will bear."[38]

In summary: Mortgage brokers, who are responsible for originating over 70 percent of loans in the subprime market, have strong incentives to make abusive loans that harm consumers, and no one is stopping them. In recent years, brokers have flooded the subprime market with unaffordable mortgages, and they have priced these mortgages at their own discretion. Given the way brokers operate today, the odds of successful homeownership are stacked against families who get loans in the subprime market.

D. The Role of Investors

Lenders sometimes claim that the costs of foreclosing give loan originators adequate incentive to avoid placing borrowers into unsustainable loans, but this has proved false. Lenders have been able to pass off a significant portion of the costs of foreclosure through risk-based pricing, which allows them to offset even high rates of predicted foreclosures by adding increased interest costs. Further, the ability to securitize mortgages and transfer credit risk to investors has significantly removed the risk of volatile upswings in foreclosures from lenders. In other words, high foreclosure rates have simply become a cost of business that is largely passed onto borrowers and sometimes investors.

It is clear that mortgage investors have been a driving force behind the proliferation of abusive loans in the subprime market. Their high demand for these mortgages has encouraged lax underwriting and the marketing of unaffordable loans as lenders sought to fill up their coffers with risky loans. For example, approximately 80 percent of subprime mortgages included in securitizations issued the first nine months of 2006 had an adjustable-rate feature, the majority of which are 2/28s.[39]

We applaud Freddie Mac, one of the largest mortgage investors, for recently announcing a new policy to only buy subprime adjustable-rate mortgages (ARMs) -- and mortgage-related securities backed by these subprime loans -- that qualify borrowers at the fully-indexed and fully-amortizing rate. Freddie Mac is implementing this policy to protect future borrowers from the payment shock that could occur when their adjustable rate mortgages increase.

Fannie Mae should follow suit, and should not compete with other investors to buy securities backed by high-risk subprime loans that hurt consumers and reverse the benefits of homeownership. The GSEs, with their public mission, should not be permitted to purchase loans to distressed or minority or low-to-moderate income families that do not meet an "ability to repay" standard.

Recently, as foreclosure rates have sharply increased, investors are looking more closely at underwriting practices that have produced foreclosure rates far higher than predicted. While the recent turmoil in the subprime market may force lenders to make some adjustments to accommodate investor concerns, it will not help those borrowers who are in 2/28s now, many of whom will lose their homes, their equity and their credit ratings when lenders foreclose on loans that never should have been made.

E. Federal Neglect

When Congress passed HOEPA in 1994, subprime loans made up only a very small share of the total mortgage market, and predatory lending practices were not nearly as prevalent as they were to become a few years later. It would have been helpful to update HOEPA to keep pace with the rashes of innovative predatory lending practices that occurred after the law passed, but with the pace of change in the mortgage market and the challenges of passing major legislation, that has not been—and never will be—feasible.

On the federal level, one regulatory agency was required to take action: the Federal Reserve Board. The Board's primary authority comes through HOEPA, which requires the Board to prohibit unfair or deceptive mortgage lending practices and to address abusive refinancing practices. Specifically, the Act includes these provisions:

> (l) DISCRETIONARY REGULATORY AUTHORITY OF BOARD.--
> (2) PROHIBITIONS.--The Board, by regulation or order, shall prohibit acts or practices in connection with--
> (A) mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section; and
> (B) refinancing of mortgage loans that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower.[40]

While HOEPA generally applies to a narrow class of mortgage loans, it is important to note that Congress granted the authority cited above to the Board for all mortgage loans, not only loans governed by HOEPA (closed end refinance transactions) that meet the definition of "high cost." Each of the substantive limitations that HOEPA imposes refer specifically to high-cost mortgages.[41] By contrast, the authority granted by subsection (l) refers to "mortgage loans" generally.[42]

The legislative history makes clear that the Board's authority holds for all mortgage loans. The HOEPA bill that passed the Senate on March 17, 1994, and the accompanying Senate report, limited the Board's authority to prohibit abusive practices in connection with high-cost mortgages alone.[43] However, this bill was amended so that the bill that ultimately passed both chambers, as cited above, removed the high-cost-only limitation, and the Conference Report similarly removed this restriction.[44] The Conference Report also urged the Board to protect consumers, particularly refinance mortgage borrowers.[45]

The Board has been derelict in the duty to address predatory lending practices, in spite of the rampant abuses in the subprime market and all the damage imposed on consumers by predatory lending—billions of dollars in lost wealth. While the Board has recognized that it has this authority, it has never implemented a single such rule under HOEPA outside of the high-cost context. To put it bluntly, the Board has simply not done its job.

III. Solutions

Congress has a long history of strong policies to support homeownership, but that task has become more complicated than ever. Supporting homeownership continues to involve encouraging fair lending and fair access to loans. But supporting homeownership also means refusing to support loans that are abusive, destructive and unnecessarily risky.

A few years ago, the problem of subprime foreclosures likely would have received scant attention from policymakers, since subprime mortgages represented only a small fraction of the total mortgage market. Today subprime mortgages comprise almost one quarter of all mortgage originations. The merits of this expanding market are widely debated, but one point is clear: Subprime mortgage credit—and the accompanying foreclosures—have become a major force in determining how and whether many American families will attain sustainable wealth. This is particularly true in urban areas, where wealth-building is a critical issue.

There are simple, known solutions to help preserve the traditional benefits of homeownership and to address many of the problems I have mentioned today. Here I discuss our five recommendations:

1. Strengthen protections against destructive home lending by passing a new national anti-predatory lending bill. Federal law has clearly not kept up with the abuses in the changing mortgage market. HOEPA needs to be extended and updated to address the issues that are driving foreclosures today. Even should this happen, we need to realize that it is impossible for any single law to cover all contingencies or to anticipate predatory practices that will emerge in the future. Any new federal law must therefore preserve the right of the states to supplement the law, when necessary, to address new or locally-focused lending issues. While HOEPA is weak, it did recognize the limits of federal law, and therefore functions as a floor, not a ceiling. If HOEPA had not allowed states to take action, today's disastrous levels of foreclosures would be even worse.

2. Restore safety to the subprime market by imposing a borrower "ability to repay" standard for all subprime loans. The federal banking and credit union regulators should adopt the proposed subprime statement that calls on federally regulated banking institutions and their affiliates to make sure lenders underwrite loans to the fully indexed, fully amortizing rate.

3. Require mortgage brokers to have a fiduciary duty to their clients. We know it is both feasible and desirable to require mortgage brokers to serve the best interests of the people who pay them. Brokers manage the most important transaction most families ever make. Their role is at least as important as that of stockbrokers, lawyers and Realtors—professions that already have fiduciary standards in place.

4. Require the Federal Reserve to act, or address abuses through the FTC. HOEPA, the major federal law designed to protect consumers against predatory mortgage lending, has manifestly failed to stem the explosion of harmful lending abuses that has accompanied the recent subprime lending boom. Congress has required that the Federal Reserve Board address these problems for all mortgage loans, but to date the Board has not done so. Given the Board's record, Congress should seriously consider enlisting the Federal Trade Commission's assistance in addressing abuses that have gone on too long.

5. Require government-sponsored enterprises to stop investing in abusive subprime loan securities. Currently Fannie Mae is purchasing mortgage-backed securities that include high-risk subprime loans. By doing so, the agency is providing liquidity to lenders who market abusive, high-risk loans that are not truly affordable. This is clearly counter to its mission. Fannie Mae should follow Freddie Mac's lead and voluntarily stop investing in these securities. In addition, HUD should stop giving them affordable goals credit for purchasing these AAA securities (take them out of both the numerator and denominator in assessing the market), and OFHEO should prohibit the agencies from adding these securities to their portfolios.

Thank you very much for the opportunity to testify before you today. I would be happy to answer any questions you may have.

APPENDIX A

To illustrate the unfortunate realities of inappropriate and unaffordable 2/28 adjustable rate mortgages (ARMs), recently the North Carolina Justice Center informally contacted a few practicing attorneys in North Carolina to provide examples from their cases. They received a number of responses, including these described below.

1. **<u>From affordable loan to escalating ARM .</u>**
   Through a local affordable housing program, a homeowner had a 7% fixed-rate, 30-year mortgage. A mortgage broker told the homeowner he could get a new loan at a rate "a lot" lower. Broker originated a 2/28 ARM with a starting rate of 6.75%, but told borrower that it was a fixed-rate, 30-year mortgage. At the 24th month, the loan went up to 9.75%, following the loan's formula of LIBOR plus 5.125% and a first-change cap maximum of 9.75%. Loan can go up to a maximum of one point every six months, with a 12.75% total cap. Now borrower cannot afford the loan and faces foreclosure.

2. **<u>Temporary lower payments—a prelude to shock.</u>**
   Homeowner refinanced out of a fixed-rate mortgage because she wanted a lower monthly payment. The homeowner expressly requested lower monthly payments that included escrow for insurance and taxes. Mortgage broker assured her that he would abide by her wishes. Borrower ended up in a $72,000 2/28 ARM loan with first two years monthly payments of $560.00 at a rate of 8.625%. This initial payment was lower than her fixed-rate mortgage, but it did <u>not</u> include escrowed insurance and taxes. After two years, loan payments increased every six months at a maximum one percent with a cap of 14.625%. At the time of foreclosure, the interest rate had climbed to 13.375% with a monthly payment $808.75. If the loan had reached its maximum interest rate, the estimated monthly payment would be close to $900.00.

3. **<u>Unaffordable from the start.</u>**
   Homeowner had a monthly payment of $625 and sought help from a mortgage broker to lower monthly payment. Broker initially said he could lower the payment, but before closing said the best he could do was roughly $800. He assured borrower that he could refinance her to a loan with a better payment in six months. Previously he had advised homeowner not to pay her current mortgage payment because the new loan would close before the next payment due date. In fact, closing occurred after the payment was due, and borrower felt she had to close. Loan was a 2/28 ARM with an initial interest rate of 11% and a ceiling of 18% at an initial monthly payment of $921. Interest at first change date is calculated at LIBOR plus 7%, with a 12.5% cap and a 1.5% allowable increase/decrease at each 6-month change date. First change date is June 1, 2008. By approximately the third payment, however, borrower could not afford mortgage payments and is now in default.

End Notes

[1] Rakesh Kochkar, "The Wealth of Hispanic Households: 1996 to 2002," Pew Hispanic Center at 5 (2004). See also Gregory D. Squires and Charis E. Kubrin, "Privileged Places: Race, Opportunity and Uneven Development in Urban America," National Housing Institute, Shelterforce Online, issue #147 (fall 2006).

[2] Christian El Weller, "Middle-Class Turmoil: High Risks Reflect Middle-Class Anxieties," Center for American Progress (December 2005).

[3] Mortgage Finance Industry Overview, Lehman Brothers Equity Research (December 22, 2006).

[4] See, e.g., Robert B. Avery, Kenneth P. Brevoort, and Glen B. Canner, "Highest-Priced Home Lending and the 2005 HMDA Data," Federal Reserve Bulletin (amended September 18, 2006); see also Matt Fellowes, "From Poverty, Opportunity: Putting the Market to Work for Lower-Income Families," Brookings Institution, http://www.brookings.edu/metro/pubs/20060718_povop.htm

[5] See, e.g., Vikas Bajaj and Christine Haughney, "Tremors at the Door – More People with Weak Credit are Defaulting on Mortgages," *The New York Times*, citing *Inside Mortgage Finance* (January 26, 2007).

[6] Much of the following material originally appeared in a recent CRL report: Ellen Schloemer, Wei Li, Keith Ernst, and Kathleen Keest, "Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners," Center for Responsible Lending (December 2006).

[7] Ira Goldstein, *Bringing Subprime Mortgages to Market and the Effects on Lower-Income Borrowers*, p.2 Joint Center for Housing Studies, Harvard University (February 2004) at http://www.jchs.harvard.edu/publications/finance/babc/babc_04-7.pdf.

[8] Mike Hudson and E. Scott Reckard, *More Homeowners with Good Credit Getting Stuck in Higher-Rate Loans*, L.A. Times, p. A-1 (October 24, 2005). For most types of subprime loans, African-Americans and Latino borrowers are more likely to be given a higher- cost loan even after controlling for legitimate risk factors. Debbie Gruenstein Bocian, Keith S. Ernst and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, Center for Responsible Lending, (May 31, 2006) at http://www.responsiblelending.org/issues/mortgage/reports/page.jsp?itemID=29371010; *See also* Darryl E. Getter, *Consumer Credit Risk and Pricing*, Journal of Consumer Affairs (June 22, 2006); Howard Lax, Michael Manti, Paul Raca, Peter Zorn, *Subprime Lending: An Investigation of Economic Efficiency*, 533, 562, 569, Housing Policy Debate 15(3) (2004).

[9] *Subprime Mortgage Origination Indicators*, Inside B&C Lending (November 10, 2006).

[10] See, e.g., Eric Stein, *Quantifying the Economic Costs of Predatory Lending*, Center for Responsible Lending (2001).

[11] Roberto G. Quercia, Michael A. Stegman and Walter R. Davis, *Assessing the Impact of North Carolina's Predatory Lending Law*, Housing Policy Debate, (15)(3): (2004); Wei Li and Keith S. Ernst, *The Best Value in the Subprime Market: State Predatory Lending Reforms* (2006) *available at* http://www.responsiblelending.org/pdfs/rr010-State_Effects-0206.pdf.

[12] See, e.g., David W. Berson, *Challenges and Emerging Risks in the Home Mortgage Business: Characteristics of Loans Backing Private Label Subprime ABS*, Presentation at the National Housing Forum, Office of Thrift Supervision (December 11, 2006).

[13] *Curbing Predatory Home Mortgage Lending*, U.S. Department of Housing and Urban Development and U.S. Department of the Treasury, p47 (June 2000), at http://www.huduser.org/publications/hsgfin/curbing.html.

[14] Robert B. Avery, Glenn B. Canner & Robert E. Cook, *New Information Reported Under HMDA and Its Implication in Fair Lending Enforcement, Federal Reserve Bulletin* (Summer 2005), at http://www.federalreserve.gov/pubs/bulletin/2005/3-05hmda.pdf.

[15] Calculations from Keith S. Ernst and Deborah N. Goldstein, *Comment on Federal Reserve Analysis of Home Mortgage Disclosure Act Data*, Center for Responsible Lending Comment No. 1 (September 14, 2005), at http://www.responsiblelending.org/pdfs/cb001-FRB-091505.pdf.

[16] Debbie Gruenstein Bocian, Keith S. Ernst and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, Center for Responsible Lending (May 31, 2006). The study can be accessed at http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf.

[17] The rate of new foreclosures as a percent of all loans rose from 0.13 in 1980 to 0.42 in 2005, as reported in the *National Delinquency Survey*, Mortgage Bankers Association. 2005 new foreclosure filings statistic from Realty Trac in *Home Foreclosures on the Rise*, MoneyNews (February 23, 2006) at http://www.newsmax.com/archives/articles/2006/2/23/134928.shtml.

[18] National Foreclosures Increase 17 Percent In Third Quarter, Realty Trac (November 1, 2006) at http://www.realtytrac.com/ContentManagement/PressRelease.aspx?ItemID=1362

[19] *See, e.g.*, Saskia Scholtes, Michael Mackenzie and David Wighton, *US Subprime Loans Face Trouble*, Financial Times (December 7, 2006); *Nightmare Mortgages*, Business Week (September 11, 2006).

[20] The Home Mortgage Disclosure Act requires most lenders to file annual reports containing specified information about the "higher-cost loans" they originated. "Higher-cost loans" are those for which the APR exceeds the rate on a Treasury security of comparable maturity by 3 percentage points for first liens, and 5 percentage points for second liens. FRB analysis of 2005 HMDA data indicates that non-Hispanic whites received over 1.2 million higher-cost loans, compared to 388,471 for African-Americans and 375,889 for Latinos. Authors' calculations from data reported in Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, *Higher-Priced Home Lending and the 2005 HMDA Data*, Federal Reserve Bulletin A123, A160-161 (Sept. 8, 2006), at http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf.

[21] A balloon loan is one that is not repayable in regular monthly installments, but rather requires repayment of the remaining balance in one large lump sum. While 2/28s are not balloon loans, the impact of higher interest rates at the end of the two-year teaser rate period, resulting in higher monthly payments, may force a borrower to seek refinancing.

[22] See, e.g., *Structured Finance: U.S. Subprime RMBS in Structured Finance CDOs*, p. 2 Fitch Ratings Credit Policy (August 21, 2006).

[23] Here we are describing the 2/28 because it is by far the most common product in the subprime market, but the concerns are the same with the 3/27, which differs only in that the teaser rate remains in effect for three years.

[24] *Structured Finance*, note 20.

[25] *Structured Finance*, note 20.

[26] Kirstin Downey, "Mortgage-Trapped: Homeowners with New Exotic Loans Aren't Always Aware of the Risk Involved," Washington Post (January 14, 2007).

[27] January 25, 2007 letter from CFAL to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner, at 3.

[28] See e.g., Office of the Comptroller of the Currency, National Credit Committee, *Survey of Credit Underwriting Practices 2005.* The Office of The Comptroller of Currency (OCC) survey of credit underwriting practices found a "clear trend toward easing of underwriting standards as banks stretch for volume and yield," and the agency commented that "ambitious growth goals in a highly competitive market can create an environment that fosters imprudent credit decisions." In fact, 28% of the banks eased standards, leading the 2005 OCC survey to be its first survey where examiners "reported net easing of retail underwriting standards." *See also* Fitch Ratings, 2007 Global Structured Finance Outlook: Economic and Sector-by-Sector Analysis (December 11, 2006).

[29] See, e.g., "B&C Escrow Rate Called Low," *Mortgage Servicing News Bulletin* (February 23, 2005), "Servicers of subprime mortgage loans face a perplexing conundrum: only about a quarter of the loans include escrow accounts to ensure payment of insurance premiums and property taxes, yet subprime borrowers are the least likely to save money to make such payments... Nigel Brazier, senior vice president for business development and strategic initiatives at Select Portfolio Servicing, said only about 25% of the loans in his company's subprime portfolio have escrow accounts. He said that is typical for the subprime industry."

[30] See, e.g., "Attractive Underwriting Niches," Chase Home Finance Subprime Lending marketing flier, at http://www.chaseb2b.com/content/portal/pdf/subprimeflyers/Subprime_AUN.pdf (available 9/18/2006) stating, " Taxes and Insurance Escrows are NOT required at any LTV, and there's NO rate add!", (suggesting that failing to escrow taxes is an "underwriting highlight" that is beneficial to the borrower). 'Low balling' payments by omitting tax and insurance costs were also alleged in states' actions against Ameriquest. *See, e.g.* State of Iowa, ex rel Miller v. Ameriquest Mortgage Co. et al, Eq. No. EQCE-53090 Petition, at ¶ 16(B) (March 21, 2006).

[31] *Partnership Lessons and Results: Three Year Final Report,* p. 31 Home Ownership Preservation Initiative, (July 17, 2006) at www.nhschicago.org/downloads/82HOPI3YearReport_Jul17-06.pdf.

[32] In fact, Fannie Mae and Freddie Mac, the major mortgage investors, require lenders to escrow taxes and insurance.

[33] See 71 Fed. Reg. 58609 (October 4, 2006) for the federal Interagency Guidance on Nontraditional Mortgage Product Risks, issued by the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Department of the Treasury and the National Credit Union Administration.

[34] MBA Research Data Notes, "Residential Mortgage Origination Channels," September 2006.

[35] About one-third of the states have established, through regulation or case law, a broker's fiduciary duty to represent borrowers' best interests. However, many of these provisions are riddled with loopholes and provide scant protection for borrowers involved in transactions with mortgage brokers.

[36] Brokers earn money through up-front fees, not ongoing loan payments. To make matters worse for homeowners, brokers typically have a direct incentive to hike interest rates higher than warranted by the risk of loans. In the majority of subprime transactions, brokers demand a kickback from lenders (known as "yield spread premiums") if they deliver mortgages with rates higher than the lender would otherwise accept. Not all loans with yield-spread premiums are abusive, but because they have become so common, and because they are easy to hide or downplay in loan transactions, unscrupulous brokers can make excessive profits without adding any real value.

[37] Remarks by Federal Reserve Board Chairman Ben S. Bernanke at the Opportunity Finance Network's Annual Conference, Washington, D.C. (November 1, 2006).

[38] Joint Center for Housing Studies, "Credit, Capital and Communities: The Implications of the Changing Mortgage Banking Industry for Community Based Organizations," Harvard University at 4-5. Moreover, broker-originated loans "are also more likely to default than loans originated through a retail channel, even after controlling for credit and ability-to-pay factors." Id. at 42 (citing Alexander 2003).

[39] *Inside B&C Lending*, Inside Mortgage Finance, p. 2 (November 24, 2006).

[40] 15 USC Section 1639(l)(2). Emphasis added.

[41] These limitations concern certain prepayment penalties, post-default interest rates, balloon payments, negative amortization, prepaid payments, ability to pay, and home improvement contracts. See subsections 129(c)-(i). High cost mortgages are those "referred to in section 103(aa)."

[42] Most subprime abuses occur with refinance loans rather than loans used to purchase a house (what HOEPA calls a "residential mortgage transaction", Sec. 152(aa)(1)). HOEPA's enumerated protections are limited to closed end refinance loans that meet the high cost standard. However, section (l) refers to "mortgage loans" generally, which would include purchase-money loans. The fact that section (l)(2) prohibitions are directed at two separate types of loans -- (A) those the Board finds to be unfair, deceptive, or designed to evade HOEPA, and (B) abusive refinancings -- provides evidence that subsection (A) includes purchase money loans as well.

[43] See S.1275, Section 129(i)(2): "PROHIBITIONS--The Board, by regulation or order, shall prohibit any specific acts or practices in connection with high cost mortgages that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section." Reported in 140 Cong. Rec. 3020, S3026. According to the Senate Report, No. 103-169, p. 27, "the legislation requires the Federal Reserve Board to prohibit acts or practices in connection with High Cost Mortgages that it finds to be unfair, deceptive, or designed to evade the provisions of this section."

[44] See House Conf. Rep. No. 103-652, p. 161, "the Board is required to prohibit acts and practices that it finds to be unfair, deceptive, or designed to evade the section and with regard to refinancing that it finds to be associated with abusive lending practices or otherwise not in the interest of the borrower."

[45] "The Conferees recognize that new products and practices may be developed to facilitate reverse redlining or to evade the restrictions of this legislation. Since consumers are unlikely to complain directly to the Board, the Board should consult with its Consumer Advisory Council, consumer representatives, lenders, state attorneys general, and the Federal Trade Commission, which has jurisdiction over many of the entities making the mortgages covered by this legislation.

"This subsection also authorizes the Board to prohibit abusive acts or practices in connection with refinancings. Both the Senate and House Banking Committees heard testimony concerning the use of refinancing as a tool to take advantage of unsophisticated borrowers. Loans were "flipped" repeatedly, spiraling up the loan balance and generating fee income through the prepayment penalties on the original loan and fees on the new loan. Such practices may be appropriate matters for regulation under this subsection." Id.

Unfair Lending:

The Effect of Race and Ethnicity on the Price of Subprime Mortgages

Debbie Gruenstein Bocian, Keith S. Ernst and Wei Li
Center for Responsible Lending

May 31, 2006

CENTER FOR RESPONSIBLE LENDING

www.responsiblelending.org

I. EXECUTIVE SUMMARY

Last year, for the first time, lenders were required to report details on the costs of subprime home loans—mortgages intended to serve borrowers with blemished credit or other high-risk characteristics. Lenders disclosed pricing information related to the most expensive subprime loans (referred to here as "higher-rate" loans), while lower-rate loans in the subprime market and virtually all prime loans were exempt from this reporting requirement. Several analyses of this information, collected under the Home Mortgage Disclosure Act (HMDA), have shown that African-American and Latino borrowers received a disproportionate share of higher-rate home loans, even when controlling for factors such as borrower income and property location.

A number of concerned groups have pointed to these disparities as evidence of discrimination that slows economic progress among groups who already lag far behind in homeownership and wealth. Others contend, however, that the pricing disparities are not meaningful, since they do not fully account for legitimate differences in credit risks. In this report, we attempt to move the debate forward by providing a more detailed examination of pricing patterns in the subprime home loan market. Our study analyzed subprime home loan prices charged to different racial and ethnic groups while controlling for the effects of credit scores, loan-to-value ratios, and other underwriting factors. To our knowledge, this is the first full research report that examines 2004 HMDA data to assess the effects of race and ethnicity on pricing in the subprime market while controlling for the major risk factors used to determine loan prices.

Our findings show that, for most types of subprime home loans, African-American and Latino borrowers are at greater risk of receiving higher-rate loans than white borrowers, even after controlling for legitimate risk factors. The disparities we find are large and statistically significant: For many types of loans, borrowers of color in our database were more than 30 percent more likely to receive a higher-rate loan than white borrowers, even after accounting for differences in risk.

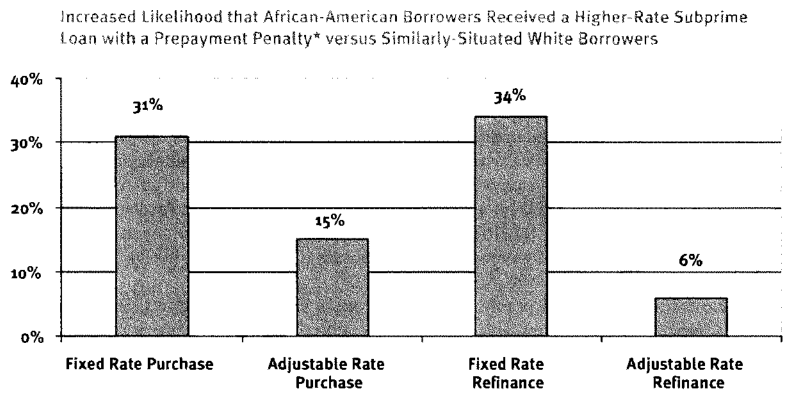
This analysis was possible because we supplemented the 2004 HMDA data with information from a large, proprietary subprime loan dataset. Individually, both databases lack certain pieces of data that would be helpful for an in-depth comparison of subprime loan pricing. By combining loan information from both sources, however, we obtain more complete information on a large set of loans. Using a combined dataset of over 177,000 subprime loans, we analyzed whether borrowers of color are at greater risk of receiving higher-rate subprime loans than similarly-situated white borrowers.

Our basic findings are outlined here:

1) African-Americans were more likely to receive higher-rate home purchase and refinance loans than similarly-situated white borrowers, particularly for loans with prepayment penalties.

- The effect of being an African-American borrower on the cost of credit was greatest for loans containing penalties for early payoff, which comprised over 60 percent of the loans we examined.

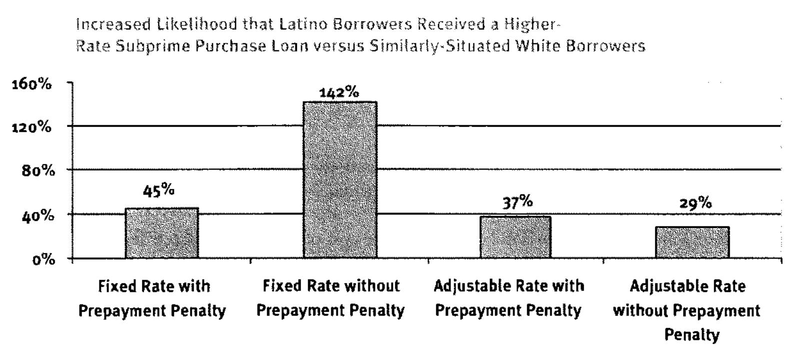
- As shown in the chart below, African-American borrowers with prepayment penalties on their subprime home loans were 6 to 34 percent more likely to receive a higher-rate loan than if they had been white borrowers with similar qualifications. Results varied depending on the type of interest rate (i.e., fixed or adjustable) and the purpose (refinance or purchase) of the loan.



* During 2004, approximately two-thirds of all home loans in the subprime market had prepayment penalties.

2) Latino borrowers were more likely to receive higher-rate loans than similarly-situated non-Latino white borrowers for mortgages used to purchase homes. Differences for refinance loans were not significant at a 95 percent confidence level.

- Latino borrowers purchasing homes were 29 to 142 percent more likely to receive a higher-rate loan than if they had been non-Latino and white, depending on the type of interest rate and whether the loan contained a prepayment penalty.
- Pricing disparities between Latinos and non-Latino white borrowers for refinance loans were not significant at the 95 percent confidence level in our dataset.



This analysis does not allow us to estimate precisely how much race and ethnicity increase the prices charged to borrowers. It is also beyond the scope of this paper to determine definitively why these disparities exist. However, we do posit several possible causes, including the considerable leeway mortgage originators have to impose charges beyond those justified by risk-based pricing.

A notable and pervasive example of discretionary pricing occurs through "yield-spread premiums," which are monetary incentives for mortgage brokers to inflate rates on subprime loans. Other causes of pricing disparities may include the inconsistent application of objective pricing criteria, targeting of families of color by higher-rate lenders or brokers, and lack of investment by lower-cost lenders in these communities. It is likely that all of these factors contribute to making subprime home loans more costly than necessary.

While these results are particularly disturbing for borrowers of color, the results have negative implications for all borrowers in the subprime market, since common business practices such as discretionary pricing can affect anyone.

For African-Americans, the most striking disparities that emerged in our research were associated with prepayment penalties; for Latinos, the greatest disparities related to loan type (purchase versus refinance). Examining these differences, we discuss several hypotheses. First, we believe the larger disparities observed for African-Americans in subprime loans with prepayment penalties may be related to yield-spread premiums, since lenders are often more willing to pay these premiums on loans that include prepayment penalties. Mortgage originators routinely make exceptions to guidelines, but it may be that African-Americans receive fewer favorable exceptions than white borrowers. Second, we believe that the disparities evidenced for Latinos on purchase mortgages might arise from a greater concentration of recent immigrants among this borrower pool. If so, the higher disparities in the purchase market may be a result of higher-cost lenders targeting recent immigrants.

While these results are particularly disturbing for borrowers of color, the results have negative implications for all borrowers in the subprime market, since common business practices such as discretionary pricing can affect anyone. The cost of mortgages matters more than the cost of typical consumer goods. Whether or not families receive fairly priced home loans is a major factor in their fundamental financial security. Higher loan costs will both dissuade some potential borrowers from investing in homeownership and increase the risk of foreclosure for those who do.

Lenders and policymakers can take a number of constructive actions to help ensure more equitable pricing for all borrowers. These include:

- Curtailing steering by requiring objective pricing standards;
- Holding lenders and brokers responsible for providing loans that are suitable for their customers;
- Amending HMDA to expand the disclosure requirements for risk and pricing information;
- Ensuring that adequate resources are dedicated to fully enforcing fair lending laws; and
- Creating incentives and supporting a policy framework that lead the market to better serve African-American and Latino communities.

Mr. KUCINICH. I thank the gentleman.

Next we will hear from Dan Immergluck, Ph.D, associate professor, City and Regional Planning Program, Georgia Tech. Thank you.

STATEMENT OF DAN IMMERGLUCK

Mr. IMMERGLUCK. Good afternoon and thank you, Chairman Kucinich, and members of the subcommittee.

It is clear to me that the subprime mortgage market and some parts of the prime market are in many respects fundamentally dysfunctional. We have had a flood of poorly structured mortgage credit, much of it which works to the detriment of the borrower and to the benefit of brokers, lenders, and some investors. The phenomenon is distorting housing markets and harming neighborhoods and communities.

One major problem which is being amplified nationally now as housing appreciation stalls in many more places is that subprime foreclosure rates are routinely running at more than 10 to 15 times those of prime mortgages. In some localities this is more than 30 times difference. The greatest increases in foreclosures in the late 1990's were generally confined to central city neighborhoods with high proportions of lower income and minority residents. These areas continue to be hit very hard, but now, as the subprime industry has grown so much in recent years, its appetite for pushing product to a wider and increasingly suburban market has swelled and foreclosures are now following.

In the five-county Atlanta market, for example, really a region that hasn't suffered from weak economy of any kind, foreclosures increased over 180 percent from 2000 to 2006, and the county with the highest rate of increase was Gwinnett County, a predominantly middle-income suburban county.

Overly aggressive lending, especially in the subprime market, hurts housings by encouraging speculation, driving up property values to unsustainable levels, and creating essentially bubble neighborhoods. Faculty at the Wharton Business School recently found that aggressive adjustable rate lending pushes up neighborhood housing values at first and then pushes them down much farther when the inevitable market decline occurs.

Property appreciation that is built upon financing gimmicks and short-term teaser rates is not real, sustainable appreciation, and in the long run discourages the smooth functioning of housing markets and neighborhood economies. Many neighborhoods subject to high levels of aggressive lending end up suffering from high foreclosure rates, which my own research has shown depressed values of surrounding properties.

So the true complete cost of foreclosures are borne more by the borrowers and the communities in which they live than by the lenders and investors supplying the credit. Cities, counties, and school districts lose tax revenue and have to control the abandoned properties that fall out.

Therefore, irresponsible, overly aggressive lending hurts neighborhoods and neighbors who had no role in the credit decision. Even if one does not believe it is the Government's role to protect vulnerable homeowners—and I should add that I do believe that it is—it is hard to argue there is no role for Government in regulating practices and products that harm entire communities. Given that some cities have not experienced, at least until recently, the high levels of foreclosures that cities like Cleveland, Detroit, Baltimore, and Atlanta have, and the fact that many of these markets are now cooling, we can be very sure that the foreclosure problems will be getting far worse at a national level before they get better.

Some have portrayed the increases in subprime and exotic mortgages as merely responding to demand as housing prices have risen in some markets. However, when such products allow buyers to stretch much farther, farther than they should, they can become as much a cause as an effect of higher home prices.

I would like to mention just a few quick policy recommendations.

First, regulators and Congress should issue regulations that return the mortgage market to a predominant reliance on an ability to pay rationale in all underwriting. Congress, the Federal Reserve, and other regulators should do whatever is necessary to extend such regulations to State-regulated mortgage lenders and not just depository institutions.

Second, there is an urgent need for making all actors in the mortgage supply chain accountable for their role in the mortgage process. Liability for reckless lending needs to follow from the broker to the lender to the investor. Nothing will create more accurate information and reduced fraud better than exposing investors to the downside risk of providing capital to irresponsible lenders.

Third, Federal preemption of stronger State laws is not an appropriate quid pro quo for better Federal regulation. The research shows that mortgage markets are not significantly impeded by different State regulatory regimes. We have had different regimes in foreclosure for many years, and I haven't seen a significant problem. Federal law should be strengthened to provide a structurally sound floor of basic mortgage regulation, not one based solely on a confusing battle of dozens of disclosure documents.

Thank you.

[The prepared statement of Mr. Immergluck follows:]

Testimony of Dan Immergluck, PhD
Associate Professor
City and Regional Planning Program
Georgia Institute of Technology[1]

before

Committee on Oversight and Government Reform
Subcommittee on Domestic Policy

Honorable Dennis Kucinich, Chair

March 21, 2007

Good morning Chairman Kucinich, Ranking Member Issa and members of the Subcommittee for inviting me here today to testify on issues concerning the mortgage market in the U.S. The issues that will be discussed today are critically important, not only to the housing conditions and credit histories of millions of directly impacted American families, but also to the economic sustainability of the neighborhoods and communities in which these families reside, and to the long-term viability of U.S. housing and financial markets.

I am an Associate Professor of City and Regional Planning at Georgia Institute of Technology in Atlanta, where I conduct research on housing and mortgage markets. I also teach graduate courses in real estate finance, statistics and other courses. I have been conducting research on U.S. mortgage markets for more than 10 years now. I have also done substantial research on the housing markets and neighborhood economies more generally.

As some context for the statistics that you are hearing today, I would like to relay a slightly longer historical view on the issue. In the early to middle 1990s, after decades of decline of older urban neighborhoods, it appeared that, in many modest-income neighborhoods, things were really beginning to really turn around. There was a strong sense that groups like NeighborWorks organizations, community development corporations, and community development financial institutions were making real progress in reviving the housing stock and economies of neighborhoods and communities around the country. To their credit, some banks – often in partnership with local community organizations – were beginning to become much more

[1] Atlanta, GA, 30332-0155, dan.immergluck@coa.gatech.edu, 404-385-7214.

active in lending to these communities. The revitalization of housing and small business markets was happening in many places. Indeed, census data show that, from 1990 to 2000, there was an overall decline in geographically concentrated poverty in U.S. metropolitan areas.[2] In many cities, the population losses of the 1970s and 1980s slowed or even reversed, and many observers saw real hope that the urban trauma of earlier decades had come to an end.

However, many of us who followed housing patterns began to notice a development in home finance in the middle 1990s that caused some concern. While some banks and thrifts were doing more to serve urban communities – especially within their Community Reinvestment Act assessment areas -- a set of different lenders, many of which were new firms or formerly niche lenders that were growing into much larger firms, was also beginning to target these underserved markets. These communities were now beginning to be supplied with a new form of high-priced credit, often involving disadvantageous terms that were rarely employed in the conventional, prime market. Many borrowers were being charged very large up-front fees or sold ancillary financial products for which they did not appear to have any use. Moreover, it appeared that, in many cases, borrowers were being given loans that they had little prospect of being able to repay right from the get-go. Some loans contained terms that would make default more likely and refinancing to more affordable products more difficult. In other cases, borrowers that would qualify for traditional loans at conventional, low rates, were being given loans with excessive fees or interest rates. Frequently, traditional ability-to-pay underwriting practices appeared to be being discarded by some of these new lenders.

Well, ten-plus years later, it is clear that the subprime market and some parts of the prime market are in many respects fundamentally dysfunctional – both from the perspectives of affected borrowers and the communities impacted by large numbers of subprime and aggressive, exotic mortgages.

The industry publication, *Inside Mortgage Finance*, shows that subprime lending grew from approximately $35 billion in 1994 to $665 billion in 2005. We now have a flood of credit, much of which is structured to the detriment of the borrower and to the benefit of the credit

[2] Jargowsky, P. (2003). Stunning progress, hidden problems: The dramatic decline of concentrated poverty in the 1990s. Brookings Institution Center on Urban and Metropolitan Policy. At http://www.brookings.edu/es/urban/publications/jargowskypoverty.pdf

arrangers. This flood of credit is distorting housing markets and causing negative spillovers from directly impacted borrowers onto neighbors and communities.

A now substantial body of research points to severe problems in the subprime market. There have been at least three sorts of problems. First, there has been ample documentation of the rise in abusive practices and terms, which have been associated primarily with the subprime industry.[3] Second, there is compelling body of evidence that, even after controlling for credit scores and other factors, minority and, especially, African American households are more likely than similarly situated white households to receive subprime mortgages.[4] Subprime disparities are particularly glaring at the neighborhood level, with subprime lenders often accounting for much larger shares of home loans in predominantly minority neighborhoods.[5]

The third concern, which is now being amplified as housing appreciation stalls in many places, is that the sector is responsible for excessive foreclosures, with subprime foreclosure rates at over 10 to 15 times those of prime loans.[6] While foreclosures increased in all sorts of neighborhoods, the greatest increases in the late 1990s were generally in neighborhoods with high proportions of lower-income and minority residents.[7]

Foreclosures are the clearest manifestation of how overly aggressive and irresponsible lending harms neighborhoods and communities. The true, complete costs of foreclosures are born mostly by the borrowers and the communities in which they live. Neighborhoods see values and confidence decline. My own research shows that, even after controlling for other neighborhood characteristics, higher foreclosure levels significantly suppress the values of

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[3] U. S. Department of Treasury and U.S. Department of Housing and Urban Development. (2000). Curbing predatory home mortgage lending. Washington, DC: Author.

[4] See, for example, Gruenstein-Bocian, D., Ernst, K., & Li, W. (2006). *Unfair lending: The effect of race and ethnicity on the price of subprime mortgages.* Washington, DC: Center for Responsible Lending. May 31, and Nichols, J. Pennington-Cross, A., & Yezer, A. (2005). Borrower self-selection, underwriting costs, and subprime mortgage credit supply. *Journal of* Real Estate Finance and Economics, 30 (2), 197-219.

[5] See, for example, Calem, P., Gillen, K., & Wachter, S. (2004). The neighborhood distribution of subprime mortgage lending, *Journal of Real Estate Finance and Economics, 29 (4)*, 393-410, and Wyly, E., Atia, M., & Hammel, D. (2004). Has mortgage capital found an inner-city spatial fix? *Housing Policy Debate 15* (3), 623-685.

[6] See, for example, Immergluck, D. and Smith, G. (2005). Measuring the effects of subprime lending on neighborhood foreclosures: Evidence from Chicago. *Urban Affairs Review* 40: 362-389; Schloemer, E., Li, W., Ernst, K., & Keest, K. 2006. *Losing ground: Foreclosures in the subprime market and their cost to homeowners.* Washington, DC: Center for Responsible Lending, at http://responsiblelending.org/pdfs/FC-paper-12-19-new-cover-1.pdf; Quercia, R., Stegman, M. & Davis, W. 2005. The impact of predatory loan terms on subprime foreclosures: The special case of prepayment penalties and balloon payments. Chapel Hill, NC: Center for Community Capitalism at the University of North Carolina at Chapel Hill, at http://www.kenan-flagler.unc.edu/assets/documents/ki_CCC_PreventiveServicing.pdf

[7] Immergluck and Smith, (2005). supra.

nearby properties.[8] For every foreclosure within one-eighth of a mile of a single-family home, property values are expected to decline by approximately 1 percent. For neighborhoods with multiple foreclosures, then, property values are impacted even more. In Chicago, we estimated the cumulative impact of two years of foreclosures on property values to exceed $598 million, for an average of $159,000 per foreclosure.

Cities, counties and school districts then lose tax revenue due to lower values. Moreover, William Apgar and Mark Duda of the Harvard Joint Center for Housing Studies found that the direct costs to city government in Chicago – not counting those due to falling property values -- involve more than a dozen agencies and two dozen specific municipal activities, generating governmental costs that in some cases exceeded $30,000 per property.[9] And when foreclosures catalyze true property abandonment, these properties can become blighted and havens for crime, begetting a spiral of severe neighborhood decline.

As the subprime industry continued to grow rapidly in recent years, its appetite for pushing product to a wider and increasingly suburban market swelled. The result has been that foreclosures have increased substantially in many suburban communities. Figure 1 shows that, in the core five-county Atlanta market, for example, foreclosures increased from just over 8,200 in 2000 to more than 23,000 in 2006, an increase of over 180 percent. Moreover, the county with the highest (258%) rate of increase – Gwinnett County – is a predominantly middle-income, county with an increase of 258 percent. All five counties (all of which are majority suburban) saw increases in foreclosures of more than 135 percent between 2000 and 2006. And I fully expect these numbers to grow even more in 2007 as many adjustable rate loans reset to much higher rates.

Beyond the costs imposed by foreclosures and distressed sales, overly aggressive lending –especially in the subprime market -- hurts neighborhoods by encouraging speculation and driving up property values to unsustainable levels, creating essentially bubble-neighborhoods. Such lending is sometimes accompanied by high levels of appraisal fraud and associated property flipping in which mortgage brokers and others orchestrate schemes to extract large

[8] Immergluck, D. and Smith, G. (2006). The external costs of foreclosure: The impact of single-family mortgage foreclosures on property values, *Housing Policy Debate* 17: 57-79.

[9] Apgar, W. and Duda, M. (2005). *Collateral damage: The municipal impact of today's mortgage foreclosure boom.* Washington, DC: Homeownership Preservation Foundation. May 11. At http://www.nw.org/Network/neighborworksprogs/foreclosuresolutions/documents/Apgar-DudaStudyFinal.pdf.

sums from lenders by obtaining fraudulent appraisals, allowing them to buy and sell properties for much higher rates of appreciation than can be justified by any underlying fundamentals.

When lenders redesign loan products so that they dramatically – but only temporarily -- reduce the monthly mortgage payment with the primary purpose of supposedly providing more "purchasing power," some of this increased purchasing power will be extracted in the form of higher prices for homes, especially in markets where demand for housing is strong. As long as this lending – and borrowing – is sustained, values may continue growing. However, aggressive lending is partly based on continuing appreciation, but this appreciation is in turn dependent upon the continuation of aggressive lending. If either the lending or the valuations stall in some way, the negative impact on credit availability and property values are mutually reinforcing, which can result in a spiraling down of values and neighborhood confidence.

In a recent research paper, University of Pennsylvania Wharton School professors Andrey Pavlov and Susan Wachter find that neighborhoods in which more aggressive products are highly prevalent, prices are substantially more volatile. Pavlov and Wachter argue that the prevalence of these loans "puts the market at risk as their originations tend to decline on a relative basis faster than the traditional more conservative instruments in the face of a negative demand shock in the underlying market."[10] More specifically, in looking at the impacts of high levels of adjustable rate mortgage (ARM) lending on neighborhood price trends, they find that, for each one percent increase in the share of loans that were ARMs when the market peaked, the amount of price decline increases by 1.3 percent.

So, aggressive lending can push values up at first, but then pushes them down much further when the inevitable market downturn occurs. Property appreciation that is built upon financing gimmicks and short-term teaser rates is not real, sustainable appreciation and, in the long run, discourages the smooth functioning of housing markets and neighborhood economies.

Thus, overly aggressive lending is not just an issue between buyers and sellers of credit. It has serious implications for homeowners and residents of impacted communities who had no role in the credit decision. Even if one does not believe it is government's role to protect vulnerable borrowers (and I believe it is), it is hard to argue that there is no role for government in regulating practices and products that can do so much harm to entire communities.

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[10] Pavlov, A. and Wachter, S. (2006). Aggressive Lending and Real Estate Markets. Unpublished manuscript. December 20. Page 13.

The Spread of Foreclosure Problems and the Destabilization of Housing Markets

We are now seeing that the stalling of the aggressive lending-appreciation cycle is having significant impacts on entire regional housing markets. My recent research shows that, from 1997 to 2003, while home purchase lending by subprime firms grew in all metropolitan areas with a population of at least 500,000, such lending grew substantially faster in some large metros than others.[11] Many Californian metros, in particular, experienced very large increases and, in general, metropolitan areas with larger home prices– saw larger increases in subprime lender share.

Given that some of these high-appreciation communities have, at least until recently, not experienced the large numbers of foreclosures associated with subprime lending in other markets, I believe we can only assume that the foreclosure problem will be getting far worse – and more widespread – before it gets better. I have compared early 2006 foreclosure activity across 81 large metropolitan areas to subprime activity in the same markets in a preceding year (2003) .[12] Figure 2 plots this relationship. The dashed and dotted ovals indicate that large metro markets cluster along two distinct axes running northwest on the chart at different angles. In the markets in the dashed oval, foreclosure rates are much higher for cities with high levels of subprime lending. The metro markets in the dotted oval experience exhibit a weaker, though still positive relationship. Most of the metros in the steeper, dashed oval were experiencing weaker appreciation trends as of early 2006.

The difference in these two groups of markets is that, as of early 2006, the markets in the dotted oval were experiencing relatively high levels of appreciation. (We know that things are now changing for the worse in many of these markets.) If a homeowner in a high-appreciation market runs into trouble paying her mortgage, she can sell the house or refinance the property rather than face foreclosure. So, while appreciation continues at a fast pace, foreclosures tend not to reach severe levels. However, when prices in these areas stall or decline, foreclosures follow and property values may fall more precipitously than in markets where values had not gotten so hot. In fact, Schloemer and her colleagues use Moody's housing price forecasts to predict future foreclosure trends and suggest that many high value markets – especially many in

[11] Immergluck, D. (2007). From the subprime to the exotic: Expanded mortgage market risk and implications for metropolitan communities and neighborhoods. Unpublished manuscript. Available upon request.

[12] Ibid.

California – are likely to experience some of the highest foreclosure rates in the country in coming years.[13] Moreover, as was the case in their neighborhood analysis, Pavlov and Wachter find that metropolitan markets with high levels of aggressive lending tend to experience greater declines in value when their markets cool. More specifically, they write, "The proportion of ARMs on the top of the market has a large and significant impact on the subsequent price decline."[14]

Many if not most exotic and subprime mortgages involve adjustable interest rates, especially those made in the 2003 to 2005 period, when exotic mortgage products became so popular. Much of the increase in ARM activity in recent years has been attributed to exotic products and subprime loans. The Federal Housing Finance Board's Monthly Interest Rate Survey (MIRS) of major lenders tracks the prevalence of ARMs for all home purchase loans. Figure 3 indicates the shares of home purchase loans that were ARMS from 1990 to 2004. [Because large loans that exceed GSE purchasing limits ("jumbo" mortgages) are more likely to be ARMs, the figure distinguishes ARM share for jumbo versus nonjumbo loans.] This chart shows that ARM share fluctuates widely. Traditionally, as rates for fixed-rate loans fall, the short-term savings that ARMs can provide decline, and fixed-rate loans increase. This was the case from 1990 to 1992. As rates rose from 1998 to 2000, ARMs increased as expected. However, from 2001 to 2003 interest rates generally fell and ARMS held steady for jumbo loans and increased for nonjumbo mortgages. Then, although rates remained relatively flat, ARMs increased dramatically in 2004, so that ARM share reached 71 percent of jumbo loans and 31 percent of nonjumbo loans. Moreover, the MIRS data most likely understates the growth in ARM share in later years, especially in the subprime market and for loans with teaser rates.[15]

The Federal Housing Finance Board breaks out historical MIRS data on ARM share for some of the largest metropolitan areas. Figure 4 plots the proportion of conventional home purchase loans in 2004 that were ARMs against the 2004 average home purchase price (for properties bought with conventional loans) for 31 large metropolitan markets The plot indicates that metros with higher sales prices tend to see higher ARM share.

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[13] Schloemer et al., supra.

[14] Pavlov and Wachter, supra, page 14.

[15] The MIRS data omits some significant segments of the mortgage market, including refinance loans, very large loans, those made by specialized subprime lenders, and in latter years, those with interest rates below 2.75 percent, which would include many ARMs with teaser rates. This latter omission is particularly relevant in recent years with the advent of exotic mortgages and the relatively low interest rate environment.

The increase in exotic mortgages has been portrayed by some as merely being driven by rising property values, as home buyers "demand" such loans to lower the initial debt service of increasingly expensive properties. However, when such products allow buyers to "stretch" farther – often too far – they actually fuel the demand for higher cost homes and become as much a cause as an effect of higher home prices. Basic urban economics tells us that land is relatively fixed in supply, so increasing the size of loans that borrowers can afford – especially in tight housing markets – is likely to result in higher housing prices.

In fact, many lenders have promoted adjustable rate and exotic loan products as a means for buyers to afford larger homes. In effect, many lenders in the last few years began competing much more based on maximizing the borrower's loan size than on interest rate or similar factor. This is a fundamental shift in the mortgage market – and not a healthy one.

As long as they expect values to continue to rise overall, some lenders will be willing to take on added repayment risks associated with more highly leveraged borrowers, because they are confident that properties will appreciate sufficiently to cover losses. The private mortgage insurer, PMI, Inc., has developed an index measuring the risk of property values declining in the next two years (called "market risk").[16] Figure 5 combines the 2006 PMI market risk index with MIRS data for the same 31 metropolitan markets. The chart shows two clusters of metros – one with market risks below 20 percent and the other with market risks above 30 percent. Most of the higher-risk metros have relatively high ARM shares. Even for the lower-risk cluster, higher ARM share appears to be related to market risk. This chart should give policy-makers significant cause for concern. When interest rates reset, many borrowers could find themselves struggling to meet their mortgage obligations. If housing appreciation can be maintained in such an environment – which is in question – then large increases in foreclosures may not result, although increased mobility may still occur as some homeowners are forced to sell their homes. Higher foreclosure rates, however, are likely to spur lower housing values which could, in turn, prompt difficulties in refinancing loans or in selling properties.

[16] The PMI Market Risk Index is based on measures of housing price escalation, employment growth, and local housing market affordability. PMI, Inc. (2006). *Economic and real estate trends*. Summer. At http://www.pmigroup.com/lenders/media_lenders/pmi_eret06v3s.pdf.

Implications for Federal Policy

First, it seems a sad commentary on state of the federal regulatory regime that federal agencies have – at least until very recently-- been more willing to act to control exotic mortgages in the prime market while doing little to protect the even more vulnerable borrowers in the subprime market. The regulators deserve credit for issuing earlier guidance on alternative mortgage products like interest only and payment-option loans. But they should go much further in two key respects. They should go beyond guidance and issue proscriptive regulations strictly limiting the most aggressive products and practices. Secondly, they need to include subprime hybrid ARM products such as 2/28s and 3/27s *explicitly* in this sort of guidance. (They have very recently proposed doing so.) These products effectively involve deferring interest from the teaser period – where the nominal rate is artificially suppressed to the post-reset period. The rate adjustment is effectively not any different than what happens when an interest-only or negative amortization loans converts to an amortizing product, except that the payment increase – or shock – will often be much higher in the case of the subprime loan. Regardless of whether we are talking about alternative products in the prime market or subprime hybrid products, these loans should be underwritten at the fully indexed interest rate. The Center for Responsible Lending has documented that large subprime lenders frequently underwrite loans at rates either at the initial teaser rate or hundreds of basis points below the fully indexed rate.[17] The announcement recently by Freddie Mac that it would now require underwriting at the fully indexed rate is certainly a welcome development.

Second, the market has shown that it does not transfer risk appropriately across different agents in the lending process. Brokers and originators are able to pass poorly underwritten loans off to packagers of special purpose investment vehicles who are, in turn, able to tolerate losses as long as their investors are receiving adequate average returns from their entire portfolio of mortgage-backed-securities. And when housing markets overall are appreciating fairly rapidly, high levels of risk can be tolerated –at least in the short run. Moreover, the de-localization of credit markets has meant that geographically diversified lenders can tolerate very high foreclosure rates in particular communities while maintaining nationwide rates that they are able to cover through high margins and aggressive growth.

[17] See written testimony of Martin Eakes, Center for Responsible Lending, before the Senate Committee on Banking Housing and Urban Affairs, February 7, 2007. At http://www.responsiblelending.org/pdfs/martin-testimony.pdf.

In order to return sanity to the mortgage market and make homeownership more sustainable, there is an urgent need for making all actors in the credit supply chain more accountable for their roles in the mortgage process. Liability for reckless lending needs to follow the loan from broker to lender to investor. Investors should not be able to hide behind a veil of ignorance. Nothing will create accurate information and reduce fraud better than exposing investors to the downside risk of providing capital to irresponsible lenders. As it stands now, the bulk of the costs of overly aggressive and irresponsible lending accrue to the borrowers and the local communities in which they reside. When the impacts on housing markets reach a tipping point and values begin to fall, eventually some lenders with the highest risk profiles will pay the price – which is what we have begun to see in the last few months. But the hyper-boom-bust cycle of the subprime market is not good for America's homeowners or communities. It fuels instability in household budgets, neighborhoods, and housing and financial markets more broadly.

Regulation must work to shift a much more substantial share of the costs of irresponsible lending to the supply side of the market – to lenders, brokers, and, especially, the Wall Street investors that feed the beast of irresponsible credit. On the origination side, mortgage brokers should bear fiduciary responsibility to borrowers. If stockbrokers have an obligation to act in accordance with the interests of their clients, should not mortgage brokers – who serve a much broader cross section of the American public – have the same obligation?

Third, subprime loans should be regulated in a way that returns this major segment of the mortgage market to one where underwriting is once again based fundamentally on an ability-to-pay rationale. Debt-to-income ratios should be calculated at or very near the fully indexed rate for adjustable rate loans. Moreover, the growth of low- and no-documentation loans in the subprime market has given far too much opportunity for brokers and originators to commit or facilitate fraud. The Mortgage Asset Research Institute, Inc., an industry consultant that tracks mortgage fraud, cites a compelling piece of lender research that corroborates the notion that stated-income loans are rife with problems:

> One of MARI's customers recently reviewed a sample of 100 stated income loans upon which they had IRS Forms 4506. When the stated incomes were compared to the IRS figures, the resulting differences were dramatic. Ninety percent of the stated incomes were exaggerated by 5% or more. More disturbingly, almost 60% of the stated amounts were exaggerated by more than 50%.[18]

Finally, while I share the desire of many who would like to see a stronger, basic set of federal regulations for subprime and alternative mortgage products, I do not think that federal preemption of stronger state laws is a necessary or appropriate quid-pro-quo for such regulation. The notion that mortgage markets are significantly impeded by differential state regulatory regimes is not consistent with the existing evidence. The research on state predatory lending laws has shown that states with predatory lending laws can actually encourage healthier mortgage markets. Moreover, lenders have always dealt quite well with different state foreclosure regimes. There is no compelling evidence that the state-based foreclosure regime has had any significant retarding effect on the mortgage market. (At the same time, I do believe that there are states – including my own -- in which homeowner protections in the foreclosure process are woefully inadequate.)

Federal law should be strengthened to provide a structurally sound floor of basic mortgage regulation – one not based solely on the confusing babble of dozens of disclosure documents that even professors who teach real estate finance have difficulty understanding. A more stable mortgage and housing market requires a much firmer federal regulatory foundation. Then, states should then be able to exercise their prerogative to supplement this regime with additional protections for their citizen homeowners.

Thank you again for this opportunity to offer my comments on this very important topic.

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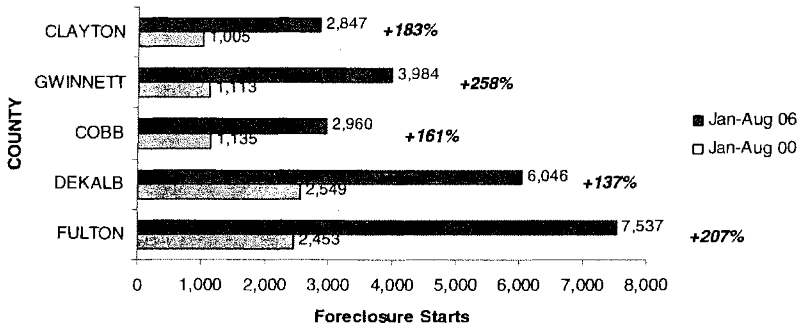
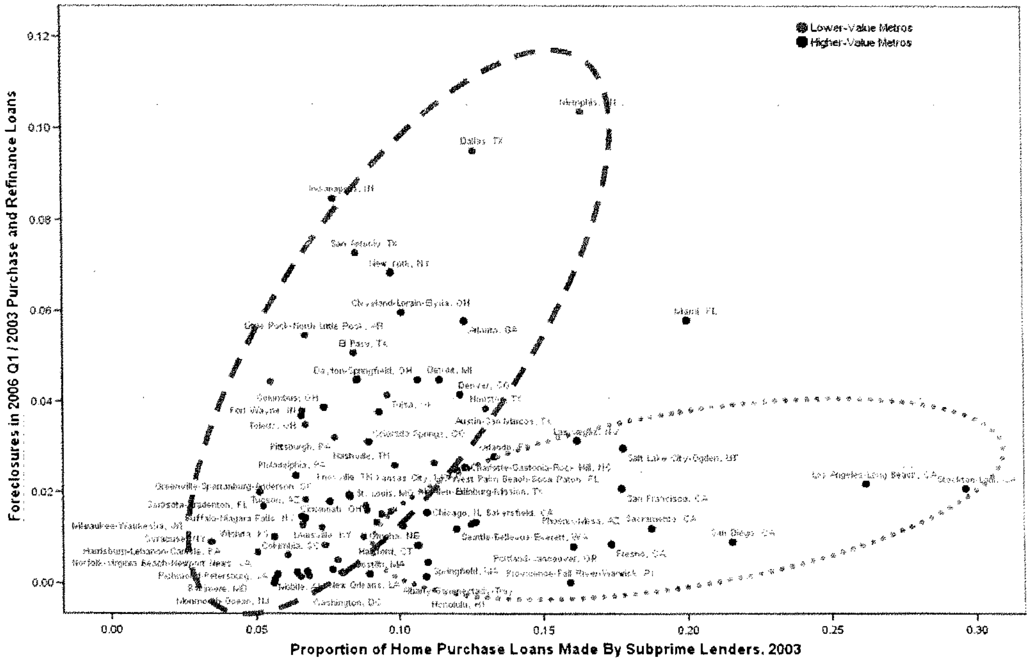
[18] Sharick, M., Omba, E., Larson, N., Croft J. D., 2006. Eighth periodic mortgage fraud case report to Mortgage Bankers Association. April. At http://www.mari-inc.com/pdfs/mba/MBA8thCaseRpt.pdf.

Figure 1. Growth in Foreclosures in the Five Core Atlanta Metro Counties, 2000-2006 (first 8 months 2000 to first 8 months 2006 comparison)



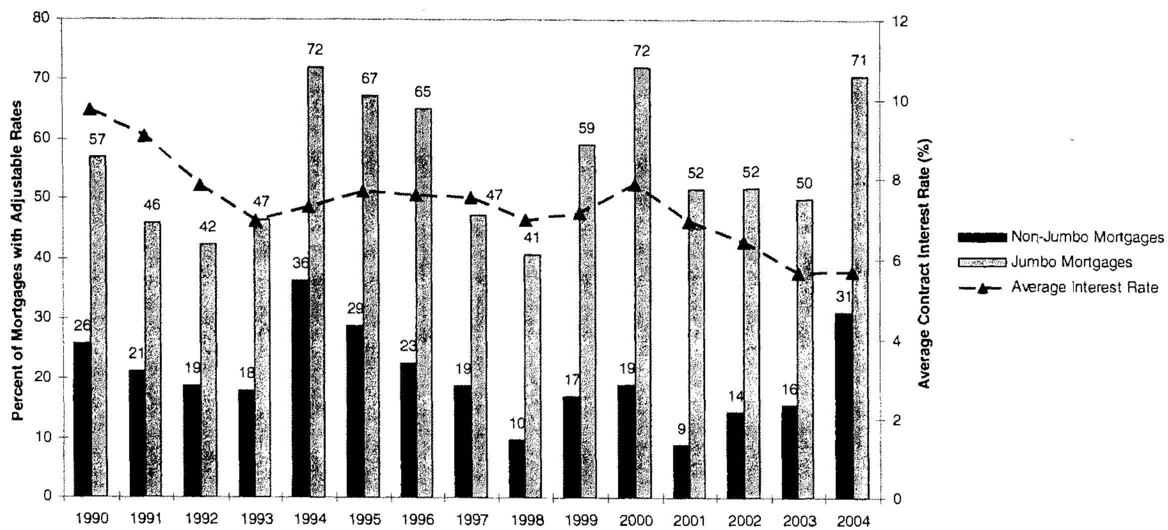
Source: Atlanta Foreclosure Report; EquityDepot.net, 2006

Figure 2. Foreclosure Filing Rate by Subprime Lender Share of Home Purchase Loans for 81 Large Metros



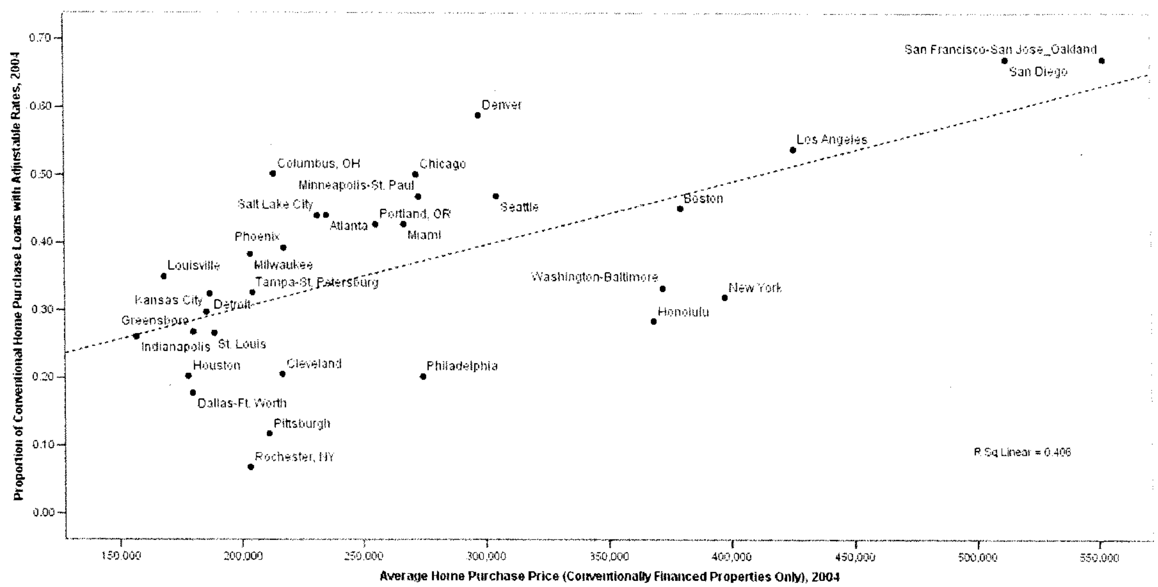
Source: RealtyTrac, Inc. (2006); Authors calculations of Home Mortgage Disclosure Act data.

Figure 3. Proportion of Conventional Mortgages with Adjustable Rates by Jumbo/Nonjumbo Status, 1990-2004



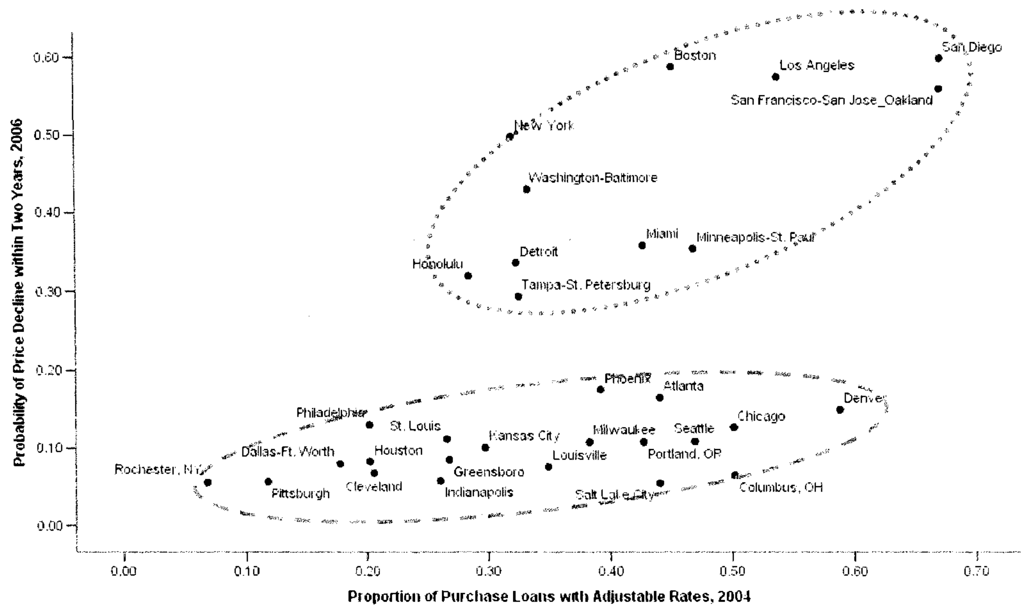
Source: Federal Housing Finance Board, Monthly Interest Rate Survey

Figure 4. Proportion of Conventional Mortgages with Adjustable Rates by Average Home Purchase Price, 2004



Source: Federal Housing Finance Board, Monthly Interest Rate Survey

Figure 5. Adjustable Rate Mortgage Presence and Overvaluation Risk, Large Metro Markets



Source: PMI, Inc. Market Risk Index; Federal Housing Finance Board, Monthly Interest Rate Survey

Mr. KUCINICH. Thank you very much.

We will now hear from Harry Dinham, who is the NAMB president, National Association of Mortgage Brokers.

Thank you, sir. Welcome. Please proceed.

STATEMENT OF HARRY DINHAM

Mr. DINHAM. Good afternoon, Chairman Kucinich and members of the subcommittee. I am Harry Dinham, president of the National Association of Mortgage Brokers. NAMB is committed to preserving the vitality of our cities and the dream of homeownership. We commend this committee for holding this hearing.

NAMB is the only trade association devoted to representing the mortgage broker industry. We speak on behalf of more than 25,000 members in all 50 States and the District of Columbia. Mortgage brokers must comply with a number of State and Federal laws and regulations. We are subject to the oversight of not only State agencies, but also HUD, the FTC, and, to a certain extent, the Federal Reserve Board.

First let me say that it is a tragedy for any family to lose their home. No one disputes this. Foreclosure hurts not only the family but the neighborhood and surrounding communities. As small business brokers, we live, eat, shop, and raise our families in these communities. When consumers' property values decline, our property values decline. When consumers' neighborhoods become unstable and prone to violence, our neighborhoods become unstable and prone to violence. More than any other channel, brokers live by the motto: once a customer, a customer for life.

What happens in our neighborhoods and in our communities hurts all of us. Mortgage brokers do care. We believe that everyone from Wall Street to mortgage originators has a role to play when a consumer is in trouble and facing foreclosure.

At the same time, we must remember that today America enjoys an all-time record rate of homeownership, almost 70 percent. The challenge we face now is how do we help people avoid foreclosure while at the same time ensure they have continued access to credit.

We realize that a number of recent reports have focused on the rise in home foreclosures. The truth is we can only speculate on the causes responsible for any rise in home foreclosures. There are a number of possible factors: bankruptcy reform, minimum wage gains, credit card debt, decreased savings rate, decreasing home values, second homes, fraud, illness, and other life events, to name just a few. Do not rush to judgment before we have all the facts.

We understand that Congress is calling for a GAO study on the causes of foreclosure. We expect the study to take into account a number of possible economic and non-economic factors such as product pricing, seasonal and market changes. We should examine the conclusions before implementing any policy decisions that could unfairly curtail access to credit.

In 2002, our President challenged the industry to increase minority homeownership by 5.5 million families by 2010. Mortgage originators, realtors, lenders, underwriters, and the mortgage securitizers and investors on Wall Street responded and helped families in urban America own homes. With this said, all of us—

industry, government, and consumers—have a role in helping these families stay in their homes.

Let me close with a brief summary of what NAMB is doing to help families achieve and maintain responsible homeownership.

We continue to advocate for affordable housing, including FHA reform, and have pushed for increased mortgage participation in the program. We must make FHA a real choice for nonprime customers. We support authorizing VA to provide reverse mortgages and expand access to credit, especially for elderly veterans.

Since 2002, NAMB is the only trade association that has advocated for education, criminal background checks, and increased professional standards for all mortgage originators, not just mortgage brokers.

We have prepared and submitted a revised HUD statement, good faith estimate, to help provide comparison shopping.

Our Code of Ethics and best business practices prohibit placing pressure on or being pressured by other professionals, and we propose the development of a loan specific payment disclosure to be given to consumers at the shopping stage and again at funding. This will help consumers avoid payment shock.

Thank you for the opportunity to appear before you today. I am happy to answer any questions.

[The prepared statement of Mr. Dinham follows:]

National Association of Mortgage Brokers

Prepared Testimony of

Harry Dinham, CMC, NAMB President

National Association of Mortgage Brokers

On

"The State of Urban America:

Foreclosure, Subprime Lending and Other Financial Services"

Before the

Subcommittee on Domestic Policy

Committee on Oversight and Government Reform

United States House of Representatives

Wednesday, March 21, 2007

Good morning Chairman Kucinich, Ranking Member Issa, and Members of the Subcommittee, I am Harry Dinham, CMC, President of the National Association of Mortgage Brokers ("NAMB"). Thank you for inviting NAMB to testify today on the state of urban America as it relates to homeownership and the mortgage industry. We appreciate the opportunity to address the nature of the subprime lending industry, the effectiveness of federal regulators and the problems posed by foreclosure.

NAMB is the only trade association exclusively devoted to representing the mortgage broker industry and speaks on behalf of more than 25,000 members in 50 states and the District of Columbia. Our members are independent, small business men and women that adhere to a strict code of ethics and best lending practices when taking consumers through the loan process. We typically maintain business relationships with various lenders to provide consumers with numerous financing options. These partnerships allow our members to offer consumers the most competitive mortgage products available.

We commend this Subcommittee for holding this important hearing to examine the subprime mortgage industry and foreclosure, pay day lending industry and the enforcement of the Community Reinvestment Act. We appreciate the salient concerns raised by these topics.

It is a tragedy for any consumer to lose their home to foreclosure. At the same time, America enjoys an all-time record rate of homeownership. The challenge before us is to address the tragedy of foreclosure while at the same time ensuring that consumers continue to have access to the credit they need to finance their homes.

I. Record Homeownership

In 2002, the President called upon the real estate and mortgage-finance industries to help accomplish "America's Homeownership Challenge" ("Challenge"). This Challenge called on the industry to take "concrete steps to tear down the barriers to homeownership that face minority families."[1] The President set a goal of increasing the number of minority homeowners by 5.5 million families by 2010.

Shortly after the President's Challenge was released, the Department of Housing and Urban Development ("HUD") released a report that identified the most significant barriers to minority homeownership (the "Report").[2] The five major obstacles listed were:

1. lack of capital for the down payment and closing costs;
2. lack of access to credit and poor credit history;
3. lack of understanding and information about the home buying process, especially for families for whom English is a second language;
4. regulatory burdens imposed on the production of housing; and
5. continued housing discrimination.

[1] "A Home of Your Own: Expanding Opportunities For All Americans." George W. Bush (June 2002). http://www.whitehouse.gov/infocus/homeownership/homeownership-policy-book-whole.pdf
[2] "Barriers to Minority Homeownership." U.S. Department of Housing and Urban Development (June 2002). http://www.hud.gov/news/releasedocs/barriers.cfm.

The Report stated that, combined, these factors "produced a gap in which non-Hispanic whites enjoyed a 68 percent homeownership rate, compared to only 48 percent for African-Americans and 47.6 percent for Hispanics." Echoing the President's Challenge, HUD also called upon the real estate and mortgage lending industries to "increase their levels of product innovation and marketing to minority families in order to sustain" growth rates achieved in the 1990s.

The industry responded. To achieve the goals set by the Administration and reaffirmed by HUD, mortgage originators, realtors, lenders, underwriters, and the securitizers and investors of Wall Street worked together to develop and deliver innovative loan financing options. The task presented was a difficult one given that over the years affordable housing had became sparse, especially in major metropolitan and coastal cities. High home prices, along with a lack of affordable financing options from the government sponsored enterprises and the Federal Housing Administration ("FHA"), led to the inability of many first-time, low-income and minority homebuyers with imperfect credit history to enter into the housing market in these cities. But the secondary market, along with innovative banks and lenders, aptly responded to the need for these consumers to find affordable financing options so that they could obtain homeownership.

This allowed more Americans to achieve the dream of homeownership and brought about record rates of homeownership that have reached nearly 70 percent. New products are credited with addressing exactly the concerns identified in HUD's Report – providing financial options to families with little or no credit access, minimal, if any, down payment, lower monthly payments, and less "cash-out-of-pocket" at closing.

Achieving a homeownership rate of almost 70 percent and enabling more minority families to enjoy the multitude of benefits offered by homeownership – from community investment to wealth-building ability – is an impressive accomplishment for which the entire mortgage industry, along with this government, deserves credit. The zeal to achieve the benchmarks and objectives laid out by the current Administration has resulted in circumstances that now present industry and the government with a set of new concerns and challenges.

II. The Mechanics of Today's Mortgage Industry

To understand the recent achievements of record homeownership rates mentioned earlier, a short, general primer on the mortgage originator industry is beneficial. Mortgage brokers are just one participant in a larger network of loan originators – including mortgage bankers, mortgage lenders, credit unions, depository institutions and many others – all competing to deliver mortgage products to consumers. A mortgage broker is an originator that distributes the products of a wholesale lender. It used to be that lenders and brokers were differentiated by the fact that lenders always serviced their loans. That is not true today. In fact, today there are few substantive differences between these distribution channels when it comes to originating mortgages. The lines that once divided the origination channels have blurred with the proliferation of the secondary mortgage market. In the current market, mortgage lenders operate essentially as brokers – they present an array of available loan products to the consumer, close the loan and then, almost instantaneously sell the loan to the secondary market (i.e., Fannie Mae or Freddie Mac). Most residential mortgage loans – some say up to 85% – are quickly sold to Wall Street investors since holding such loans in portfolio is quite risky.

The current market is largely driven by the Wall Street investors that design risk profiles of borrowers to fit within their tolerances' for mortgage-backed securities. The products developed by Wall Street are then distributed to consumers through the various distributions channels that match the consumer to the risk profiles of the Wall Street investors, pension funds, hedge funds and others. Lenders also conduct underwriting, which means they verify to see if the consumer fits the particular loan program offered by Wall Street.

In today's market, a mortgage broker will submit a loan if it meets the pre-established underwriting standards. Once the loan qualifies under the underwriting standards, the broker is required to move forward with the closing. In other words, the underwriting standards, not the mortgage broker, dictate whether a consumer qualifies for a particular loan product.

III. Today's Reality: Rising Delinquencies and Foreclosures

Today consumers, industry, and government are challenged by the rising number of mortgage delinquencies. Consumers are faced with the prospect of losing their homes. No one questions the personal tragedy of this fact or the impact this tragedy has on America's cities. Even one family losing their home to foreclosure is one too many, regardless of the cause. For this reason, NAMB is committed to working with this Subcommittee and others to ensure that homeowners have continued access to affordable credit and are able to preserve their dream of homeownership and the vitality of our cities.

But the unanswered question is: what is causing the rise in mortgage delinquencies and home foreclosures? No one knows for sure, but we believe there may be a number of factors:

- New homeowners unprepared for the costs and responsibilities of homeownership;
- Bankruptcy Reform;
- Speculative bubble in real estate values;
- Refinancing to cure delinquencies;
- Minimal wage gains;
- Illness and other life events;
- Credit card debt;
- Decreased savings rate;
- Fluctuating home values;
- Mortgage Fraud;
- Consumer Fraud;[3]
- Appraiser Fraud;
- Title Insurance Fraud;
- Predatory Practices;

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[3] *See* Merle Sharick, Erin E. Omba, Nick Larson, D. James Croft of Mortgage Asset Research Institute, Inc. *Eighth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association* (pg. 12) (April 2006) http://www.mari-inc.com/pdfs/mba/MBA8thCaseRpt.pdf.

- Risk layering;
- Consumers desire to live above and beyond their means;
- Cash-out refinancing to maintain unsustainable standard of living;
- Consumer financial literacy;
- Owner v. non-owner occupied;
- Buyers of property with an intent to resell quickly;
- Criminal Enterprises;
- Bad Acts and Bad Actors;
- Investors and Speculators;
- Shrinking middle class;
- Exporting of jobs;
- New replacement jobs at low wages;
- The role of the secondary market; and
- Regional job loss.

The chances are unlikely that there is one cause of foreclosures.

IV. No Rush to Judgment

Before we rush to judgment and conclude that a particular segment of the mortgage market or practice is largely responsible for the increase in home foreclosures, it is imperative to at least examine and verify the true causal factors for the increase in mortgage delinquencies and home foreclosures. We should not jeopardize the vast majority of consumers who have succeeded in using many innovative loan options to attain and maintain their homes. Do not forget those consumers who could benefit in the future from these varied loan options.

We can only speculate as to the reasons for the increase in mortgage delinquencies and home foreclosures. As a result, we can only make assumptions and take what is tantamount to a trial-and-error approach to possible resolutions. We have no assurances that current proposals are either appropriate or will yield desired results. NAMB does not believe that consumers should continue to suffer as we take a 'trial and error' approach—it is unfair and can result in unintended consequences.[4]

NAMB believes the problem of rising foreclosures is complex and will not be corrected by simply removing products from the market. As a study by the Office of the Comptroller of the Currency in 2006 states, "the relationship between predatory lending practices and foreclosure rates is more complicated than the arguments for restricting their (nontraditional loan products) use suggest. Policies that encourage subprime lenders to review and tighten loan underwriting and pricing procedures to ensure borrowers' abilities to repay their loans are fully reflected in

[4] *See* Mary Umberger, *Home buyer Counseling Challenged*, Chicago Tribune, Nov. 2, 2006. *See.* *https://www.hb4050info.com/Public_Web/Home.aspx* for more information on the Cook County Illinois Predatory Lending Database, mandated by Article 3 of the Residential Real Property Disclosure Act1, ("H.B. 4050") that led to falling neighborhood values, discrimination lawsuits, and lenders pulling out of the area. The program was suspended on January 27, 2006. *See https://www.hb4050info.com/pdfs/4050Scan001.pdf.*

lending decisions and terms may be more effective than prohibitions on specific lending practices."[5]

Instead, NAMB believes government and industry should take a step back and evaluate all the factors that could play a role in determining whether a family is forced to foreclose on their home.

V. The Need for an Independent Study

NAMB firmly believes that an independent study to identify and examine the causes of foreclosures is necessary before we can create well-designed and effective solutions. Although numerous foreclosure studies exist, they are not independent and tend to focus solely on *a* single causal factor. To understand the true causal effects of foreclosures, NAMB urges Congress or the Administration to fund an independent study that is sufficiently broad to encompass all of the above-mentioned factors and is performed over an adequate period of time to take into account seasonal and cyclical changes in the market.[6]

A long-term, independent study will aid the industry and government in determining the appropriate steps for long-term solutions to the foreclosure problem while ensuring that consumer choice, product innovation and the ability to maintain record rates of homeownership are not negatively impacted. In addition, NAMB believes that to pursue a comprehensive approach to the issues raised by the increase in foreclosure rates, we must include not only originators in the discussion, but also those who fund, service, collect and invest in mortgage loans.

However, as we all confront these problems and in our zeal to protect consumers from or help them weather the causes of foreclosures, NAMB urges consumer advocacy groups, industry and the government not to forget the original goal to increase homeownership and the success that has been achieved by creating new products expanding access to credit. Today, more Americans own their home than ever before and while we must work to ensure Americans are able to stay in their homes, we must also be cognizant of the unintended consequences the policies developed can have on families who have not yet achieved homeownership. As we move forward, NAMB urges government to use caution so as not to upset the balance created by the market that provides homeownership opportunities to so many Americans.

VI. Policy Recommendations

Although we believe that this independent study must be performed, we appreciate that it is a long-term project that will not provide immediate relief to those consumers suffering from or facing the prospect of home foreclosure. We must also develop short-term solutions.

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[5] Morgan J. Rose "Foreclosures of Subprime Mortgages in Chicago: Analyzing the Role of Predatory Lending Practices." (August 2006).
[6] On February 7, 2007 NAMB testified before the Senate Committee on Banking, Housing and Urban Affairs and requested an independent study.

As discussed previously, the industry responded to this Administration's Challenge to increase homeownership. In the past five years alone we have witnessed a proliferation of market players and the development of numerous innovative loan products. Together, these developments have resulted in a competitive market that offered increased access to affordable credit.

But during this same time period, there were missed opportunities to address the growing need for a simplified mortgage process; prevent payment shock; and ensure that all loan originators were able to communicate the risks and benefits of increasingly complex loan products.

Now is the time to act. NAMB takes this opportunity to emphasize once more the need to increase mortgage broker access to the FHA program and make it a viable alternative to subprime products; move forward with Real Estate Settlement Procedures Act of 1974 ("RESPA") Reform; create uniform, minimum education standards for all loan originators; and commit funding towards enforcement and consumer financial literacy efforts. In addition, NAMB proposes the creation and use of a consumer tested, loan-specific disclosure to communicate key loan features upfront and deter the prospect of payment shock.

Before we address each of these policy proposals, we want to emphasize that regardless of what measures we pursue, we should (1) ensure that the integrity of the consumer decision-making process remains intact, and (2) that we do not risk 'turning back the clock' to a pre-Fair Housing Act era where certain population segments were unfairly denied access to loan financing options.

Protecting the Consumer's Right to Remain the Decision-Maker

The consumer is the ultimate decision maker on the product, the price and the services purchased in conjunction with obtaining their financing. No merchant, no government and no company should superimpose their own moral judgments on what is a basic American privilege of homeownership.

Some have proposed that a fiduciary duty standard should be implemented and mortgage originators and their loan officers should act in the "best interests" of the consumer. NAMB remains opposed to any proposed law, regulation or other measure that attempts to impose a fiduciary duty, in any fashion, upon a mortgage broker or any other originator.[7]

Simply put, a mortgage broker should not, and cannot, owe a fiduciary duty to a borrower. The consumer is the decision maker, *not the mortgage broker.* Mortgage brokers do not represent every loan product available in the marketplace, nor do we bave the "best" loan available. Rather, the mortgage broker enters into contracts with various lenders and is then able to offer such lenders' loan products directly to the consumer. This is a critical point because there is no "best" result. What is "best" depends upon three inter-related concepts: product availability, price, and service. Focusing solely on a price of a product may not yield the "best" result for a consumer. Only the consumer can determine the "best" combination of factors that fit their needs.

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[7] *See* Attached Appendix A, *The Relationship of the Mortgage Broker to Its Consumer.*

Some have suggested that mortgage originators (not exclusively mortgage brokers) be subject to a suitability standard when dealing with consumers. This concept has not been thoroughly defined in the mortgage context. An ill-defined and vaguely worded suitability standard will do nothing more than inject greater subjectivity and vagueness into a process that today should be incorporating mostly, if not only, objective factors. Moreover, such a standard will create uncertainty and confusion in the marketplace, spurring litigation, which in turn will increase the cost of credit.

Some have suggested that mortgage brokers are not regulated. We disagree and we have submitted for the record a memorandum that highlights the federal and state laws that govern our industry.[8] It is difficult to harmonize the assertion that the mortgage originator industry suffers from inadequate oversight and enforcement with a proposal that will require these very same originators to make highly discretionary and subjective judgments.

For these reasons, no law or regulation should ever require any mortgage originator to supplant the consumer's ability to decide for him or herself what is or is not an appropriate loan product. As the decision-maker, the role of the consumer is to acquire the financial acumen necessary and take advantage of the competitive market place, shop, compare, ask questions and expect answers.

A. Make FHA a Real Choice for Subprime Borrowers

A stated objective of the FHA is to increase origination of FHA loan products and expand homeownership opportunities for first-time, minority and low to moderate-income families. NAMB supports increased access to FHA loans so that prospective borrowers who have blemished credit histories, or who can afford only minimal down payments, have increased choice of affordable loan products. These prospective borrowers should not be forced by default into the subprime market. A recent *Inside Mortgage Finance* publication estimated the current FHA market share at 2.7%.[9] NAMB believes the solution to increasing FHA loan origination and market share is increasing the number of origination sources responsible for delivering FHA loan products directly to consumers. Today, the most effective and efficient origination source is through mortgage brokers.

Mortgage brokers originate over 50% of all home loans, yet brokers are responsible for just 10% of FHA's origination volume, or .27% of all home loans. This is due, in large part, to the fact that mortgage brokers are discouraged from participating in the FHA program by the unnecessarily burdensome financial audit and net worth requirements. These requirements erect a formidable barrier and prevent a significant majority of mortgage brokers from participating in the program.

NAMB estimates that less than 18% of all mortgage brokers are approved to originate FHA loans under the current requirements; however, recent NAMB surveys indicate that roughly 80% of "non-participating" mortgage brokers would offer FHA loans to their customers if there were no financial audit or net worth requirement. NAMB predicts that such a change would increase

[8] *See* Attached Appendix B, *The Regulation & Oversight of the Mortgage Broker Industry*.
[9] *See Inside Mortgage Finance, Mortgage Originations by Product, p.7 (March 2, 2007)*.

mortgage broker participation in the FHA program from 18% to roughly 85%. This, in turn, would increase FHA's loan origination volume and market share by nearly 40%.

For example, in 2006, FHA's origination volume was roughly $80 billion.[10] All things being equal, the 67% increase in broker participation would increase FHA's origination volume to nearly $112 billion, and FHA's total market share from 2.7% to 3.78%. This increase of $32 billion and 1.08% total market share will be directly tied to an increase in mortgage broker participation in the FHA program.

B. Out-Dated Disclosures

NAMB supports clear, consistent, and uniform communication with the consumer from the shopping stage through consummation and afterwards throughout the life of the loan (*i.e.*, monthly statements). Disclosures – when designed and used appropriately in conjunction with originator and consumer financial literacy efforts – alert potential borrowers to the risks and benefits presented by any particular loan product and support meaningful comparison shopping. Disclosures aid the consumer in exercising their right to make an informed choice.

NAMB reiterates the need to revise existing mortgage disclosures. We encourage HUD and the Federal Reserve Board (the "Board") to review and update key disclosures given to consumers during the home buying process, such as the GFE and the Truth In Lending ("TIL") statement. These disclosures are critical to the home buying process and should be modernized to reflect the growing popularity of nontraditional mortgage products in the mortgage market.

1. GFE Reform

In 2005, NAMB proposed a one-page GFE[11] in response to a series of roundtables conducted jointly by the U.S. Department of Housing and Urban Development and the Small Business Administration throughout the summer of 2005. This one-page GFE mirrors the HUD-1 consumers receive at settlement and communicates not only the loan features and costs, but fully discloses the role of the loan originator in the mortgage transaction. Most important, the revised GFE would provide the information most valued by the consumer—meaningful closing costs and monthly payment.

The one-page GFE is a viable solution to the problem of abusive lending because it applies equally to all segments of the mortgage industry; is effective in preventing abusive lending tactics, such as bait-and-switch schemes; is informative because it clearly and objectively informs the borrower of the role of the loan originator in the transaction; and is enforceable, because it grants the consumer a private right of action.

Specifically, the NAMB proposed GFE possesses four distinct attributes:

First, it is even-handed. The NAMB proposed GFE would be equally applicable to all originators conducting business in the mortgage marketplace. Of import, the proposed NAMB

[10] *See Inside Mortgage Finance, Mortgage Originations by Product, p.7 (March 2, 2007).*
[11] *See* Attached Appendix B, *NAMB Proposed GFE.*

GFE treats the disclosure of rate, fees, costs and points uniformly regardless of distribution channel, giving meaning to the ability to "comparison shop." As a result, distribution channel bias is eliminated and all consumers are afforded the same level of protection against abusive lending tactics.

Second, it is informative. The NAMB proposed GFE clearly discloses the role of the originator in the mortgage transaction. The borrower is notified that the loan originator does not distribute all of the loans available in the marketplace and therefore, can not guarantee the lowest rate. This aspect of the proposed GFE is significant. For example, as discussed previously, a loan product offering the lowest interest rate may not necessarily be the "best" loan product for the borrower. It is far more effective to disclose the role of the broker, the loan features and costs, and empower the consumer to comparison shop and choose a product that suits his or her needs. Also, requiring that every mortgage originator disclose his or her role and relationship with the borrower will eliminate any confusion on the part of the borrower—this approach actually ensures that a borrower is not operating under a faulty impression that an originator, such as a bank-affiliated mortgage lender, owes him or her a fiduciary duty.

Third, it is effective. The NAMB proposed GFE is effective in combating abusive lending tactics because it provides simplicity, clarity and transparency of the loan costs and features. It is one-page in length; mirrors the HUD-1 settlement statement; requires mandatory re-disclosure if settlement costs increase by more than 10% of the original estimate, or if the proposed interest rate increases.

Fourth, it is enforceable. Consumers are given a private right of action to enforce the GFE tolerance limits of 10% if no timely re-disclosure is given to the consumer.

We believe the NAMB proposed GFE form will build consensus among stakeholder groups while achieving HUD's stated goals of simplicity, clarity, transparency, and greater cost certainty for consumers. However, it is now 2007 and HUD has yet to release a revised version of the GFE. NAMB urges HUD to move forward with in working with the industry to develop and roll-out a GFE that incorporates the key elements outlined above and is more beneficial to consumers.

2. *Loan Specific Payment Shock Disclosure*

Current disclosures have failed to keep pace with market innovations, especially in the area of variable rate loans. Today, consumers are not given the tools needed to shop effectively for a mortgage in a market offering increasingly creative and complex options. Disclosures are laden with legalese, inconsistent, not required uniformly across all distribution channels, and fail to provide the information that consumers need most when making a decision. Most notably, there is no current loan specific disclosure that communicates to the borrower the variability of their monthly payment (*i.e.*, your monthly payment can go up to X) or interest rate (*i.e.*, your current interest rate is valid only for X months).[12] As a result, consumers are left confused, unable to

[12] TILA does not adequately reflect the changing payment scheme and interest rate of many loan product types available on the market today. The recent CHARM booklet, as well as the new Interest Only & Pay-Option ARM

comparison shop loan products and subject to payment shock. There is a critical need for a uniform disclosure required across all distribution channels that will clearly and concisely impart loan specific information to the consumer and prevent unwanted surprises about payment shock and interest rate variations.

NAMB proposes a loan specific payment disclosure notice that will: (1) educate the consumer about the specific loan product being considered and/or chosen, and (2) enable consumers to exercise an informed and independent choice about a particular loan product. A mortgage originator knowledgeable about the various market products would be able to also assist the consumer in understanding the information provided on the loan specific disclosure – the risks, the benefits and the choices available.

To address the issues of payment and interest rate shock, we recommend:

1. Requiring all loan originators to provide consumers, regardless of loan-product type, with a loan-specific payment disclosure;

2. Disclosing the consumer payment variations, (*e.g.*, a minimum and maximum payment for every loan product), interest rate variations, and disclose information about pertinent features such as prepayment penalty and negative amortization, if applicable;

3. Implementing this disclosure can be implemented through regulation to speed its implementation. Specifically, the initial loan-specific disclosure provided early in the shopping stage can be required through RESPA (*e.g.*, can accompany the estimated GFE), and the final loan-specific disclosure can be required at closing through Truth In Lending Act ("TILA"); and

4. Consumer testing by an independent third-party or governmental agency prior to implementing and requiring that all originators provide this disclosure.

A uniform and straight-forward disclosure, such as the one proposed here, will aid in the comparison shopping process for consumers and will provide a more simplistic explanation of the "worst-case-scenario."

C. Standard Education Requirements for All Mortgage Originators

NAMB believes that part of the solution to successfully combat abusive lending tactics and reduce the number of foreclosures in America is to require education of all mortgage originators – not just mortgage brokers. Education of each and every mortgage originator helps to ensure that consumers are provided with sufficient information to make an informed decision about available loan financing optious in the market.

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booklet, provide excellent background information, but lack the specificity about a loan product's features that the consumer needs to know when deciding which loan product meets their needs.

To ensure all mortgage originators are well educated and knowledgeable about all loan products, NAMB has long advocated for uniform licensure, education (including ethics training) and criminal background checks for each and every individual that handles a 1003 application,[13] *i.e.* every mortgage originator.[14] NAMB agrees that all "[l]ending personnel should be trained so that they are able to convey information to consumers about product terms and risks in a timely, accurate, and balanced manner."[15]

NAMB is committed to ensuring that all originators are knowledgeable about the range of loan products available in the marketplace and understand the features, risks and benefits of the loan types that they offer. For this reason, we support federal efforts to implement a national minimum standard for all states to meet or exceed in lieu of a federal licensing mandate.

D. Improve Standards for All Mortgage Originators

Although consumers are often unable to distinguish one origination source from another, mortgage brokers stand singularly accused of operating on an unregulated basis. This accusation is plainly false. Mortgage brokers[16] comply with multiple state and federal laws and regulations governing the mortgage loan origination industry. Mortgage brokers are licensed or registered and must comply with pre-licensure and continuing education requirements and criminal background checks in forty-nine states and the District of Columbia. Over half of these states require not only mortgage broker licensure, but the licensure or registration of brokers' individual loan officers as well. An increasing number of states are requiring these originators to pass tests before obtaining a license. The same is not true for the thousands of loan officers employed by mortgage bankers and other lenders, who are exempt in most states from loan officer licensing statutes. While the Office of the Comptroller of the Currency exempts depository institutions from state licensing requirements, the states continue to increase their regulation of mortgage brokers and their individual loan officers. Many states also exempt lenders from licensing if they are approved by Fannie Mae or HUD, which subjects those lenders and their employees to significantly less regulation than most mortgage brokers.

Today, we have an opportunity to create a system that will better serve consumers; unfortunately current proposals, such as the Conference of State Bank Supervisors ("CSBS") and American Association of Residential Mortgage Regulators ("AARMR") proposed registry system,[17] are flawed because they largely include only one channel of the industry, *i.e.*, the mortgage broker. In addition, the proposed CSBS/AARMR proposed registry system will include companies, but not loan originators dealing with consumers inside those companies. Such a system will not eliminate abusive practices or prevent foreclosures, but rather create a false sense of security in

[13] A Form 1003 is a Uniform Residential Loan Application.
[14] The basic requirements of education, continuing education, ethics training, written exams, and criminal background checks can be found in NAMB's ongoing work and commitment on the Model State Statute Initiative (MSSI) that NAMB began in 2002, which is attached hereto as Appendix C.
[15] *See* Proposed Interagency Guidance on Nontraditional Mortgage Products (December 2005) p.35.
[16] Mortgage brokers are regulated by more than ten federal laws, five federal enforcement agencies and at least forty-nine state regulation and licensing statutes. Moreover, mortgage brokers, who typically operate as small business owners, must also comply with a number of laws and regulations governing the conduct of commercial activity within the states.
[17] *See* Appendix D NAMB Statement on CSBS/AARMR Proposed Registry, dated November 4, 2006.

the market because it does not prevent a bad actor from moving from one segment of the industry to another unchecked.

For example, under the CSBS/AARMR proposed registry system a loan officer who is found guilty of committing fraud would not be prevented from moving from one lender's office to a another because that individual would not be tracked under the proposed system. Therefore, placing additional restrictions on legitimate and law-abiding originators will not successfully address the problem of the truly unscrupulous lenders who brazenly ignore the laws as they currently exist. It is only through the enforcement of existing laws and the application of uniform legal standards to all originators that a lending environment will be created where consumers are free to shop and compare mortgage products and pricing among different distribution channels without fear or confusion.

NAMB remains committed to working with regulators at both the federal and state level to move forward on a licensing and registration system that includes all originators and will better assist consumers in throughout the mortgage process. In addition, NAMB urges the regulators to include all parties in an open dialogue regarding the creation these standards.

<u>E. Financial Literacy and the Borrower</u>

NAMB believes consumers should possess the necessary financial knowledge to carefully evaluate the risks and rewards of traditional and nontraditional products. Financial literacy is the tool that consumers need to make an informed decision as to whether a particular product—traditional or nontraditional—meets their needs. Financial literacy is also a valuable tool that will help consumers avoid foreclosure. If a consumer understands the risks and rewards of the product they have chosen, they will have a better understanding of how to stay in their home and avoid foreclosure.

Regardless of how knowledgeable a mortgage originator is or becomes, an educated consumer is always in a better position to make an informed decision when selecting a loan product that can match his or her financial needs. Borrowers must possess the financial literacy tools to properly evaluate the risks and benefits of nontraditional mortgage products that have been highlighted and communicated by the educated mortgage originator. For this reason, NAMB urges Congress to allocate funds for financial literacy programs at the middle and high school level so that consumers are educated about the financial decisions they make and retain their decision-making ability.

NAMB has always been a staunch supporter and advocate for consumer financial literacy. Our firm belief that an educated borrower is significantly less likely to fall victim to any abusive lending practice and to avoid foreclosure is demonstrated by our active involvement in various consumer education efforts. For example, NAMB initiated a pilot consumer credit education program using Freddie Mac's CreditSmart® and CreditSmart® Español financial literacy curricula. The pilot is currently being managed by NAMB state affiliates in California, Florida and Texas. NAMB partnered with United Guaranty in 2003 to create a consumer information presentation – "Are You Prepared to Head Down the Road to Homeownership?®" – to help educate minorities, immigrants and low-to-moderate income households on the home-buying process. The presentation covers common home mortgage terminology, important steps in the home-buying process, fair housing laws, credit reports and more.

We recommend Congress put forth measures and explore those avenues that outreach to borrowers and provide meaningful education to them in a timely fashion rather than just at the time of application or at the closing table. Possessing a fundamental understanding of the mortgage lending marketplace and the loan product types available will empower borrowers to comparison shop, ask meaningful questions and make financial decisions that advance their personal life objectives. Again, NAMB strongly believes that because financial education is the key to choosing the right loan product and protecting oneself against fraud, the consumer education process should begin at a young age. To this end, NAMB supports any effort that calls for federal funding to support consumer financial literacy efforts and outreach programs during the school years.

Again, thank you for the opportunity to appear before this Subcommittee today to discuss this timely issue. I am happy to answer any questions that you may have.

Appendix A

NAMB
National Association of Mortgage Brokers

The Relationship of the Mortgage Broker to its Customer

The majority of mortgage brokers are small, independent businesses operating retail offices open to the public for the purpose of obtaining mortgage financing. Like any retail source, the mortgage broker has wholesale distribution channels which supply them with inventory, in this case, a variety of mortgage products. The mortgage broker provides rate and price flexibility and among other things, offers numerous loan products, collects information from the borrower, communicates such with the lenders and facilitates closings. The public, in turn is able to choose the product offered by that particular mortgage brokerage firm. If the shopper does not find the product or price they want, they go to another mortgage source.

It has been suggested that we should be the fiduciary agent for the borrowing consumer. The mortgage broker is **not** the exclusive agent for the lender **or** the borrower. The mortgage broker is an independent entity that typically has contractual loan origination arrangements with multiple wholesale lenders. As an independent entity, mortgage brokers rely on referral business, which is obtained by offering a combination of good customer service, a variety of mortgage products and competitive interest rates. A broker that does not offer all of the afore-mentioned, will most often not get the business, since customers have the ability to shop for the rate, product and service that they prefer. Since not all mortgage brokers offer the same loan products or are approved with all lending sources, it would be impossible to assure the "best" mortgage options to every customer, thus making fiduciary responsibility unattainable.

A member of the National Association of Mortgage Brokers adheres to a strict code of ethics and best lending practices which can be found at www.namb.org. Mortgage brokers do the majority of all the mortgage loans in this Country and the public has declared us their mortgage originator of choice. For the past several years the borrowing public has opted to use the mortgage broker as their lending source, primarily because of competitive pricing, varied mortgage products, professional service and convenient location and hours.

7900 Westpark Drive, Suite T309
703-342-5900

McLean, Virginia 22102
www.namb.org

Appendix B

NAMB
National Association of Mortgage Brokers

THE REGULATION & OVERSIGHT OF THE MORTGAGE BROKER INDUSTRY

Background Information

There are a variety of distribution channels in the mortgage industry today, and each of these distribution channels is heavily regulated at both the state and federal level. Mortgage brokers, like bankers and other lenders, comply with every federal law and regulation affecting the mortgage loan origination industry. Additionally, mortgage brokers comply with a host of state laws and regulations affecting their businesses, from which bankers and lenders are largely exempt.

Mortgage brokers are just one participant in a larger network of loan originators – including mortgage bankers, mortgage lenders, credit unions, and depository institutions – all competing to deliver mortgage products to consumers. There are actually very few substantive differences between these distribution channels when it comes to originating mortgages. The lines that once divided them have become increasingly blurred with the proliferation of the secondary mortgage market. Today, mortgage brokers and mortgage lenders are performing essentially the same function – they present an array of available loan products to the consumer, close the loan and then, almost instantaneously sell the loan to the secondary market (i.e., Fannie Mae or Freddie Mac).

Although consumers are often unable to distinguish one origination source from another, mortgage brokers stand singularly accused of operating on an unregulated basis. This accusation is plainly false. Mortgage brokers are regulated by more than ten federal laws, five federal enforcement agencies and at least forty-nine state regulation and licensing statutes. Moreover, mortgage brokers, who typically operate as small business owners, must also comply with a number of laws and regulations governing the conduct of commercial activity within the states.

Federal Regulation of Mortgage Brokers

Mortgage brokers are governed by a host of federal laws and regulations. For example, mortgage brokers must comply with: the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA), the Home Ownership and Equity Protection Act (HOEPA), the Fair Credit Reporting Act (FCRA), the Equal Credit Opportunity Act (ECOA), the Gramm-Leach-Bliley Act (GLBA), and the Federal Trade Commission Act (FTC Act), as well as fair lending and fair housing laws. Many of these statutes, coupled with their implementing regulations, provide substantive protection to borrowers who seek mortgage financing. These laws impose disclosure requirements on brokers, define high-cost loans, and contain anti-discrimination provisions.

Additionally, mortgage brokers are under the oversight of the Department of Housing and Urban Development (HUD) and the Federal Trade Commission (FTC); and to the extent their promulgated laws apply to mortgage brokers, the Federal Reserve Board, the Internal Revenue Service, and the Department of Labor. These agencies ensure that mortgage brokers comply with the aforementioned federal laws, as well as small business and work-place regulations such as wage, hour and overtime requirements, the do-not-call registry, and can-spam regulations, along with the disclosure and reporting requirements associated with advertising, marketing and compensation for services.

Mortgage Broker Regulation in the States

The regulation of mortgage brokers begins at the federal level, but it certainly does not end there. Mortgage brokers are licensed or registered and must comply with pre-licensure and continuing education requirements and criminal background checks in forty-nine states and the District of Columbia. Additionally, over half of these states require not only mortgage broker licensure, but the licensure or registration of brokers' individual loan officers as well. An increasing number of states are requiring these originators to pass tests in order to become licensed. The same is not true for the thousands of loan officers employed by mortgage bankers and other lenders, who are exempt in most states from loan officer licensing statutes. While the Office of the Comptroller of the Currency exempts depository

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institutions from state licensing requirements, the states continue to increase their regulation of mortgage brokers and their individual loan officers. Many states also exempt lenders from licensing if they are approved by Fannie Mae or HUD, which subjects those lenders and their employees to significantly less regulation than most mortgage brokers.

As small businessmen and women, mortgage brokers must also comply with numerous predatory lending and consumer protection laws, regulations and ordinances (i.e., UDAP laws). Again, this is not true for a great number of depository banks, mortgage bankers, mortgage lenders and their employed loan officers, which remain exempt due to federal agency preemption. Many states also subject mortgage brokers to oversight, audit and/or investigation by mortgage regulators, the state's attorney general, or another state agency, and in some instances all three.

Conclusion

The mortgage industry is heavily regulated at both the state and federal levels; yet no amount of law or regulation will ever completely eliminate abusive practices from this or any industry. Placing additional restrictions on legitimate and law-abiding originators will not successfully address the problem of the truly unscrupulous lenders who brazenly ignore the laws as they currently exist. It is only through the enforcement of existing laws and the application of uniform legal standards to all originators that a lending environment will be created where consumers are free to shop and compare mortgage products and pricing among different distribution channels without fear or confusion.

Appendix C

US Department of Housing and Urban Development

Uniform Good Faith Estimate Statement

Name and Address of Borrower	Originating Company Name and Address: Loan #: ______
Property Address	**Proposed Interest Rate:** ____ % **Term of the loan:** ____ **Years**
	Proposed Loan Amount: $ ______
	Program Type: ☐ Conventional; ☐ FHA; ☐ VA; ☐ Other: ______
	☐ Fixed Rate Mortgage Loan or ☐ Adjustable Rate Mortgage Loan
	Prepayment Penalty: ☐ May; ☐ May Not Balloon Payment: ☐ Yes; ☐ No

Settlement Charges:

800: Items Payable in Connection With The Loan:	
801: Loan Origination Fee (%) to:	
802: Loan Discount Fee (%) to:	
803: Appraisal Fee to:	
804: Credit Report Fee to:	
805: Lender's Inspection Fee to:	
806: Application Fee to:	
807: Flood Certification Fee to:	
808: Mortgage Broker Fee (%)	
809: Tax Service Fee to:	
810: Processing Fee to:	
811: Underwriting/Admin Fee to:	
812: Wire Transfer Fee to:	
813:	
900: Items Required By Lender To Be Paid In Advance	
901: Interest for ____ days at $______ /day	
902: Mortgage Insurance Premium for ____ mos. to ______	
903: Hazard Insurance Premium for ____ mos. to ______	
904: Flood Insurance Premium for ____ mos. to ______	
905: VA Funding Fee / Mortgage Insurance Premium	
1000: Reserves Deposited with Lender: Waived ☐ Yes ☐ No	
1001: Hazard Insurance: ____ months @ $______ per mo.	
1002: Mortgage Insurance: ____ months @ $______ per mo.	
1003: City Property Taxes: ____ months @ $______ per mo.	
1004: County Property Taxes: ____ months @ $______ per mo.	
1005: Annual Assessments: ____ months @ $______ per mo.	
1006: Flood Insurance: ____ months @ $______ per mo.	
1007: months @ $______ per mo.	
1008:	
1100: Title Charges	
1101: Settlement or Closing/Escrow Fee to:	
1102: Abstract or Title Search to:	
1103: Title Examination to:	
1104: Title Insurance Binder to:	
1105: Documentation Preparation to:	
1106: Notary Fees to:	
1107: Attorney's Fee to: (Includes above item numbers:)	
1108: Title Insurance Fee to: (Includes above item numbers:)	
1109: Lender's Coverage $	
1110: Owner's Coverage $	
1111: Includes Commitment Fee to:	
1112: Endorsement Fee to:	
1113: Wire Fee to:	
1114: Electronic Doc Fee to:	
1115: Courier Fee to:	
1116:	
1117:	
1118:	
1200: Government Recording and Transfer Charges	
1201: Recording Fees: ☐ Deed $ ☐ Mortgage $ ☐ Release(s)/Reconveyance(s) $	
1202: City/County Tax/Stamps: ☐ Deed $ ☐ Mortgage $	
1203: State Tax/Stamps ☐ Deed $ ☐ Mortgage $	
1204: Assignment Fee to:	
1205: Subordination Fee to:	
1300: Additional Settlement Charges	
1301: Survey to:	
1302: Pest Inspection Fee to:	
1303: General Inspection(s) to:	
1304: Home Warranty Fee to:	
1305: Elevation Certificate Fee to:	
A: Settlement Cost (Sections 800, 1100, 1200, 1300 above) **B: Prepaid Items (Sections 900 and 1000 above)**	
1400: Total Estimated Settlement/Closing Costs	

Summary of the Borrower's Transaction:

Contract Purchase Price	
Existing Loan Amount to be Paid Off	
Personal Property	
Total Settlement/Closing Cost Charges to Borrower(s): **1400 A**	
Total Pre-Paids/Reserves Charged to Borrower(s): **1400 B**	
Gross Amount Due From Borrower(s):	
<Deposit of Earnest Money>	( )
<Principal Amount of new loan(s)>	( )
<Seller Paid Closing Cost Credit(s)>	( )
<Subordinate Loan Proceeds>	( )
<Other Credit(s)>	( )
Amounts Paid By or In Behalf of Borrower(s):	( )
Cash at Settlement Due From/To Borrower(s):	
Proposed Payment(s):	
1st Mortgage: ☐ Principal & Interest pmt ☐ Interest Only pmt	
2nd Mortgage: ☐ Principal & Interest pmt ☐ Interest Only pmt	
Property Taxes	
Home Owners Insurance	
Private Mortgage Insurance	
Homeowners Association Dues	
Other	
Other	
Total Proposed Monthly Payment:	

Nature of Relationship: In connection with this residential mortgage loan, you the Borrower(s), has/have requested assistance from ______________________ (Company name) in arranging credit. We do not distribute all products in the marketplace and cannot guarantee the lowest rate.

Termination: This agreement will continue until one of the following events occur:

1. The Loan closes
2. The Request is denied.
3. The Borrower withdraws the request.
4. The Borrower decides to use another source for origination.
5. The Borrower is provided a revised Uniform Good Faith Estimate Statement.

Notice To Borrower(s): Signing this document does not obligate you to obtain a mortgage loan through this mortgage originator; nor is this a loan commitment or an approval; nor is your interest rate locked at this time unless otherwise disclosed on a separate Rate Lock Disclosure Form. Do not sign this document until you have read and understood the information in it. Fees received under this estimate are legal and permissible under the Real Estate Settlement and Procedures Act. You will receive a re-disclosure of any increase in interest rate or if the total sum of disclosed settlement/closing costs in **Section 1400A** increase by 10% or more of the original estimate. Should any such increase occur; mandatory re-disclosure must occur prior to the settlement or close of escrow.

Applicant(s) hereby acknowledge(s) the receipt of a copy of this Good Faith Estimate and that you/they inquired into estate mortgage financing with ______________________ (Company) on ______________ (date).

Borrower: ______________________ Co-Borrower: ______________________

______________________ ______________________

Originator Date License # (if applicable) GFE ver.1.2

Appendix D

National Association of Mortgage Brokers

Model State Statute Initiative

Licensing, Pre-licensure Education and Continuing Education Requirements for All Originators

NAMB proposes a state statute initiative to protect consumers and ensure originator competency.

June 2002
Amended January 2005

The National Association of Mortgage Brokers (NAMB) is the national trade association representing the mortgage broker industry. With 49 state affiliates and more than 27,000 members, NAMB promotes the industry through programs and services such as education, professional certification and government affairs representation. NAMB members subscribe to a code of ethics and best lending practices that foster integrity, professionalism and confidentiality.

National Association of Mortgage Brokers, 7900 Westpark Drive, Suite T309
McLean, VA 22102 (703) 342-5900 www.namb.org

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Acknowledgements[*]

This Model State Statute Initiative is the result of a consensus process involving the Model State Statute Task Force, the NAMB Board of Directors and the NAMB Delegate Council and many internal committees.

NAMB wishes to thank President Joseph L. Falk, CMC, CRMS, for his leadership and commitment in proposing and promoting this major consumer protection initiative.

The Model State Statute Task Force provided inspirational leadership in developing the concepts and articles to be included in this Initiative. Thank you Mitch Medigovich, CMC, Leo Davenport, CRMS and Kate Crawford for your many hours of service and your clear thinking and thoughtfulness throughout the deliberative process.

Thank you to the Communications Committee, chaired by Al Wood, CRMS, NAMB's public relations firm of Merton G. Silbar Public Relations, Natalie Bachiri, NAMB's Director of Communications, NAMB's management firm, Association Management Group, as well as NAMB's legal counsel Robert Lotstein and staff of the firm of Lotstein Buckman.

The Legislative Committee, chaired by J.J. Sims and the Education Committee, chaired by Carol Gardner, CMC, CRMS, contributed mightily to the end product using their committee structure, committee members and other individuals to add to this national initiative.

We would also like to acknowledge and thank the NAMB Board of Directors and Delegate Council who have endorsed this proposal for protecting mortgage consumers.

[*] As of June 2002

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National Association of Mortgage Brokers

June 2002

Dear Mortgage Professional:

Buying or financing a home is one of the largest, most complicated and vitally important decisions facing consumers in the United States. Therefore, residential mortgage loan originators who work directly with the public should be educated, honest and professional.

The National Association of Mortgage Brokers is proud to announce a comprehensive initiative to better serve and protect the public through increased licensure, training and education of all residential mortgage originators. The NAMB Model State Statute Initiative is based on NAMB's firm belief that part of the solution to consumer abuse and predatory lending is mandatory licensing and education of all residential loan originators.

NAMB is taking a proactive stance on consumer protection. This model statute serves as a model for state regulators and legislators whose states do not have such statutes or whose states need to improve their statutes to protect and serve the general public.

The concept has four basic tenets:

a) It should apply to all residential mortgage loan originators
b) There should be a state licensing requirement
c) There should be a pre-licensure education requirement
d) There should be a continuing education requirement to maintain competency

Our 44 state affiliates, which comprise NAMB, support this initiative and recommend that specific concepts for licensure and education be considered based on each state's current statute(s). NAMB recognizes that some states have aggressively monitored the industry through licensure and others have made education mandatory; whereas other states have determined different levels of oversight to regulate the mortgage industry.

While each state is different, NAMB believes that this initiative will serve to help reduce the incidence of predatory lending and improve the overall competency of the industry in every state. NAMB urges each state to adopt these concepts in the best interest of the public. NAMB is committed to see this matter through to fruition and will monitor the progress of this initiative in each state.

Our state affiliates will now lead the charge to protect consumers through enbanced licensing, pre-licensure and continuing education proposals to their respective state legislatures and mortgage regulators.

Thank you for your support of this proposal for State Licensure, Pre-licensure Education and Continuing Education for all originators.

Sincerely,

Joseph L. Falk, CMC, CRMS
President

Appendix D

NAMB
National Association of Mortgage Brokers

NAMB Model State Statute Initiative

Goal: To better serve and protect the public, the residential mortgage loan industry will endeavor to license, train and educate all residential mortgage originators. NAMB firmly believes that part of the solution to consumer abuse and predatory lending is mandatory licensing and education of all residential loan originators.

Concept: Buying or financing a home is one of the largest, most complicated and vitally important decisions facing consumers in the United States. Residential mortgage loan originators who work directly with the public should be educated, honest, and professional.

Overview: NAMB is taking a proactive stance on consumer protection. NAMB seeks to have individual state statutes enacted that require pre-licensure education and mandate continuing education requirements for all residential loan originators. This model statute would serve as a model for state regulators and legislators whose states do not have such statutes or whose states need to improve their statutes to protect and serve the general public.

The concept has several basic tenets:

a) **It should apply to all residential mortgage loan originators**
b) **There should be a state licensing requirement**
c) **There should be a pre-licensure education requirement**
d) **There should be a continuing educations requirement to maintain competency**

NAMB believes that such an initiative will serve to help reduce the incidence of predatory lending and improve the overall competency of the industry. NAMB urges each state to adopt these concepts in the best interest of the public. NAMB is committed to see this matter through fruition and will monitor the progress of this initiative in each state.

All residential mortgage loan originators should have formal training and should be tested on their knowledge of matters including financial analysis, ethics, federal and state disclosures, real estate law, and mathematical computations germane to real estate and mortgage lending prior to contact with the public. Residential Mortgage Loan Originators should be well qualified before they work with homeowners on mortgaging or financing their most valuable asset.

For this reason, NAMB recommends and supports a standardization of education and experience for every person who holds themselves out to the public to be a Residential Mortgage Loan Originator.

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Licensing Overview

We believe that each state should enact a licensing requirement for all residential mortgage loan originators. The requirements for licensure should encompass all residential mortgage loan originators and all owners or responsible individuals of residential mortgage loan entities.*

Residential Mortgage Loan Officer Shall be defined as any individual who, for compensation or gain, takes or receives a mortgage application, assembles information, and prepares paperwork, and documentation necessary for obtaining a residential mortgage loan, or arranges for a conditional mortgage loan commitment between a borrower and a lender, or arranges for a residential loan commitment from a lender. Residential Mortgage Loan Officers also include an employee who solicits financial and mortgage information from the public for sale to another residential mortgage broker.

Principal Mortgage Owners/ Responsible Individual Defined as the owner, or managing general partner, or responsible individual, or any Officer, or stock holder, who holds themselves out to be the party accountable for residential mortgage loan originations or branch mortgage operations, with in the state, and/or the person in direct management of residential mortgage loan origination.

Exempt Any individuals who do not deal (i.e. negotiate interest rates, loan programs, offer loan locks, loan commitments) directly with borrowers. This includes persons who complete incidental services in arranging or procuring a mortgage loan, including administrative staff wherein their primary function is the verification of data provided by the borrower, assembly of documents and coordination of third party services such as ordering an appraisal, title report or credit reports.

Anyone who deals directly with a consumer and reviews, analyzes, evaluates a proposed borrowers financial statements, income, property characteristics and credit history should obtain a license.

Licensing Requirements

To obtain a state license to become a residential mortgage loan originator, the following concepts should be adopted:

1. A written application for licensure must be required. The application should require an attestation by the applicant as to the applicant's experience and knowledge of the mortgage industry.

2. The applicant should submit to a background investigation of, at a minimum, criminal records, and employment history.

   - No individual should be licensed who has had a license, or the equivalent, to practice any profession or occupation revoked, suspended or otherwise who has acted beyond legal limits.

   - No person should be licensed who has been convicted of acts against society that could be deemed 'moral turpitude'. Such acts where licenses should be denied must include duties owed by licensees to the public including acts contrary to justice and the doctrine of "fair dealing", honesty, principle or good business morals. This includes, but is not limited to theft, extortion, use of the mail to obtain property under false pretenses, tax evasion and the sale of, or the intent to sell controlled substances.

   - The licensee should provide evidence that they have managed their business and personal financial affairs with care and diligence.

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3. A first time Residential Mortgage Loan Officer Licensee Applicant shall provide a certificate of satisfactory completion of a course of study, as defined by the state, consisting of the subjects listed below.

4. A Principal Mortgage Lending Entity/Owner/Responsible party Licensee Applicant shall provide a certificate of satisfactory completion of a course of study, as defined by the state, consisting of course work from the subjects listed below.[1]

5. A Licensee Applicant shall pass an examination of the applicant's knowledge after items 1-4above have been completed.

6. Licenses shall be valid for a two-year period. Upon expiration of the two-year period, the licensee should submit an application for renewal to the appropriate licensing authority. The renewal application should, at a minimum, include evidence of completion of continuing education courses, as described below.

7. The licensing authority should have the authority to request additional information from the Licensee Applicant to support statements made on the application or dispute matters discovered through investigation.

8. All initial applicants shall submit a finger print card, which shall be forwarded to the local Department of Public Safety and/or FBI for a records check.

9. The Licensee Applicant shall pay sufficient fees to pay for Licensing Authorities' costs of processing the license application and investigations.

10. Upon receipt of a Residential Mortgage Loan Officers license, the licensee shall immediately deliver the license to his/her employing broker. Upon termination of employment of a Residential Mortgage Loan Officer, the license shall be transferred to a new employing broker and the regulating authority should be notified. If the Residential Mortgage Loan Officer does not have a new employing broker, the license shall be returned to the Licensing Authority with an explanation or the reasons for termination.

11. The appropriate state regulatory authorities should maintain state licensing or registration records.

Grandfathered Persons

Every Residential Mortgage Loan Officer, currently registered, licensed or otherwise employed in the mortgage industry immediately preceding enactment of this initiative shall be permitted to continue employment as a Residential Mortgage Loan Officer. Each current originator shall be required to meet all of the necessary elements of licensure at the next renewal period specified by state law.

Unless provided for in state law, every Principal Residential Mortgage Lending Entity or Owner, currently licensed immediately preceding enactment of this initiative shall be permitted to maintain their license and position. Each current Principal Residential Mortgage Lending Entity/Owner shall be required to meet all of the necessary elements of licensure at the next renewal period specified in the state law.

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[1] Based upon the experience of many mortgage brokers, the educational requirement should be greater than that required of Residential Loan Officers.

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Pre-Licensing Education

All persons making an initial application for licensing must:

a) Attend educational courses, determined by the state, when applying for a Residential Loan Officer license;
b) Attend educational courses, determined by the state, when applying for a Principal Mortgage Owner license;
c) Pass a test of core competencies;
d) Receive a certificate of completion from the school or organization that provided courses.

Each State or Licensing Authority should, with the assistance of the local mortgage professionals, establish review and approve curriculum sufficient to establish a baseline of knowledge for licensees.

Recommended Course Curriculum Pre-licensure course curriculum may include:

a. Federal Lending Laws;
b. Ethics, Diversity and Sensitivity;
c. Practices of Residential Lending.
d. Real Estate and Mortgage Mathematics;
e. Escrow Procedures, Title Insurance and Loan Settlement;
f. Appraisals and Land Survey;
g. Loan Processing and Loan Underwriting Process;
h. Secondary Mortgage Market;
i. Loan Default and Foreclosure Law;
j. State Statutes and Rules.

Continuing Education Requirements

Every residential mortgage originator, whether a Residential Loan Officer or Principal Mortgage Owner, shall, upon renewal of an existing license, submit proof of satisfactory completion of a course of study.

Subjects may include:

a) Federal and State Lending Law;
b) Local Rules and Regulations;
c) Ethics and Professional Standards;
d) General Real Estate or General Financial Studies;
e) Product Update;
f) Personal Development;
g) Diversity Training.

Continuing education courses may be offered through classroom instruction, electronic transmission, or distance learning. Qualifying hours may be obtained by attendance at a locally chartered real estate or mortgage business school, accredited college, university or community college, or vocational school or other institution approved by the state licensing agency.

The licensee should receive a completion certificate that such hours have been successfully completed. Licensees shall submit the appropriate completion certificate(s) with the license renewal form.

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Conclusion

It is the intent of this initiative to engage measures to reduce the incidence of predatory lending and to raise the standards for those persons who interact with the public in the area of home financing. Every Residential Loan Originator should be licensed, responsible and accountable for his or her actions when working with the public. We at NAMB believe that establishing minimum educational requirements as well as requiring continuing education will substantially increase each Residential Loan Originator's awareness of their responsibility and duty to give consumers fair and honest service. It may be desirable for each state to consider establishing a mortgage oversight board to assist the commissioner with up-to-date material for pre-licensing and continuing educational courses.

*This initiative contemplates using the words 'license' and 'registration' interchangeably. We leave to the States to determine if this process includes an individual license, permit or an aggregated corporate registration methodology, so long as both aspects of educational requirements are maintained and criminal background investigations and prohibitions are maintained. If a corporate registration of all originators is contemplated, it should require 'employee' status and a bonding requirement should be considered. It is understood that if such a corporate methodology is utilized, paragraph 10 under Licensing Requirements is not applicable.

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Recommended Course Curriculum

Pre-licensure course curriculum may include:

I. Federal Lending Laws. Licensees should develop competencies in matters of federal mortgage statutes, which may include:

a) Regulation Z, Truth in Lending Act;
b) Real Estate Settlement Procedures Act (RESPA);
c) Regulation B, the Equal Credit Opportunity Act;
d) Regulation C, the Home Mortgage Disclosure Act;
e) National Flood Insurance Act;
f) Fair Credit Reporting Act;
g) Federal Trade Commission rules concerning advertising for credit;
h) Servicing Transfer Act;
i) Privacy Act;
j) Consumer Protection Act;
k) Community Reinvestment Act.

II. Ethics, Diversity and Sensitivity. Licensees should be able to discuss the canons of:

a) Fair Housing Act;
b) Emerging Markets;
c) Redlining and Block-busting;
d) Ethical practices of mortgage lending.

III. Practices of Residential Lending. Licensees shall develop competencies in the subjects of:

a) Evolution of Residential Lending in the United States
b) The role of Government Sponsored Enterprises (GSE's)
c) Federal National Mortgage Association
d) Government National Mortgage Association
e) Federal Home Loan Mortgage Corporation
f) Federal Housing Administration
g) Veteran's Administration
h) Farmers Home Administration
i) Private Mortgage Insurance Industry Principles of Mortgage Lending, including but not limited to:
j) Assisting consumers in selection of loan programs including adjustable rate loans;
k) Evaluating the relationship between discount points and interest rates;
l) Describing the costs of originating a mortgage loan;
m) Preparing and discussing the required state and federal disclosures with a consumer;
n) Interpreting and discussing loan contingencies and covenants with the consumer;
o) Explaining the loan commitment issued by a lender;
p) Reading and understanding a real estate contract as it relates to financing of real property;
q) Identifying methods of holding title to real estate and discuss options with the consumer;
r) Describing the advantages of primary and subordinated financing options;
s) Explaining and preparing a Good Faith Estimate of costs for a consumer.

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IV. Real Estate and Mortgage Mathematics. Licensees should develop competencies in basic mathematics.

The licensee should have the basic skills to:

a) Calculate gross and net loan amounts to satisfy a consumers loan request;
b) manually prepare a Good Faith Estimate of costs and Truth in Lending statement;
c) calculate and analyze ratios of mortgage payment-to-income;
d) calculate the ratio of total obligations-to-income to determine loan acceptability;
e) analyze income tax returns for self-employed borrowers to confirm sufficient income;
f) calculate loan to value ratios;
g) calculate origination fees, yield spread premiums and discount points;
h) calculate prorations for real estate taxes and insurance amounts for the reserve account;
i) calculate rate changes on adjustable rate mortgages;
j) convert hourly and weekly salaries to monthly income to compute ratios;
k) determine that the consumer has sufficient funds for closing;
l) calculate monthly principal and interest payments and the amortization of a loan;
m) calculate per diem interest amounts;
n) manually calculate the Annual Percentage Rate
o) describe the theory of Time Value of Money and the impact on the financing contract.

V. Escrow Procedures, Title Insurance and Loan Settlement. Licensees should develop competencies in matters of closing forms and the closing process. The licensee should be able to explain the documents and process so that the borrower fully understands what is taking place.

The documents to be explained include, but are not limited to:

a) the mortgage note and its provisions for default, the lenders rights and the borrowers rights;
b) the security agreement, (mortgage or deed of trust), including each of the covenants and conditions;
c) the HUD-1 closing statement and its relationship to the Good Faith Estimate of Costs;
d) the Good Faith Estimate of costs and final Truth in Lending statement;
e) the consumers right of rescission.
f) the purpose and cost of lenders title insurance;
g) the purpose and cost of owners title insurance;
h) title examination;
i) title abstract;
j) lien theory;
k) Schedule "B" exceptions to title insurance

VI. Appraisals and Land Survey. The licensee should be able to describe:

The three methods of valuation, including:
- cost approach;
- market approach;
- income Approach;

a) the theory of economic obsolescence;
b) the theory of functional obsolescence;
c) the theory of depreciation;
d) the theory of depletion;

e) the Rectangular Survey System;
f) the method of legal identification of real property in their state;
g) calculate the number of acres in a given area;
h) calculate the number of square feet in a given area.

The licensee should be able to understand and communicate with the borrower the purpose and process of the appraisal, the survey, title insurance, restrictive covenants, deed restrictions, and encroachments and pest inspections.

VII. Loan Processing and Loan Underwriting Process. Licensees should study the subjects of loan processing and underwriting. After study in this section, the licensee should be able to:

a) prepare, explain, and execute a business agreement with the consumer;
b) demonstrate the ability to understand and explain an FNMA 1003 mortgage application;
c) explain requirements for determining if the property, income and credit of borrower fit the loan offerings available through the licensee.

The licensee should have the knowledge to collect the necessary exhibits anticipated for:
a) underwriting contingencies;
b) understanding the procedures and requirements for issuing adverse action notices;
c) assembling for submission an entire loan package for underwriting.
d) evaluation of an appraisers conclusions.

The licensee should also have a basic knowledge of:
a) negotiating a rate lock;
b) investigation and confirmation of application data;
c) arranging for a property inspection;
d) evaluating and reviewing a title insurance policy;
e) owner's versus mortgagee's title insurance policies;
f) the function and operation of private mortgage insurance and knowing when it is required;
g) when private mortgage insurance can be canceled;
h) the meaning of the terms novation, assumption, and "subject to the mortgage";
i) release of liability.

The licensee should be able to demonstrate an understanding of the basics concepts of:
a) fixed versus variable rate mortgage loans;
b) negative and positive amortization principles;
c) graduated payment mortgages;
d) reverse mortgages;
e) shared appreciation mortgages;
f) bi-weekly mortgages;
g) temporary and permanent interest rate "buy-downs";
h) the concept of a wraparound mortgage.

VIII. Secondary Mortgage Market. Licensees should study the process of the secondary market. The licensee should be able to describe:

a) how interest rate markets are established;
b) interest rate risks;
c) the theory of "yield spread premiums";
d) the theory and process by which loans are sold;

e) the theory and purpose of a loan purchase commitment;
f) FNMA and FHLMC standard eligibility requirements;
g) the function and method of operation of FNMA, GNMA and FHLMC;
h) the method and marketing aspects of a GNMA mortgage-backed pass-through security;
i) the theory of "service release premiums".

The licensee should also be able to explain the basic functions of;
a) mortgage servicing;
b) collections;
c) remittance of payments;
d) escrow accounts for taxes and insurance;
e) payoffs ;
f) assumptions;
g) the transfer of servicing rights.

IX. Loan Default and Foreclosure Law. Licensees should study Foreclosure Law. Licensees should be able to describe:
a) the type of foreclosure law most frequently used in their state;
b) the legal process of a judicial foreclosure;
c) the legal process of a trustee's sale and how it differs from a judicial foreclosure;
d) the borrower's rights of reinstatement;
e) the borrower's right of redemption;
f) the legal process of a forfeiture of equitable title;
g) the effects of subordinate liens after foreclosure;
h) the effects of mechanics and materialmens' liens;
i) the process of tax lien sales.

X. State Statutes and Rules. Licensees should study of State and local law. Licensees should be able to identify:
a) minimum record keeping requirements;
b) record retention requirements;
c) minimum requirements for licensing;
d) the process for examination of a licensees records;
e) standards for accounting;
f) standards for maintaining Trust Funds;
g) minimum net worth requirements;
h) minimum bonding requirements;
i) local disclosure requirements;
j) contracts and written agreements with consumers;
k) minimum requirements for supervision of employees;

Appendix D

NAMB
National Association of Mortgage Brokers

The National Voice of the Mortgage Broker

Established in 1972, the National Association of Mortgage Brokers (NAMB) is the national trade association representing the mortgage broker industry. With 49 state affiliates, and more than 27,000 members, NAMB promotes the industry through programs and services such as education, professional certification and government affairs representation. NAMB members subscribe to a code of ethics and best lending practices that foster integrity, professionalism and confidentiality.

A mortgage broker is an independent real estate financing professional who specializes in the origination of residential and/or commercial mortgages. There are approximately 33,000 active mortgage broker operations across the nation that employ an estimated 240,000 people and originate 65% of all residential loans in the U.S.

A mortgage broker is also an independent contractor who markets and originates loans offered by several wholesale lenders. By offering superior market expertise, and direct access to many different loan programs, a mortgage broker provides the consumer the most efficient and cost-effective method of obtaining a mortgage that fits the consumer's financial goals and circumstances. Mortgage brokers originate more mortgages than any other single loan source group in this nation.

The brokerage industry plays a significant role in the mortgage lending process and American economy, increasing competition and driving down costs. The expansive mortgage broker network allows loan wholesalers of all sizes to immediately gain a national presence without incurring the great expense of national advertising and maintenance of branch offices.

The mortgage broker industry is regulated by 10 federal laws, five federal enforcement agencies and over 45 state laws or licensing boards. Additionally, brokers typically have some type of Quality Control requirements and NAMB members also adhere to a strict Code of Ethics and best lending practices.

Mr. KUCINICH. Thank you very much, Mr. Dinham.

We are now going to go to questions for the witnesses. The round of questions will be proceeding under the 5-minute rule, and I will ask the first set of questions and then recognize the Members after I complete my questioning.

To Mr. Rokakis, one of the things that you made clear in your testimony and what was made clear in testimony of a number of individuals here is that foreclosure is, in and of itself, a significant contributor to stress on a city. Do you feel that you and all the forces you can marshall are keeping up with the demand for foreclosure prevention services?

Mr. ROKAKIS. Mr. Chairman, Congressman Kucinich, members of the committee, no, we are not. I don't like to admit this. We really are losing. As I said, for every mortgage we are able to save, 20 more are filed. There is an effort underway at the State level, but we really need help at this level. We can respond quickly at a local level, but the reality is our resources are limited. We have tried to partner with local banks, local financial institutions. Some joined in our efforts, some did not.

So we are doing the best we can, but this really is a problem that goes far beyond the power of the Cuyahoga County government. Really, we needed help at the State level. We have not really gotten it. You know, there has been a raging battle in State government over some legislation that was passed and then repealed. Ultimately, I think the best help can come from the Federal level and it can come from this Congress.

Mr. KUCINICH. So you have done so much work on mortgage foreclosure prevention. What do you think the consequence will be for Cleveland, for example, and Ohio and the Nation if the supply of foreclosure prevention help does not keep up with the demand?

Mr. ROKAKIS. Well, we already know that it has been devastating to neighborhoods. As we said, some entire neighborhoods have emptied out. Cuyahoga County has lost 50,000 people in the past 5 years. I think that a significant percentage of that loss is attributable to these practices and these houses going vacant.

I think that beyond that we really need other tools. I know the industry would bristle at this, but whether you want to call it a moratorium or a forbearance period, we know that many of these ARM resets—which, by the way, are known by some in the industry as explosive ARMs—we know that many of these ARM resets are going to push people over the edge, and the industry needs to really consider whether they want these resets to go forward, given the fact that so many of these people will go into foreclosure, or, if they are not better, entering into a cooling off period or a forbearance period. I know they don't like the word moratorium.

They are better off having somebody in that home making a payment that individual can afford than watching one additional property enter the foreclosure and sheriff's list.

Mr. KUCINICH. Thank you, Mr. Rokakis.

Ms. Killingsworth, I noted your statement and I heard the comments of my colleague, Mr. Cummings, how he said that you can go for miles and not see a bank. What are your opinions about why this absence of banks, particularly in inner cities, has occurred? Why do you think that has happened?

Ms. KILLINGSWORTH. Mr. Chairman, I think, and in fact I believe that the reason my community is like I like to say debanked, because the banks wanted to find a way around CRA and they found it, as I like to call it, back door redlining by having financial institutions that they could use to avoid doing a prime loan to the individual and go to the subprime factor. They found it profitable there. That is why I believe that they left.

Mr. KUCINICH. And this debanking, as you call it, what are the practical implications for people in the neighborhoods when they don't have a bank to go to?

Ms. KILLINGSWORTH. When people don't have a bank to go to—and in my community banks are not known to be very friendly, so they turn to the payday lenders that you heard about today, and the payday lenders are going up all over the city. They are almost on every corner. I just recently heard that you can count more payday lending institutions in our community than you can count McDonald's, Wendy's, or Burger Kings put together. So the lack of banks causes people to look for other alternatives to cash their checks or to pay their utilities, so they go to the payday lender to get that exotic loan.

Mr. KUCINICH. Just one last question. It is my understanding the last time the Federal Reserve Bank of Cleveland held a public hearing to consider a proposed bank merger affecting Cleveland was 30 years ago. In your experience, what does that say about the robustness, if you can call it that, of Federal regulation, and what would you say about how regulators are doing their job, seeing the conditions that are existing right now in your neighborhood?

Ms. KILLINGSWORTH. I think the regulators need to do a better job of monitoring what banks do. They don't do that, because if they were doing that I believe that we would not see as many payday loans. We wouldn't see all these financial institutions that are up there. The regulators are allowing the banks to use something other than what they should be using as a measuring stick for how they perform in the community. They go around that by developing community development banks, and they invest their resources in those development banks, thereby allowing them to get credit for CRA.

Mr. KUCINICH. I thank the gentlelady.

Now let's go to Mr. Turner. Do you want to participate?

Mr. TURNER. Sure.

Mr. KUCINICH. Thank you, Mr. Turner.

Mr. TURNER. Thank you, Mr. Chairman. I apologize that I am popping in and out. Luckily, in the room we have your continued testimony, so I am able to hear the comments. I greatly appreciate both the dedication that each of you have to this issue, but also your ability to communicate how this relates to the average American, how it relates to their neighborhood, how this relates to what we look at even as the most basic issue of fairness.

As I have heard your discussions of neighborhoods and the impacts on individuals—Ms. Killingsworth, you were talking about a home that you had been at that ultimately had been lost to predatory lending—one of the things that I do think that gets lost is it is not just the individuals that in predatory lending have their homes at risk, but it really is the whole neighborhood. When you live next to a house that becomes abandoned, it takes down the neighborhood, it takes down your housing value, it is a blighting influence, it attracts crime and other impacts. As you have a whole neighborhood where this happens, you have then the repetition of this occurring as housing values begin to drop because of the incidence of blighting, of abandoned houses. Their resale goes down, resulting in even more capital being lost for those individuals that are in a foreclosure situation.

Then the resulting abandonment of these properties represents a title block on future redevelopment. Once a house becomes abandoned, has been through sheriff's sale, if no one has purchased it, the number of liens that are there, the tax liens that are there, the community, the city, the neighborhood, even those interested to bring the capital in to reinvest in that abandoned property have difficulty in doing the transaction because it is not readily available on the market. There are so many impediments that are in the way to clean it up. It has, in fact, left behind not only just a broken family and a broken, abandoned house; it has left behind a title problem so that future investors cannot resurrect this building and it begins to decay further.

I was wondering if each of you might speak of, in that context, those that aren't even subject to predatory lending but are the neighbors. Even those that are not subject to predatory lenders, let's say I live next to a house and I have not been a victim of predatory lending but my neighbor has, what is the impact on me?

Mr. ROKAKIS. Mr. Chairman and Congressman Turner, in my role as county treasurer I serve on something called Board of Revision. It is a three-member board comprised of an auditor, a member of the County Commission, and my office. I chair the committee. I have been asking my board members, this is a year, because of reappraisals, that tens of thousands of filings are occurring where people are arguing or contesting the value of their property. At least at this point one of three people who are applying for property tax appeals in Cuyahoga County are citing the fact they live next to or on a street with abandoned properties. I can tell you, knowing what I know and knowing of the work of Professor Immergluck and others, knowing what I know I would be hard pressed to not consider that request for reduced property value because both what I have read and both what I see, talking to realtors, I know the property is worthless because it is next to.

Can you imagine, Congressman, if you are on a street state 7, 8, 9, 10 of these homes, as we have in some communities in Cleveland?

Mr. TURNER. It would translate, also, that the impact of that, I mean, the reason why they are going to you to ask for lowered values is so that they can pay lower taxes.

Mr. ROKAKIS. Absolutely.

Mr. TURNER. And what that does to the community then of the lower revenues.

Mr. ROKAKIS. Well, it obviously lowers the revenue base, and because of the way something called 920 works, which you know in Ohio, it increases property values within that category—I am talking about residential—so when people vote for higher taxes, they would like to see those taxes eventually come down over time, but it doesn't work. In fact, in cases where property values decrease on a really substantial basis, there can be an increase in property taxes for those people who are left. It is kind of an arcane, complex topic, but it is significant and it is devastating, especially to schools that rely upon this funding.

Mr. TURNER. Others who want to comment on that topic?

Mr. IMMERGLUCK. I think the literature is pretty clear that there is a big impact. Congressman Davis talked about the $30,000. There are also effects on crime that have been associated, as you suggested. That is not just kind of anecdotal; that has been shown in the literature that vacant houses to increase neighborhood crime levels. Foreclosures related to vacant houses increase neighborhood crime levels. It is also true that in lower-income neighborhoods the effect on property values is actually greater for a foreclosure than in a middle-or upper-income neighborhood.

Mr. TURNER. Mr. Chairman, I just want to say that, throughout the country, as people are faced with this, not only those who have been victims but those we were just talking about that live next to houses that have been impacted, they want to know whether or not anybody cares with what they are living with and what they are facing. I appreciate, Mr. Chairman, you being one of those individuals that cares enough to have this hearing to bring to light the challenge.

Mr. KUCINICH. Thank you, Mr. Turner. I think that is a very important point that you just made, because, indeed, the entire community is affected.

Thank you, again. Mr. Davis of Chicago, you may proceed with your questioning.

Mr. DAVIS OF ILLINOIS. Thank you very much, Mr. Chairman.

Ms. Killingsworth, you mentioned the failure of different levels of government to do something about the problem and the issues. Could you think of something that, say, a local government or a State government or perhaps the Federal Government, where would you put the pressure point as being in terms of ability to impact the situation?

Ms. KILLINGSWORTH. Congressman Davis, I would put the impact on the State level, because that is what we try to do. We try to work on the State level with our Governor. Their response to us was we need to study it. We were saying to them, while you are studying we are dying. Our neighborhood is becoming a ghost town. One of the things that you said, maybe, well, why don't you get out. You can't get out because you can't sell the property because the devalue. The property keeps decreasing.

So I think from a State level, the States should to more to regulate the subprime lenders, and in particular the brokers. In Cleveland that I didn't get to in my written statement, Argent, part of Ameriquest, didn't have a presence in the city of Cleveland in 2002, but in 2003 they had 1,600 loans. Of those 1,600 loans, in 2004 half of them were on default, in foreclosure. So if the State of Ohio was regulating those brokers in a proper manner, I think that is one of the things that could happen.

As I mentioned, the only relief that we had was through our county treasurer and the efforts that he put.

Mr. DAVIS OF ILLINOIS. Thank you very much. Mr. Nassar, I was going to ask you if you felt that there was a great deal of potential for the industry, for example, to regulate itself and incorporate some best practices without the intervention of government.

Mr. NASSAR. Well, unfortunately, I think the track record shows the best practices have had really minimal effect in the fact that the dominant subprime loans have these enormous payment shocks. This has been known for some time.

To the question of who has responded and done a good job, I would say that States have led the way, including North Carolina, in combatting predatory lending, but when Congress passed HOPE in the mid 1990's it gave the Federal Reserve the authority to regulate the entire mortgage industry when it comes to abusive practices for all lenders. They have never used that authority. They have never used that authority. So there is no question that the Federal Reserve could do a lot more.

Mr. DAVIS OF ILLINOIS. Professor Immergluck, I have been so accustomed to calling you Dan, because we have interacted so much when you were at the Woodstock Institute and we pestered you all the time, and this is perhaps a great opportunity for me to just express some serious appreciation for all of the help that you have given to me personally over the years as we have called you for information for studies, for direction, and approaches, and you escaped us and went to Georgia.

What do you see the role of the Federal Government trying to seriously impact now the situations that we have described?

Mr. IMMERGLUCK. It is a big question. I definitely would agree with Mr. Nassar that the Federal Reserve can do a lot more. They made a few moves in 2001, only on refinanced loans and only on kind of high-cost refinanced loans, and that takes up such a small part of the market it has had very minimal effect, although it did have some effect, so it proves that the Federal Government can do something.

The action on refinances I think actually shifted a lot of subprime activity into the home purchase market, because they were totally unregulated there.

I think the Federal Reserve can do a lot more by using that other authority to work on home purchase and all types of refinance loans and home equity loans.

I also think that, although some States have done a good job, the Federal Government at least has to get out of the way and quit preempting States when they do take action. To me that has been just a travesty of Federal policy for Federal regulators to allow banks to export regulations from easy States into States that want to do something to protect their consumers.

Finally, I think, yes, Congress can do something to bring back the discipline in the industry. I think securitization has just really taken the industry out of regulatory control.

One other thing. We have a dual regulatory market. Most subprime lenders are not essentially regulated by the Federal Government and we don't have the capacity at the State level to regulate them.

Mr. DAVIS OF ILLINOIS. Thank you also very much. And thank you, Mr. Chairman.

Mr. KUCINICH. You know, Mr. Davis, what is interesting, from what Professor Immergluck said, is the lack of regulation of subprimes. When we see that hedge funds are included as one of the principal capital formations now and we know that they are not regulated, so this is an area that we are starting to move into that raises questions about the Government's responsibility for the regulation of capital and for massive movement of that. So I appreciate Professor bringing that up, and thank you, Mr. Davis.

We will ask Congresswoman Watson to participate. Thank you very much for being here. You may proceed with your round of questioning.

Ms. WATSON. I appreciate that. Almost a decade ago the subprime market lending business exploded in America, increasing the availability of credit to portions of the population that do not qualify for loans based on their credit and income and saving profiles. I look at a chart that was compiled by the Center for Responsible Lending and it appears that my District in Los Angeles—and I guess it covers Long Beach and Glendale in California—Riverside, San Bernadino County, has the highest rate of foreclosures. Now, that is very disturbing. These areas that I just pointed out, certain areas in my District, the 33rd District, certain areas of Long Beach, certain areas of Riverside and San Bernadino County, are now minority neighborhoods. Most of the minorities in those neighborhoods are African Americans.

I am very disturbed that the unfair practices, these detrimental practices, kind of center in on neighborhoods that are poor and minority with aging homes. They lend this money at high rates knowing the credit backgrounds of these people.

This goes to Mr. Nassar. Can you explain what you found when you put this chart together? Can you give us some idea of why they locate and target these communities? What did you find?

Mr. NASSAR. Sure. Yes, well, a few things. One is that we used economic forecasting from Moody's and others to talk about assumptions about what has already been going on as far as foreclosures and the mortgage market but what will happen. What we have seen is that really the explosion of these unsustainable loans with huge built-in payment shocks, which become the dominant loan in the subprime market, have had a devastating impact. It doesn't need to be that way. Subprime homeowners make great homeowners, and there is no need for loans to be made in this way.

The other thing I would just like to point out is that, when looking for solutions here, disclosures will not solve this problem. Anyone who has been through closing knows about the kind of paperwork you have to go through, and the thought and the suggestion that one little line about what could happen to your mortgage will actually stop these abusive practices is not credible. Disclosures will not work here.

The other thing is that we do know something about the type of loan and whether someone is likely to enter foreclosure. Based on loans made in 2000 and based on our research, if someone has a prepayment penalty, which most subprime homeowners have, they are 52 percent more likely to enter foreclosure. If someone is an ARM, they are 72 percent more likely to enter foreclosure. That is keeping other factors constant.

So the quality and the type of loan does, in fact, have a huge impact here, and the impact on family wealth is just difficult to overstate.

Ms. WATSON. Our committee, Mr. Chairman, if I may, is focusing on domestic policy. I think this is one of our first hearings, because this is a scourge in my District but it is only in certain parts of my District. If you know the Los Angeles area, I have Hollywood and I have places where the land value is at the top of the chart, but when you go south in my District it is just the reverse, so I am quite concerned about this.

I was very impressed with Mr. Rokakis' testimony and Ms. Killingsworth's testimony, because we are facing that problem, too.

Let me ask Mr. Immergluck what would you suggest that we do at the Federal level that might assist these neighborhoods that are collapsing, being abandoned, and really producing very little to the economy because there are very few people that stay behind once they lose their homes. What would you suggest that we can do here at the Federal level?

Mr. IMMERGLUCK. The first thing I would suggest, which is to be, I understand, the subject of a later panel, is tell regulators to enforce the Community Reinvestment Act again. I think since the late 1990's but especially in the last——

Ms. WATSON. Let me just interrupt you.

Mr. IMMERGLUCK. Sure.

Ms. WATSON. Are you saying it is an enforcement issue?

Mr. IMMERGLUCK. I am not saying it is only enforcement issue. I am saying the first thing that could be done that I think was done in the late 1980's and early 1990's is enforce the Community Reinvestment Act and the fair lending laws under the Fair Housing Act.

We saw a large increase in financing for minority homeownership and small business lending and lots of other good things from about 1989 to 1996, 1997, because of a couple of things. One, the savings and loan bailout, which improved CRA and HMDA, made CRA regulations public, made HMDA—Home Mortgage Disclosure Act—include race and gender, and made CRA evaluations public. That really boosted the impact of CRA. CRA has not been effectively enforced since the late 1990's.

Ms. WATSON. That is very good to know. I think we can use that information, Mr. Chairman, to maybe fashion some language that would enforce what we already have on the books.

Mr. KUCINICH. If the gentlelady would yield?

Ms. WATSON. Yes.

Mr. KUCINICH. I would respond that this committee, the Subcommittee on Domestic Policy, is going to be the vehicle to not only gather information about what is happening with the economy of cities, but to propose specific legislative remedies to respond. That response to what Mr. Cummings raised at the onset of the hearing, response to what Mr. Davis has commented on based on his long history of involvement on these issues at a community level, going back to Gail Sincata, who I also had the chance to work with many years ago, and response to your concern that, you know, it is one thing to get this information. You know, it is another thing to recommend a path of action to do something about it.

Mr. Rokakis and Ms. Killingsworth, who are really on the front lines of dealing with this on a regular, daily basis, your coming here matters greatly, and all the others who have dedicated their careers to this. Your coming here matters greatly, because we are going to take this information and put it together with some solid legislative recommendations and present it to the Congress, so thank you.

Mr. Cummings, did you have any additional questions?

Mr. CUMMINGS. Yes, I do.

Mr. KUCINICH. Wait. Excuse me, I moved too quickly here. Did you have any final questions, Ms. Watson?

Ms. WATSON. I yield back the balance of my time, Mr. Chairman.

Mr. KUCINICH. I want to thank the gentlelady from California for bringing up that central issue of what do we do.

Mr. Cummings.

Mr. CUMMINGS. Yes, Mr. Chairman, I just have one or two questions.

I can't remember who said it, but somebody talked about how these loans are given, and they qualify them for the first few years and then it balloons, and then they are not qualified actually for the balloon. To me there is something awfully wrong about that, because it seems like a setup for failure. It is blatant. Then I hear my good friend, Mr. Dinham. I listened to what you said, but it seems as if one of the things that is so hard, Mr. Chairman, to deal with is when you have things that are controlled by money and money is the incentive for doing them, it is hard to get a hold of your hands around it and try to stop it.

In my former life as a practicing lawyer, and I saw what my clients went through to qualify for loans, then I hear stuff like this, how do you get to that? I know the opposite, then you hear on the other hand the mortgage industry saying people are not going to be able to get loans, but yet still I think it was you who said that it becomes a nightmare. I guess in the end what happens is the person would have been far better off if they had never even gotten the house.

As I have said many times, we have one life to live. This is no dress rehearsal. This is the life. Well, we just destroyed just about somebody's life for maybe 20 years if they ever get back to a point where they can even buy a house.

The reason why I say it is hard to get your hands around something when it is motivated by money is because I think coming up with the strategies to deal with it are going to be hard because you are going to have so much opposition going in another direction.

One of you also said something that I found very interesting. You said that it is beginning to spread to neighborhoods. There was a time when these issues were just in the African American community where, you know, no big deal. Now it is spreading beyond those communities, and, sadly, it is sad, but in a way it may allow folks to have more umph when more communities begin to join in, and then these other communities that you all talked about, the ones where they are the adjacent communities who are finding that their property values are being affected, and maybe, just maybe, we will have enough power with all of this going forward to do something about it.

But what I fear is that I don't want to be sitting here saying these same things 5, 10 years from now, because you know what that means? That means that a whole lot of people have lost their houses. And we don't think about the children in these situations. The children have seen their mothers and fathers excited about a dream, walk in the house, excited, and the next thing you know they see that dream plummet. I don't know what effect. I know it has a detrimental effect on them in the moment, but it also has an effect of it puts a damper on any dreaming that they might do. I don't even know how you put a value on that.

So I just think that is why I was so glad, Mr. Chairman, that you did this. I am just amazed at how this thing has a rippling effect. We see in Baltimore where, when we have the foreclosures, you know, folks come in like vultures, so the next thing you know neighborhoods are changing, and a lot of the very people who gave their blood, their sweat, their tears for 30 years or so, stayed in the city when they didn't have to, and now they find they have nowhere to go.

Anybody want to comment? I still have a minute or two on my time?

Mr. ROKAKIS. Mr. Chairman, as you know, I came to city government back in the late 1970's, and we dealt with redlining issues. I will tell you this has a far more negative impact on urban neighborhoods than redlining. I never thought I would say I miss the days of redlining. Too much credit is far worse, and it has emptied these neighborhoods out far faster. In a very strange way, redlining locked people into place. This has opened the doors and basically emptied entire neighborhoods out past the point—and I have said it before—there is a tipping point. There is a point at which urban communities like Cleveland and Baltimore and Dayton can no longer afford the cost associated with trying to bring a neighborhood back. You hate to tell the person living in that community it is beyond our means, but it is happening, and the tipping point has been reached in neighborhoods all over this country. This process, as I have said, has helped to accelerate it in a way that I never thought I would see possible.

Mr. CUMMINGS. What is the easiest thing you all think we can do? I know you all mentioned recommendations, but what is the easiest thing? We need to start with those things first. This place is a hard place to get stuff done.

Mr. NASSAR. I don't know about easy as far as the political reality, but as far as talking about what is just sound practice, that is bring back decent underwriting, where basically a person is qualified to afford the payment increase, where they don't have to refinance, at best, or foreclose once the adjustment hits. That is just straightforward.

But it is also important to point out that steering has a huge role here. You have a situation where so many people who receive subprime loans should be getting prime loans, and most of the subprime market is still a refinance market, and so that should be kept in mind. A lot of people already have equity, then they are losing that equity. That is just another point I want to raise.

Mr. CUMMINGS. Who does all the steering? The broker? I mean, is it several people down the line and all of them get a little piece of the change?

Mr. NASSAR. Yes. I mean, the broker has a financial incentive to put someone in a higher-priced loan than what they qualify for. It is just plain and simple, and they get paid at closing. Those are just the facts. I am not smirching particular brokers.

Mr. CUMMINGS. I understand.

Mr. NASSAR. But those are the financial incentives.

Mr. CUMMINGS. I see the chairman looking at me. I have a yellow light, so I will stop.

Mr. KUCINICH. That is fine. You may proceed. We will give you a few extra minutes.

Mr. CUMMINGS. No.

Mr. KUCINICH. Short clock.

Mr. CUMMINGS. No, I am fine. But I want to thank you all very much. We are going to do everything that we can, and we do appreciate you for being here.

Thank you, Mr. Chairman.

Mr. KUCINICH. Actually, when we started these hearings and came up with the idea for this hearing, Mr. Cummings and Mr. Davis and other members of the committee thought that this was so critical to proceed, based on their own experience. This is what we are talking about. So I thank Mr. Cummings for his participation.

What I would like to do is followup on a question that you asked. We are calling votes, but we are going to get in a few more questions. We are going to proceed until the end of this panel, or 10 minutes.

I am going to ask a question, and I am going to go down the line, starting with Mr. Rokakis. This picks up on a question that Mr. Cummings raised. To what do you attribute the explosion of predatory mortgage loans, just in a very short answer. If you can say it in two words, that would be great.

Mr. ROKAKIS. How about unbridled greed.

Mr. KUCINICH. That is two words. OK.

Ms. KILLINGSWORTH. He stole my comment. Greed.

Mr. KUCINICH. Mr. Rinehart.

Mr. RINEHART. I have to agree.

Mr. KUCINICH. Mr. Nassar.

Mr. NASSAR. Lenders and brokers have managed ways to avoid the repercussions and risks for bad loans and they have placed it all on the homeowners, and there is a real breakdown in the market.

Mr. KUCINICH. All right. Mr. Immergluck.

Mr. IMMERGLUCK. Yes. De-localization of risk, the spreading of risk to too many parties on the mortgage supply side.

Mr. KUCINICH. And Mr. Dinham?

Mr. DINHAM. I guess my opinion is a little different. I think it is because of the effort to try to bring homeownership to more people at this point is the reason you have seen the subprime industry become so large at this point, because there is only so many people that you can deal with.

I think, to answer your question, if we were to go back to the days of the 1970's and 1980's where we only had fixed-rate loans, you would understand the fact that every time you raise the interest rate by a quarter percent you take a certain part of the market out who cannot qualify for those loans after that point. This has been an effort overall to bring homeownership or give people the chance to do that. That is where we are on this issue.

Mr. KUCINICH. It is important that we hear your perspective.

Mr. DINHAM. Yes, sir.

Mr. KUCINICH. One of the things that I am interested in, and maybe you could give your perspective on this, in Cuyahoga County, OH, foreclosures topped 1,000 a month in 2006, and they are on a pace to top 1,200 a month in 2007. What would you say are the major causes of this epidemic?

Mr. DINHAM. That is the reason we asked for an independent Government study. We don't know the causes at this point, but I can tell you the traditional causes of foreclosure have always been job loss, economy, and health and divorce is No. 3.

Mr. KUCINICH. Let me ask you this.

Mr. DINHAM. Yes, sir.

Mr. KUCINICH. Would you agree for the committee that some of the foreclosure epidemic is the result of borrowers being allowed into loans that they cannot afford?

Mr. DINHAM. Well, at this point, without some kind of definition or some kind of evidence to that fact, it is hard for me to make that claim. I mean, I cannot make that claim that is part of the problem. That is the claim of a lot of people on this panel, but I don't know that for sure.

Mr. KUCINICH. But we are seeing a rising level of defaults, rising level of foreclosures.

Mr. DINHAM. Yes, sir, but we don't——

Mr. KUCINICH. Does that tell you anything?

Mr. DINHAM. That tells me that there is a problem out there, but it doesn't tell me what the problem is.

Mr. KUCINICH. But you are saying that you really can't say that this is the result of borrowers being allowed in loans they can't afford?

Mr. DINHAM. What I can say is that there are some borrowers that may have a problem because of that, but I can't say the majority of your problem is caused by bad products.

Mr. KUCINICH. Again, I need your perspective. Let's take Argent, for example.

Mr. DINHAM. OK.

Mr. KUCINICH. They are the top lender in Cleveland for the last 3 years. Every single loan underwritten by Argent is originated by an independent mortgage broker. Now, this is strictly broker-run business.

Mr. DINHAM. Right.

Mr. KUCINICH. Now, would you agree that Argent's independent mortgage brokers are the only people from the lender's side of the table that actually meet the borrower?

Mr. DINHAM. Yes, sir.

Mr. KUCINICH. Are the parties most likely to know if the borrower can afford the loan?

Mr. DINHAM. No, sir. I would say that Argent is the person that is most likely to know, because they do all the underwriting. The mortgage broker gets them into the house, gets them into their shop and processes the paper and sends it to Argent to be underwritten. Argent would be the one making the final decision.

Mr. KUCINICH. Well, isn't the independent mortgage broker the one who sells the loan?

Mr. DINHAM. The independent mortgage broker does get them in there and gives them options, gives them options on what they want at that point, and then the customer, the consumer makes the choice of which loan product they want to go with.

Mr. KUCINICH. What I would like to do is we now have a requirement for a recess. If the panel would be so kind as to wait for a third round of questioning, myself and other members are certainly going to return, and I would ask if we could pick up at this point because, again, I want to tell you that we are grateful for the presence of everyone here, and, Mr. Dinham, you are giving us a chance for a perspective that we often do not hear.

Mr. DINHAM. OK.

Mr. KUCINICH. So we are going to recess until 5:30, and we will come back at 5:30 with the question. I want to thank you. We will see you at 5:30.

[Recess.]

Mr. KUCINICH. The hearing will come to order.

When we recessed we were talking to Mr. Dinham, and I would like to continue.

Mr. Dinham, you said that you don't know why so many of the loans originated by independent mortgage brokers go to foreclosure. Now, does anybody on the panel know? Mr. Rokakis, do you know?

Mr. ROKAKIS. Mr. Chairman, there was a study done by a group called Policy Matters Ohio on foreclosures. They have actually done a few of them. They have been tracking foreclosures in Ohio. They went out and surveyed all 88 county sheriffs in the State of Ohio. Especially in smaller counties, nobody knows better the cause of a foreclosure than the county sheriff. Now, it may not be an issue in Montgomery, where sheriffs are far removed from the process. They have bailiffs and other people implementing the foreclosure, the eviction actions. But of the sheriffs they interviewed in Ohio, the overwhelming majority of sheriffs said that they thought the cause, or they observed that the cause of the foreclosures in the counties in Ohio were predatory loans. It was not illness, it was not job loss, it was not divorce, it was subprime and predatory lending, and it is in the Policy Matters Ohio study, which we will make available to the committee.

Mr. KUCINICH. Without objection, I would like staff to contact Mr. Rokakis' office and get the Policy Matters study and have it included in the record of this hearing, without objection.

[The information referred to follows:]

A REPORT FROM:

POLICY MATTERS OHIO

FORECLOSURE GROWTH IN OHIO 2006

ZACH SCHILLER
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Authors and Contributors

Zach Schiller, research director of Policy Matters Ohio, is the principal author of this report. Pam Rosado, outreach coordinator, oversaw the survey of county sheriffs. Policy Liaison Wendy Patton and interns Greg Claus and Quinton Cotton helped compile and analyze data from the survey.

A Note on the Sheriff Survey

This report marks the third time Policy Matters Ohio has surveyed the state's county sheriff departments to find out how many foreclosed properties they put up for auction and ask other questions. We would like to thank the 76 sheriff departments that responded to the survey. Thanks also to Gretchen Beam at the Supreme Court of Ohio for sending foreclosure filing statistics the court had collected.

POLICY MATTERS OHIO, the publisher of this study, is a nonprofit, nonpartisan research institute dedicated to bridging the gap between research and policy in Ohio. Policy Matters seeks to broaden the debate about economic policy in Ohio by providing quantitative and qualitative analysis of important issues facing working people in the state. Other areas of inquiry have included unemployment compensation, wages, taxes, education, trade and economic development.

Executive Summary

The number of Ohioans who lost their homes to foreclosure and sheriff sales continued to grow in 2005. Last year, there was one foreclosure filing for every 71 Ohio households.

Filings have quadrupled from a decade ago. Overall, according to data reported to the Ohio Supreme Court by common pleas court judges across the state, there were 63,996 new foreclosure filings in 2005, an increase of 8.45 percent from 2004. The increase, amounting to almost 5,000 more filings than the year before, follows smaller growth of 3 percent in both 2003 and 2004. Since foreclosures climbed rapidly in the 1990s, the number in 2005 represents at least a recent record.

Results from a Policy Matters Ohio survey of Ohio's county sheriff departments indicate that the number of foreclosed properties put up for sheriff sale also has continued to increase. Altogether, 71 counties representing 86.3 percent of the state's population reported 43,123 properties put up for sale. That represents a 4.6 percent increase in those counties from 2004 and a 21.3 percent increase from 2003, according to department responses. Sheriff sales grew in 56 out of the 71 counties between 2003 and 2005. The overall increases are not as great as those reported in the Policy Matters survey that covered 2001 through 2003. However, together with the increased pace of foreclosure filings, the survey reflects that stresses on homeownership in Ohio continue to grow.

The growth in foreclosure filings is widespread around the state. Filings grew last year in 60 of Ohio's 88 counties, and quadrupled in 61 counties between 1995 and 2005. Cuyahoga County ranked first in foreclosure filings per person last year. But while the problem is more concentrated in urban counties, it is common statewide. Counties with the greatest growth in 2005 were scattered across Ohio, and none of the 10 counties that saw the greatest relative foreclosure filing growth were on the list of those that grew the most in 2004.

Among 50 sheriff departments that responded to the Policy Matters survey with numerical rankings on factors contributing to foreclosures, 31 ranked predatory lending first. Another 11 cited job loss/weak economy, while divorce or family break-up ranked third.

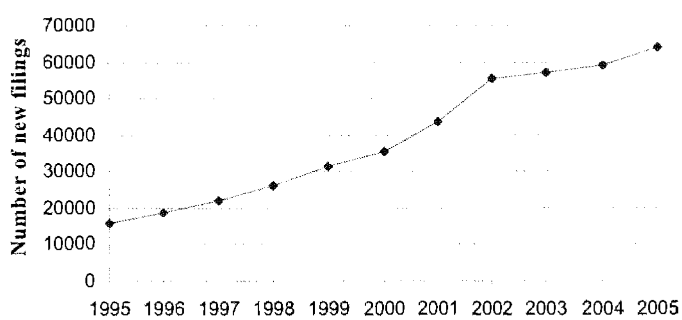
Last spring, the Ohio General Assembly passed legislation aimed at curbing predatory lending practices that have contributed to Ohio's foreclosures. The number of foreclosure filings and properties put up for sheriff sale will be among the benchmarks for assessing the law after it takes effect in January.

Foreclosure Growth in Ohio 2006

The number of Ohioans who lost their homes to foreclosure and sheriff sales continued to grow in 2005. Last year, there was one foreclosure filing for every 71 Ohio households.[1] Filings have quadrupled from a decade ago. Overall, according to data reported to the Ohio Supreme Court by common pleas court judges across the state, there were 63,996 new foreclosure filings in 2005, an increase of 8.45 percent from 2004.[2] The increase, amounting to almost 5,000 more filings than the year before, follows smaller growth of 3 percent in both 2003 and 2004. Since foreclosures climbed rapidly in the 1990s, the number in 2005 represents at least a recent record.

Losing one's home to foreclosure is one of the most financially devastating events that can befall a family. When families do lose a home, it is often neglected in the aftermath, hurting communities and raising costs for local government. Finding ways to reverse Ohio's rising proportion of homes in foreclosure, pegged in some reports as the highest in the country,[3] is essential to protect consumers and communities. Figure 1 shows how foreclosure filings have increased in the state since 1995:

Ohio Foreclosure Filings, 1995 to 2005



Source: Ohio Supreme Court

[1] This calculation is based on a U.S. Census Bureau estimate of the number of households in Ohio in 2004. See http://factfinder.census.gov.

[2] Data for 2005 was supplied to Policy Matters Ohio by the Ohio Supreme Court. Data from previous years originally obtained from the Supreme Court are republished from previous Policy Matters Ohio reports. See http://www.policymattersohio.org/Foreclosure_Growth_2005.htm. The Ohio Supreme Court's reporting of foreclosure filings includes an unspecified number of non-mortgage foreclosure cases, including delinquent tax foreclosures and others. It also includes double filings that occur if bankruptcy interrupts the process, or if a lender uses the threat of foreclosure as a collection mechanism several times against one borrower. Non-mortgage filings and double-filings have not been eliminated from the data. All foreclosure data in this report are for filings. Not all filings lead to actual foreclosures, in which borrowers lose title to their property. On the other hand, filing statistics do not cover all cases in which homeowners lose their property, such as cases in which they give the title back to the lender and walk away from the home.

[3] "Home Delinquency Rate Shows Increase," Noelle Knox and Barbara Hansen, *USA Today*, March 16, 2006, and "Ohio's Disgrace: No. 1 in Home Foreclosures," Geoff Dutton, *The Columbus Dispatch*, Sept. 18, 2005.

Results from a Policy Matters Ohio survey of Ohio's county sheriff departments indicate that the number of foreclosed properties put up for sheriff sale also has continued to increase. In all, 76 of the state's 88 sheriff departments responded to the biennial Policy Matters survey.[4] Seventy-four counties that provided figures reported a total of 43,841 properties put up for sale in 2005.[5] Sixty-six counties have provided data for each of the last three years, and another five that provided data for 2004 and 2005 also responded to the survey two years ago. Thus, it is possible to compare sheriff sales in 2003, 2004 and 2005 in 71 counties accounting for 86.3 percent of Ohio's population.[6] Altogether, those counties reported 43,123 properties put up for sale. That represents a 4.6 percent increase in those counties from 2004 and a 21.3 percent increase from 2003, according to department responses. Sheriff sales grew in 56 out of the 71 counties between 2003 and 2005. The overall increases are not as great as those reported in the Policy Matters survey that covered 2001 through 2003. However, together with the increased pace of foreclosure filings, the survey reflects that stresses on homeownership in Ohio continue to grow.

Foreclosures are rising in all parts of Ohio. Last year, the number of new filings grew in 60 of the state's 88 counties. In 2005, Cuyahoga County became the leading county in the state in foreclosure filings per person. It switched places with Montgomery County, which had been No. 1 the year before and found itself in the No. 2 position in 2005.

Table 1 (see next page) shows the top 10 counties in Ohio ranked by foreclosure filings per person. Big urban counties dominate the list; five of the state's six biggest counties are included, and Franklin County just missed the list, ranking 11th. However, high foreclosure rates are not limited to the most populous counties. They are a stubborn problem also in Brown and Highland in Southwest Ohio, as well as Marion and Clark counties. In fact, eight of the top 10 were on last year's list of the same kind. One foreclosure was filed for every 122.1 people in Cuyahoga County, as well as one for every 135.2 people in Montgomery County and one for every 146 people in Summit County:

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[4] A preliminary version of this report and an update to that were issued previously. For more details on the methodology used for this study, see Methodology, p. 6.

[5] Throughout this report, "sheriff sale" refers to a property being put up for sale. It may or may not result in the actual sale of the property. The 74 counties are listed in Table 7.

[6] The three counties that provided 2005 data but are not included among the 71 are Fayette, Gallia and Richland. See Footnote 11. Data for previous years provided by individual counties is not always consistent with their reports in earlier surveys, Policy Matters has found. Overall, sheriff departments in the 62 counties that supplied 2003 data in each of the two surveys reported putting more properties up for sale in the current survey than they had cited when surveyed about the same year two years ago. See Methodology, p. 6.

Table 1

Population/Foreclosure Filing - Top 10 Counties, 2005

County	2005 Population	2005 Filings	Population/Filing
Cuyahoga	1,335,317	10,935	122.1
Montgomery	547,435	4,050	135.2
Summit	546,604	3,744	146.0
Brown	44,398	300	148.0
Highland	42,818	286	149.7
Mahoning	254,274	1,692	150.3
Marion	65,932	433	152.3
Clark	142,376	925	153.9
Lucas	448,229	2,903	154.4
Hamilton	806,652	5,066	159.2

Source: Ohio Supreme Court, U.S. Census Bureau

None of the 10 counties that saw the greatest relative foreclosure filing growth in 2005 were on the list of those that grew the most in 2004. In fact, some of those that saw the largest relative increases in 2004 were near the bottom a year later. The changing list of counties where growth is greatest reflects the pervasiveness of the foreclosure problem, since nearly every county has seen major growth over the past decade. The counties that experienced the greatest growth last year were scattered across the state, from Erie in northern Ohio to Lawrence in the south. Of the 10, only Mahoning is a big urban county. Only Mahoning and Fayette ranked high in foreclosures per person. Table 2 shows Ohio counties with the greatest growth in foreclosure filings between 2004 and 2005:

Table 2

Ohio Counties with the Greatest Growth in Foreclosure Filings, 2004-2005

County	2004 Filings	2005 Filings	Change 2004-2005
Erie	229	370	62%
Belmont	143	209	46%
Fulton	97	141	45%
Gallia	61	84	38%
Hancock	228	309	36%
Fayette	128	167	30%
Lawrence	174	223	28%
Ashland	189	238	26%
Tuscarawas	278	346	24%
Mahoning	1,367	1,692	24%

Source: Ohio Supreme Court

The state's 10 largest counties by population accounted for 64 percent of foreclosure filings in 2005, while they contain 53 percent of Ohio's population. Overall, they had one filing per 148.3 people, compared to 179.1 statewide. All of the state's 10 biggest counties have foreclosure rates that rank among the top 18 in the state. Foreclosure filing growth in these 10 counties of 9.5 percent was only slightly higher than in Ohio as a whole last year. The same pattern was true in 2004. Mahoning County led the growth among big counties in 2005, with a 24 percent increase. Cuyahoga, Hamilton, Summit, Franklin and Lorain all showed double-digit growth since a year earlier. Table 3 shows 2005 foreclosure filings in Ohio's 10 largest counties and increases since 2001:

Table 3
Foreclosures in Ohio's Largest Counties in 2005

County	2001 Filings	2005 Filings	2001-2005 Change	Population / Foreclosure
Butler	1,370	2,032	48%	172.4
Cuyahoga	6,959	10,935	57%	122.1
Franklin	5,077	6,596	30%	165.4
Hamilton	3,080	5,066	64%	159.2
Lorain	1,111	1,656	49%	178.9
Lucas	1,807	2,903	61%	154.4
Mahoning	1,012	1,692	67%	150.3
Montgomery	3,152	4,050	28%	135.2
Stark	1,570	2,167	38%	175.6
Summit	2,525	3,744	48%	146.0
Totals	27,663	40,841	48%	148.3

Source: Ohio Supreme Court, U.S. Census Bureau

Foreclosure filings also are growing in Ohio's fastest-growing counties. Delaware and Warren counties ranked 16th and 13th, respectively, in foreclosure growth last year.

Foreclosure filings at least doubled in all but two of Ohio's counties between 1995 and 2005; in 78 counties, they at least tripled and in 61, quadrupled. Two counties – Fayette and Fulton – were among the top 10 in growth both last year and over the last 10 years. Fayette is among the 10 smallest Ohio counties, with 28,199 people. It also ranks 12th in foreclosures per person.

In its survey, Policy Matters Ohio asked sheriff departments to rank factors contributing to foreclosures in their counties. The list included: Predatory lending, job loss/weak economy, uninformed consumers, illness/medical problems, divorce or family break-up, or other, and departments were invited to add other relevant factors not mentioned. Of the 50 departments that responded with numerical rankings, 31 listed predatory lending as the leading factor.[7] Another 11 cited job loss/weak economy. Though only 4 departments cited divorce or family break-up as the leading factor, it was often cited as the No. 2 or No. 3 reason, making it the third top factor overall among those respondents. Uninformed consumers was cited as the No. 1 factor by just 3 sheriff departments and was ranked by most as the fourth- or fifth-leading factor, contradicting the idea that consumer education will provide the major solution to the foreclosure problem. Illness was cited least as a top factor among the five possible factors listed.[8]

Sheriff departments also were asked how big their backlog of properties to sell was compared to three years ago. The 51 departments that answered were split roughly in half between those who had seen no or modest change, and those who have seen backlogs grow.[9] Fourteen departments said that they had seen major increases. Clearly, the growing number of sales has added to the workload for many departments. Some have added staff to take care of the additional work, while others have absorbed it with existing personnel. In a few instances, the added time spent on sales has reduced their ability to take care of other responsibilities. "Growth in sheriff sales have definitely impacted us," wrote one. "What you used to do one afternoon a week now affects 2 employees every day!"

Since the issuance of earlier versions of this report in spring 2006, the Ohio General Assembly has passed legislation aimed at reining in predatory lending. The number of foreclosure filings and properties put up for sheriff sale will be among the benchmarks for assessing the law, which becomes effective Jan. 1, 2007.

Tables 4 and 5 following the Methodology section on the next page show recent and 1995 data on foreclosure filings for all Ohio counties based on Ohio Supreme Court data, including rankings by growth rate and persons per foreclosure. Tables 6 and 7 show data on properties put up for sale by county sheriff departments, as reported in the Policy Matters survey.

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[7] Sheriff departments in another six counties simply checked one or more of the factors listed instead of ranking them. Two of the six checked only predatory lending and job loss. Among the 4 others, 3 cited divorce or family break-up, 2 job loss and one each, predatory lending and uninformed consumers. Four departments listed other reasons as contributors to foreclosures. Among them were gambling, credit card debts and "Loans given that should not have been processed. Not enough income from borrowers." A fourth department, ranking uninformed consumers and "other" together as its top factor, said: "In looking at the judgement amounts owed by most of the borrowers, and the appraised prices of most of the properties I get, it clearly shows lenders are allowing buyers to borrow more money than what the property is worth which I'm sure comes w/ a very large downpayment." In addition, one department responded that the factors were "unknown."

[8] Foreclosures in general and predatory lending in particular received a good deal of attention in Ohio between February and June 2006, the period during which sheriff departments were responding to the survey. While conceivably this could have caused a greater number to cite that factor, predatory lending also was far and away the leading factor for foreclosures cited by sheriffs in our 2004 survey. See http://www.policymattersohio.org/Home_Insecurity_2004.htm

[9] Another half dozen of the 51 did not answer the question directly.

Methodology

This study used 2003-2005 foreclosure filing data gathered and reported by the Ohio Supreme Court from every county's clerk of courts. Sheriff sales are carried out and documented by the sheriff's department in each Ohio county. These sales are not reported at the state level. We contacted the sheriff's department in every Ohio county, by mail and by telephone, to request the number of properties put up for sale in the years 2003, 2004 and 2005. We requested the number of properties put up for sale each year and the number actually sold. We also asked departments to rank factors they saw contributing to foreclosures in their counties; their backlog of properties to sell; whether the decline or growth in sales had financially impacted the department; where families of foreclosed houses go, and other thoughts they had on foreclosures in Ohio. Seventy-four counties provided data for 2005 on the number of properties put up for sale, representing 87.9 percent of the state's population.[10] Data from the survey are included in Tables 6 and 7 of the report.

This study updates similar Policy Matters Ohio surveys conducted in 2002 and 2004. In the current survey, 66 counties provided data for 2003, 2004 and 2005. In 5 counties (Auglaize, Lake, Meigs, Mercer and Morgan) that provided 2004 and 2005 data but no or incomplete 2003 data, we have used numbers provided by those counties in the earlier Policy Matters survey to compare with those reported in the current survey.[11] Such counties, along with others that provided 2003 data in the earlier survey but not in the current one, are italicized in Table 6. In some instances, departments provided data in the 2006 survey that conflicted with what was provided in the earlier survey. In some counties the difference was substantial. In Table 6 we have identified with an asterisk those counties in which it was greater than 20 percent. Sheriffs are not required to track their sales of properties in any standard way, so some may have interpreted the survey differently than others or used different definitions in answering the two surveys.

The two surveys both obtained 2003 data from 62 of the same counties. For these counties, the current survey found 33,844 properties put up for sale, compared to 31,175 in the 2004 survey, or a 9 percent difference. We checked again with some of those counties that showed the largest differences, and used the 2006 data they provided. These changes, along with a difference in which counties responded between the two surveys, explain why some numbers from the two reports differ. However, the increase in properties put up for sale is substantial, whichever set of 2003 data is used.

The Policy Matters Ohio studies update previous research conducted in 2001 by Kent Smith of Euclid Community Concerns, reporting data on properties put up for sale from 1994 through 2000. Reports on previous Policy Matters surveys are available at http://www.policymattersohio.org/publications.htm#foreclosures

[10] Athens and Holmes counties responded to the current survey, but did not include data on properties put up for sale in 2005.

[11] Two others, Fayette and Richland, provided 2005 data in the current report but not 2004 data. Thus, the 71 counties cited in the text of the report exclude them. Gallia County also is not included in the 71 counties, though it provided 2005 data, because we lack comparative data for 2003 and 2004.

Table 4
New Foreclosure Filings by Ohio County, 1995 and 2003-2005

County	1995 Filings	2003 Filings	2004 Filings	2005 Filings	Change 2004-2005	Rank in Growth, 2004-2005	Change 1995-2005	Rank in Growth, '95-'05
Adams	25	110	130	118	-9%	82	372%	43
Allen	164	551	531	591	11%	31	260%	68
Ashland	30	176	189	238	26%	8	693%	13
Ashtabula	111	587	610	586	-4%	73	428%	29
Athens	21	118	120	128	7%	41	510%	20
Auglaize	34	153	150	174	16%	18	412%	34
Belmont	40	173	143	209	46%	2	423%	32
Brown	62	246	277	300	8%	37	384%	42
Butler	447	1,853	1,952	2,032	4%	50	355%	49
Carroll	35	137	125	122	-2%	69	249%	70
Champaign	45	221	183	208	14%	22	362%	47
Clark	144	942	894	925	3%	52	542%	18
Clermont	182	776	796	812	2%	55	346%	53
Clinton	36	217	241	216	-10%	85	500%	21
Columbiana*	258	599	599	599	0%	61	132%	84
Coshocton	19	143	166	150	-10%	84	689%	14
Crawford	31	181	235	255	9%	36	723%	11
Cuyahoga	3,345	8,686	9,751	10,935	12%	26	227%	75
Darke	45	203	176	212	20%	14	371%	45
Defiance	22	133	123	120	-2%	71	445%	27
Delaware	130	402	410	481	17%	16	270%	65
Erie	75	306	229	370	62%	1	393%	41
Fairfield	110	505	621	622	0%	60	465%	25
Fayette	16	137	128	167	30%	6	944%	2
Franklin	1,459	6,072	5,940	6,596	11%	32	352%	51
Fulton	17	135	97	141	45%	3	729%	10
Gallia	42	79	61	84	38%	4	100%	86
Geauga	81	228	219	260	19%	15	221%	77
Greene	242	549	584	528	-10%	83	118%	85
Guernsey	50	208	196	183	-7%	79	266%	67
Hamilton	1,490	4,076	4,528	5,066	12%	29	240%	72
Hancock	84	200	228	309	36%	5	268%	66
Hardin	39	152	160	158	-1%	66	305%	59
Harrison	11	53	56	63	13%	25	473%	23
Henry	7	79	100	94	-6%	78	1243%	1
Highland	31	254	279	286	3%	54	823%	4
Hocking	37	131	113	123	9%	35	232%	73
Holmes	15	78	108	105	-3%	72	600%	17
Huron	30	248	224	251	12%	27	737%	9
Jackson	63	185	148	149	1%	59	137%	83
Jefferson	57	213	259	245	-5%	76	330%	57
Knox	195	235	254	265	4%	49	36%	88
Lake	301	783	864	918	6%	44	205%	78
Lawrence	42	182	174	223	28%	7	431%	28
Licking	89	781	798	862	8%	38	869%	3
Logan	69	224	242	271	12%	28	293%	64

Table 4

New Foreclosure Filings by Ohio County, 1995 and 2003-2005

County	1995 Filings	2003 Filings	2004 Filings	2005 Filings	Change 2004-2005	Rank in Growth, 2004-2005	Change 1995-2005	Rank in Growth, '95-'05
Lorain	413	1,465	1,510	1,656	10%	33	301%	60
Lucas	1,165	2,561	2,766	2,903	5%	48	149%	81
Madison	96	158	192	176	-8%	80	83%	87
Mahoning	321	1,443	1,367	1,692	24%	10	427%	31
Marion	92	414	395	433	10%	34	371%	46
Medina	140	581	536	607	13%	23	334%	54
Meigs	13	62	86	65	-24%	88	400%	37
Mercer	21	96	86	91	6%	45	333%	55
Miami	81	423	406	427	5%	47	427%	30
Monroe	12	27	34	34	0%	62	183%	80
Montgomery	949	4,220	4,002	4,050	1%	57	327%	58
Morgan	8	39	31	36	16%	17	350%	52
Morrow	54	233	192	194	1%	58	259%	69
Muskingum	78	371	412	395	-4%	74	406%	35
Noble	5	24	29	25	-14%	86	400%	38
Ottawa	42	139	127	145	14%	21	245%	71
Paulding	24	107	97	95	-2%	68	296%	63
Perry	26	192	161	195	21%	12	650%	16
Pickaway	29	188	221	219	-1%	65	655%	15
Pike	31	103	107	101	-6%	77	226%	76
Portage	143	550	535	617	15%	19	331%	56
Preble	96	248	228	234	3%	53	144%	82
Putnam	16	84	80	80	0%	63	400%	39
Richland	128	559	592	580	-2%	67	353%	50
Ross	74	310	366	293	-20%	87	296%	62
Sandusky	42	193	218	232	6%	42	452%	26
Scioto	63	289	277	312	13%	24	395%	40
Seneca	79	221	197	226	15%	20	186%	79
Shelby	44	219	208	203	-2%	70	361%	48
Stark	380	2,119	2,129	2,167	2%	56	470%	24
Summit	745	3,352	3,358	3,744	11%	30	403%	36
Trumbull	254	1,092	1,117	1,197	7%	40	371%	44
Tuscarawas	56	252	278	346	24%	9	518%	19
Union	26	189	223	237	6%	43	812%	5
Van Wert	18	120	139	147	6%	46	717%	12
Vinton	10	35	40	40	0%	64	300%	61
Warren	112	723	778	938	21%	13	738%	8
Washington	33	209	209	190	-9%	81	476%	22
Wayne	41	272	292	356	22%	11	768%	6
Williams	17	153	139	144	4%	51	747%	7
Wood	106	283	369	352	-5%	75	232%	74
Wyandot	14	65	67	72	7%	39	414%	33
Ohio	**15,975**	**57,083**	**59,007**	**63,996**	**8%**		**301%**	

* The Ohio Supreme Court confirmed that its reports from Columbiana County show 599 filings in 2003, 2004 and 2005. Judge David Tobin of the Columbiana County Court of Common Pleas told Policy Matters Ohio he was confident the numbers were accurate.

Table 5

Foreclosure Filing Rates in Ohio Counties, 2005

County	2005 Population	2005 Filings	2005 Pop./Filing	2005 Rate Rank
Adams	28,454	118	241.1	49
Allen	106,234	591	179.8	21
Ashland	54,123	238	227.4	40
Ashtabula	103,221	586	176.1	16
Athens	62,062	128	484.9	87
Auglaize	47,242	174	271.5	62
Belmont	69,228	209	331.2	76
Brown	44,398	300	148.0	4
Butler	350,412	2,032	172.4	14
Carroll	29,388	122	240.9	48
Champaign	39,698	208	190.9	26
Clark	142,376	925	153.9	8
Clermont	190,589	812	234.7	42
Clinton	42,570	216	197.1	28
Columbiana*	110,928	599	185.2	25
Coshocton	36,945	150	246.3	52
Crawford	45,774	255	179.5	19
Cuyahoga	1,335,317	10,935	122.1	1
Darke	52,983	212	249.9	53
Defiance	39,112	120	325.9	74
Delaware	150,268	481	312.4	70
Erie	78,665	370	212.6	33
Fairfield	138,423	622	222.5	37
Fayette	28,199	167	168.9	12
Franklin	1,090,771	6,596	165.4	11
Fulton	42,955	141	304.6	69
Gallia	31,362	84	373.4	81
Geauga	95,218	260	366.2	80
Greene	151,996	528	287.9	67
Guernsey	41,123	183	224.7	38
Hamilton	806,652	5,066	159.2	10
Hancock	73,503	309	237.9	44
Hardin	32,032	158	202.7	30
Harrison	15,920	63	252.7	55
Henry	29,453	94	313.3	71
Highland	42,818	286	149.7	5
Hocking	29,009	123	235.8	43
Holmes	41,567	105	395.9	82
Huron	60,385	251	240.6	47
Jackson	33,526	149	225.0	39
Jefferson	70,599	245	288.2	68
Knox	58,398	265	220.4	35
Lake	232,466	918	253.2	56
Lawrence	63,112	223	283.0	65
Licking	154,806	862	179.6	20
Logan	46,580	271	171.9	13
Lorain	296,307	1,656	178.9	18

Table 5

Foreclosure Filing Rates in Ohio Counties, 2005

County	2005 Population	2005 Filings	2005 Pop./Filing	2005 Rate Rank
Lucas	448,229	2,903	154.4	9
Madison	41,295	176	234.6	41
Mahoning	254,274	1,692	150.3	6
Marion	65,932	433	152.3	7
Medina	167,010	607	275.1	63
Meigs	23,232	65	357.4	79
Mercer	41,202	91	452.8	86
Miami	101,619	427	238.0	45
Monroe	14,698	34	432.3	84
Montgomery	547,435	4,050	135.2	2
Morgan	14,958	36	415.5	83
Morrow	34,322	194	176.9	17
Muskingum	85,579	395	216.7	34
Noble	14,156	25	566.2	88
Ottawa	41,583	145	286.8	66
Paulding	19,537	95	205.7	31
Perry	35,246	195	180.7	22
Pickaway	52,989	219	242.0	50
Pike	28,146	101	278.7	64
Portage	155,631	617	252.2	54
Preble	42,527	234	181.7	23
Putnam	34,928	80	436.6	85
Richland	127,949	580	220.6	36
Ross	75,197	293	256.6	58
Sandusky	61,676	232	265.8	60
Scioto	76,561	312	245.4	51
Seneca	57,483	226	254.3	57
Shelby	48,736	203	240.1	46
Stark	380,608	2,167	175.6	15
Summit	546,604	3,744	146.0	3
Trumbull	219,296	1,197	183.2	24
Tuscarawas	91,944	346	265.7	59
Union	45,751	237	193.0	27
Van Wert	29,154	147	198.3	29
Vinton	13,429	40	335.7	77
Warren	196,622	938	209.6	32
Washington	62,210	190	327.4	75
Wayne	113,697	356	319.4	73
Williams	38,688	144	268.7	61
Wood	123,929	352	352.1	78
Wyandot	22,813	72	316.8	72
Ohio	**11,464,042**	**63,996**	**179.1**	

* The Ohio Supreme Court confirmed that its reports from Columbiana County show 599 filings in 2003, 2004 and 2005. Judge David Tobin of the Columbiana County Court of Common Pleas told Policy Matters Ohio he was confident the numbers were accurate.

Table 6

Sheriff Sales in Ohio Counties, 2003-2005

County	2003 Sales	2004 Sales	2005 Sales	2003-2004 Change	2004-2005 Change	2003-2005 Change	2003-2005 Rank in Growth
Adams	92	N/A	N/A	N/A	N/A	N/A	N/A
Allen	493	455	433	-7.7%	-4.8%	-12.2%	65
Ashland	135	132	165	-2.2%	25.0%	22.2%	26
Ashtabula	383	467	384	21.9%	-17.8%	0.3%	57
Athens	65	N/A	N/A	N/A	N/A	N/A	N/A
Auglaize	127	118	146	-7.1%	23.7%	15.0%	35
Belmont*	126	123	120	-2.4%	-2.4%	-4.8%	61
Brown	116	167	168	44.0%	0.6%	44.8%	10
Butler	1,344	1,682	1,771	25.1%	5.3%	31.8%	20
Carroll	100	112	100	12.0%	-10.7%	0.0%	58
Champaign	139	185	158	33.1%	-14.6%	13.7%	38
Clark	597	668	612	11.9%	-8.4%	2.5%	49
Clermont*	373	591	587	58.4%	-0.7%	57.4%	6
Clinton	126	137	168	8.7%	22.6%	33.3%	16
Columbiana*	347	418	461	20.5%	10.3%	32.9%	18
Coshocton	125	163	174	30.4%	6.7%	39.2%	14
Crawford	187	N/A	N/A	N/A	N/A	N/A	N/A
Cuyahoga	4,421	4,573	5,074	3.4%	11.0%	14.8%	36
Darke*	147	162	179	10.2%	10.5%	21.8%	28
Defiance	95	97	99	2.1%	2.1%	4.2%	45
Delaware	212	320	364	50.9%	13.8%	71.7%	3
Erie	201	214	337	6.5%	57.5%	67.7%	4
Fairfield*	386	507	556	31.3%	9.7%	44.0%	11
Fayette	103	N/A	63	N/A	N/A	-38.8%	72
Franklin	4,886	5,886	5,931	20.5%	0.8%	21.4%	30
Fulton	105	81	95	-22.9%	17.3%	-9.5%	64
Gallia	N/A	N/A	52	N/A	N/A	N/A	N/A
Geauga	177	181	185	2.3%	2.2%	4.5%	43
Greene	390	514	536	31.8%	4.3%	37.4%	15
Guernsey	120	N/A	N/A	N/A	N/A	N/A	N/A
Hamilton	3,098	3,922	3,979	26.6%	1.5%	28.4%	22
Hancock*	166	176	257	6.0%	46.0%	54.8%	8
Hardin	124	N/A	N/A	N/A	N/A	N/A	N/A
Harrison	39	41	48	5.1%	17.1%	23.1%	25
Henry	53	61	76	15.1%	24.6%	43.4%	12
Highland	208	223	245	7.2%	9.9%	17.8%	33
Hocking	103	78	98	-24.3%	25.6%	-4.9%	62
Holmes	48	N/A	N/A	N/A	N/A	N/A	N/A
Huron	196	230	200	17.3%	-13.0%	2.0%	51
Jackson	80	N/A	N/A	N/A	N/A	N/A	N/A
Jefferson*	158	228	165	44.3%	-27.6%	4.4%	44
Knox	193	195	271	1.0%	39.0%	40.4%	13
Lake	357	703	742	96.9%	5.5%	107.8%	2
Lawrence	98	N/A	N/A	N/A	N/A	N/A	N/A
Licking	780	799	862	2.4%	7.9%	10.5%	41
Logan	215	229	258	6.5%	12.7%	20.0%	32
Lorain*	1,221	1,271	1,474	4.1%	16.0%	20.7%	31

Table 6

Sheriff Sales in Ohio Counties, 2003-2005

County	2003 Sales	2004 Sales	2005 Sales	2003-2004 Change	2004-2005 Change	2003-2005 Change	2003-2005 Rank in Growth
Lucas*	2,484	2,742	2,493	10.4%	-9.1%	0.4%	56
Madison*	150	130	150	-13.3%	15.4%	0.0%	58
Mahoning	892	1,050	900	17.7%	-14.3%	0.9%	55
Marion	394	377	402	-4.3%	6.6%	2.0%	52
Medina	418	396	429	-5.3%	8.3%	2.6%	48
Meigs	98	67	76	-31.6%	13.4%	-22.4%	68
Mercer	91	85	53	-6.6%	-37.6%	-41.8%	73
Miami	328	391	400	19.2%	2.3%	22.0%	27
Monroe	14	17	38	21.4%	123.5%	171.4%	1
Montgomery	2,766	3,515	4,341	27.1%	23.5%	56.9%	7
Morgan	29	24	21	-17.2%	-12.5%	-27.6%	69
Morrow	135	120	172	-11.1%	43.3%	27.4%	24
Muskingum	264	314	339	18.9%	8.0%	28.4%	23
Noble	14	15	17	7.1%	13.3%	21.4%	29
Ottawa	135	156	113	15.6%	-27.6%	-16.3%	67
Paulding*	94	79	79	-16.0%	0.0%	-16.0%	66
Perry	149	185	165	24.2%	-10.8%	10.7%	40
Pickaway*	161	199	214	23.6%	7.5%	32.9%	17
Pike	156	107	104	-31.4%	-2.8%	-33.3%	70
Portage*	551	535	617	-2.9%	15.3%	12.0%	39
Preble	221	196	220	-11.3%	12.2%	-0.5%	60
Putnam	48	N/A	N/A	N/A	N/A	N/A	N/A
Richland	378	N/A	603	N/A	N/A	59.5%	5
Ross	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Sandusky	128	156	169	21.9%	8.3%	32.0%	19
Scioto	281	249	284	-11.4%	14.1%	1.1%	54
Seneca	160	181	243	13.1%	34.3%	51.9%	9
Shelby	173	192	180	11.0%	-6.3%	4.0%	46
Stark	1,282	2,058	1,666	60.5%	-19.0%	30.0%	21
Summit	2,469	N/A	N/A	N/A	N/A	N/A	N/A
Trumbull	704	616	806	-12.5%	30.8%	14.5%	37
Tuscarawas	255	243	265	-4.7%	9.1%	3.9%	47
Union	168	185	170	10.1%	-8.1%	1.2%	53
Van Wert	108	119	114	10.2%	-4.2%	5.6%	42
Vinton*	6	2	4	-66.7%	100.0%	-33.3%	70
Warren	506	N/A	N/A	N/A	N/A	N/A	N/A
Washington	139	N/A	N/A	N/A	N/A	N/A	N/A
Wayne	249	240	255	-3.6%	6.3%	2.4%	50
Williams	106	111	100	4.7%	-9.9%	-5.7%	63
Wood	171	N/A	N/A	N/A	N/A	N/A	N/A
Wyandot	40	52	46	30.0%	-11.5%	15.0%	34

* Reported 2003 sheriff sale number differed between 2004 survey and this survey by more than 20 percent

Figures reflect properties put up for sale. Italicized counties did not report complete 2003 data in this survey, so data from the previous Policy Matters Ohio survey were used. These include five counties (Auglaize, Lake, Meigs, Mercer and Morgan) that reported 2004 and 2005 data in the current survey, but not 2003 data. Two others, Fayette and Richland, reported 2005 data in the current survey, but not 2003 or 2004 data.

Table 7

Sheriff Sale Rates in 2005

County	2005 Population	2005 Sales	Population/ 2005 Sales	2005 Sales Rate Rank
Adams	28,454	N/A	N/A	N/A
Allen	106,234	433	245	22
Ashland	54,123	165	328	52
Ashtabula	103,221	384	269	34
Athens	62,062	N/A	N/A	N/A
Auglaize	47,242	146	324	50
Belmont	69,228	120	577	69
Brown	44,398	168	264	33
Butler	350,412	1,771	198	9
Carroll	29,388	100	294	44
Champaign	39,698	158	251	26
Clark	142,376	612	233	18
Clermont	190,589	587	325	51
Clinton	42,570	168	253	29
Columbiana	110,928	461	241	21
Coshocton	36,945	174	212	13
Crawford	45,774	N/A	N/A	N/A
Cuyahoga	1,335,317	5,074	263	32
Darke	52,983	179	296	45
Defiance	39,112	99	395	61
Delaware	150,268	364	413	62
Erie	78,665	337	233	18
Fairfield	138,423	556	249	25
Fayette	28,199	63	448	65
Franklin	1,090,771	5,931	184	7
Fulton	42,955	95	452	66
Gallia	31,362	52	603	70
Geauga	95,218	185	515	68
Greene	151,996	536	284	42
Guernsey	41,123	N/A	N/A	N/A
Hamilton	806,652	3,979	203	12
Hancock	73,503	257	286	43
Hardin	32,032	N/A	N/A	N/A
Harrison	15,920	48	332	53
Henry	29,453	76	388	59
Highland	42,818	245	175	3
Hocking	29,009	98	296	45
Holmes	41,567	N/A	N/A	N/A
Huron	60,385	200	302	47
Jackson	33,526	N/A	N/A	N/A
Jefferson	70,599	165	428	63
Knox	58,398	271	215	16
Lake	232,466	742	313	49
Lawrence	63,112	N/A	N/A	N/A
Licking	154,806	862	180	4
Logan	46,580	258	181	6
Lorain	296,307	1,474	201	11
Lucas	448,229	2,493	180	4

Table 7

Sheriff Sale Rates in 2005

County	2005 Population	2005 Sales	Population/ 2005 Sales	2005 Sales Rate Rank
Madison	41,295	150	275	40
Mahoning	254,274	900	283	41
Marion	65,932	402	164	2
Medina	167,010	429	389	60
Meigs	23,232	76	306	48
Mercer	41,202	53	777	72
Miami	101,619	400	254	30
Monroe	14,698	38	387	57
Montgomery	547,435	4,341	126	1
Morgan	14,958	21	712	71
Morrow	34,322	172	200	10
Muskingum	85,579	339	252	27
Noble	14,156	17	833	73
Ottawa	41,583	113	368	56
Paulding	19,537	79	247	23
Perry	35,246	165	214	15
Pickaway	52,989	214	248	24
Pike	28,146	104	271	37
Portage	155,631	617	252	27
Preble	42,527	220	193	8
Putnam	34,928	N/A	N/A	N/A
Richland	127,949	603	212	13
Ross	75,197	N/A	N/A	N/A
Sandusky	61,676	169	365	55
Scioto	76,561	284	270	36
Seneca	57,483	243	237	20
Shelby	48,736	180	271	37
Stark	380,608	1,666	228	17
Summit	546,604	N/A	N/A	N/A
Trumbull	219,296	806	272	39
Tuscarawas	91,944	265	347	54
Union	45,751	170	269	34
Van Wert	29,154	114	256	31
Vinton	13,429	4	3357	74
Warren	196,622	N/A	N/A	N/A
Washington	62,210	N/A	N/A	N/A
Wayne	113,697	255	446	64
Williams	38,688	100	387	57
Wood	123,929	N/A	N/A	N/A
Wyandot	22,813	46	496	67
Ohio	**11,464,042**	**43,841**	**230***	

*The Ohio sheriff sales rate was calculated using the population in the 74 counties (10,076,902) that provided data on properties put up for sale in 2005.

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COMMUNITY SHARES

Mr. KUCINICH. Well, Mr. Dinham, let's go back to the question just before the recess. Would you agree that Argent's independent mortgage brokers, who are the only people from the lender's side of the table to actually meet the borrower, the parties most likely to know if the borrower can afford the loan, the independent mortgage brokers, do they know if the borrower can or can't afford the loan?

Mr. DINHAM. Would I agree to that? The only thing I am going to agree to on that is they do not make the ultimate decision on whether the loan is approved or not.

Mr. KUCINICH. Do you know anything about that process, how it is approved?

Mr. DINHAM. I know exactly how the process works. The customer comes in, you take an application from the customer, you get all the information and documentation you have to do, and then you submit that information to the lender for approval, underwriting approval, and then they send it back normally with some additional conditions or they can't make a decision right off the bat, and then you send those additional conditions in and they give you what I always call a firm commitment that says they are willing to make that loan.

Mr. KUCINICH. So you are saying the independent mortgage brokers don't make a decision?

Mr. DINHAM. I am saying they do not make the decision on whether the loan is approved.

Mr. KUCINICH. So they are like salesmen?

Mr. DINHAM. But it goes deeper than that.

Mr. KUCINICH. Yes.

Mr. DINHAM. The people that have put these products out are the people on Wall Street. Wall Street is the one that has these products out here. Argent really is passing these products along to Wall Street, and the people at Wall Street are the people making the rules on what the rules are to get that loan approved.

Mr. KUCINICH. So these subprime loans which are very risky for those that are engaging in them, you are saying that you have to follow the system——

Mr. DINHAM. Yes.

Mr. KUCINICH [continuing]. From the borrower to the agent, independent broker——

Mr. DINHAM. Right.

Mr. KUCINICH [continuing]. To the company?

Mr. DINHAM. Right.

Mr. KUCINICH. And then you have to go back to Wall Street?

Mr. DINHAM. Yes, because Wall Street is where it all starts, and we all know that Wall Street is not used to losing money on things, so they are making money on what is going on at this point, and they still are. So even while the consumer is suffering maybe because of some of these foreclosures they are doing on this, they are still not losing their money at that point, and that is part of the reason that you are seeing these lenders, mortgage bankers, whatever you want to call them, closing their doors today, is because Wall Street is coming back to them telling them they need to repurchase these loans.

But the mortgage broker is not out there——

Mr. KUCINICH. At a higher rate of interest?

Mr. DINHAM. At a higher interest rate?

Mr. KUCINICH. They need to repurchase the loans?

Mr. DINHAM. No, they just buy them back. In other words, what happens is they put them in a pool, they go up there, and they are part of a million dollar pool.

Mr. KUCINICH. Would you say there is any fraud that is involved here in origination so you have so many bad loans? Is there incompetence or something else? What do you think it is?

Mr. DINHAM. Well, I think I have testified that I don't know what it is at this point that is causing the problems in Cuyahoga County. I don't know.

Mr. KUCINICH. In 2005 the No. 1 lender of foreclosed properties up for sheriff's auction in Cleveland was Argent. I am talking about Argent because I know what is happening in Cleveland. So in Ohio it takes about 18 months to 2 years for a foreclosure to go to sheriff's sale. Argent only entered the market in 2003. This means that a lot of Argent's loans immediately went to foreclosure. They were bad loans the day they were written, and independent mortgage brokers wrote every one of them. So how could you explain that?

Mr. DINHAM. I can't explain that particular question, but I will tell you, if you are having loans that are defaulting in the first month, 90 days, or 6 months, there is fraud involved in the deal or poor underwriting. That is the only reason.

I don't disagree with what you are saying. I cannot tell you what the exact reason is it is going on and how——

Mr. KUCINICH. Is there a permanent record of the identity of independent mortgage brokers on each loan that he or she originates?

Mr. DINHAM. Not in Texas. No, sir, I don't believe. I don't know what the rules are in Ohio.

Mr. KUCINICH. Do these independent mortgage brokers' name or address even appear on the loan?

Mr. DINHAM. Yes, sir.

Mr. KUCINICH. Now, how can a borrower and a lender or the investor, if a loan has been pulled, with thousands of other mortgages securitized and held by a large investor, how can they know whose bad judgment resulted in a bad loan?

Mr. DINHAM. That is a very hard question to answer, because the person that made the rules were the people on Wall Street, which were given to the people that purchased it from the broker. That was Argent in this case you are talking about. So Argent is the one that made the decision to make that loan.

Mr. KUCINICH. You know, staff just pointed out something that I think is worth mentioning, and that is that stock brokers, for example, have a fiduciary responsibility.

Mr. DINHAM. Yes.

Mr. KUCINICH. Trustees for estates have a fiduciary responsibility. Professional financial advisors have a fiduciary responsibility. Guardians have a fiduciary responsibility. Do you think if independent mortgage brokers had some kind of a fiduciary responsibility here this could tighten this up a little bit?

Mr. DINHAM. No, sir.

Mr. KUCINICH. Why not?

Mr. DINHAM. Because I think it is awfully hard for a mortgage broker, as an independent contractor dealing with several lenders, to have a fiduciary responsibility or a responsibility because they are under contract with lenders also at this point, so it is hard to serve two masters. In other words, in Texas we are required to tell the borrower at the time of application what our relationship is going to be to the borrower. They are told at the very beginning that we are not agents of the borrower at this point. I don't think that is going to solve your problem by making everybody a fiduciary. And if you do that, then you need to add everybody, all mortgage originators, not just brokers. You add the whole group in there.

Mr. KUCINICH. I mean, that seems like a good recommendation.

Mr. DINHAM. Because we are for all mortgage originators being licensed. We are for all of them having background checks. We are for all of them having education, continuing education, including the banks at this point. so we would really like to see that.

Mr. KUCINICH. Given that, as you put it, that borrowers or that brokers do not have a fiduciary responsibility at this point, do you think that borrowers should be able to trust brokers to bring them the best loan?

Mr. DINHAM. Well, the facts speak for themselves. Depending on who you talk to, they say that we do over 50 percent of the business on a regular basis. Do you think that the consumers would continue to come back to us if—in other words, we have to live on referrals. In other words, you don't go out and solicit new business every time, so you are living on referrals at this point. I really think that without those we wouldn't be doing as much business as we are. So the consumer believes that we are giving him a good deal.

Mr. KUCINICH. But do they have a choice, though? Do these consumers have a choice?

Mr. DINHAM. Sure they have a choice. That is one of the things we really like to see them do is to shop. That is one of the problems. They mentioned steering on here before.

Mr. KUCINICH. Yes.

Mr. DINHAM. Steering people into a particular loan? The fact of that is if they had gone out and shopped at two or three different places, they couldn't have been steered into anything.

Mr. KUCINICH. OK, but let me ask you this: do consumers have a choice, let's say, that vary in price, or does the broker present the consumer with one loan which the broker tells the consumer is the best for him? How does the broker——

Mr. DINHAM. I can't speak for every broker. I can tell you what I do. I normally give them three choices of what they would like to do. What normally will happen is you will have somebody call you up on the phone and say would you send me a good faith estimate with your cost on a particular loan product.

Mr. KUCINICH. Is a fee a percentage of a loan?

Mr. DINHAM. Sir?

Mr. KUCINICH. Is the fee——

Mr. DINHAM. Yes, sir.

Mr. KUCINICH [continuing]. Based on a percentage of the value of the loan?

Mr. DINHAM. Right. Yes, sir.

Mr. KUCINICH. So if the value of the loan is a function of appraised property, what efforts do independent brokers make to make sure that an appraiser has made a correct appraisal, rather than an inflated price to justify a loan?

Mr. DINHAM. That is another function of underwriting. Underwriters make the determination based on the comparables and the information provided on the appraisal whether the appraisal is accurate. If they don't like it, they also have the option to go out and get an independent application at that time. So the underwriter is the actual person that makes those decisions.

Mr. KUCINICH. Have you ever heard of any brokers who would choose appraisers who would inflate house values?

Mr. DINHAM. Only if they wanted to commit fraud.

Mr. KUCINICH. Does it happen?

Mr. DINHAM. Yes, it does. I am sure it does, because there have been court cases where it has happened. But I will say this, too, that any industry has some bad actors in it, and at least these are being caught. In fact, in Texas we are working on a fraud bill which will go a little further to stop these things.

Mr. KUCINICH. How long have you been doing this?

Mr. DINHAM. Since 1967.

Mr. KUCINICH. Let me ask you something. I imagine after a while you know the business so well that you can go and you can be talking to someone and kind of guess if they are going to be able to make this financial deal happen. Have you ever had a case where you told someone I can't do this, I can't loan you the money?

Mr. DINHAM. Yes, I have.

Mr. KUCINICH. What are the circumstances under which that happens?

Mr. DINHAM. Well, they don't qualify for the loan. They don't meet the guidelines at that point. In other words, you turn them down if they don't qualify.

Mr. KUCINICH. How do you suppose, then, if that is the way——

Mr. DINHAM. It is a lot easier today than it used to be. There was a time before the invention of the automated underwriting system where I could just take an application and tell you whether somebody would be approved or not at that point.

Mr. KUCINICH. Right.

Mr. DINHAM. Today, with automated underwriting, you don't dare do that because we have computers out there that are making some of the decisions, and after those decisions are made you have to get the requirements along with that and send them to the investor for the final approval.

Mr. KUCINICH. Do mortgage brokers write no-doc loans?

Mr. DINHAM. I am sure they do. Yes, sir.

Mr. KUCINICH. OK. Again, you are very helpful in describing how it works, and I think that as we work to develop some alternatives and some legislative remedies, I think it will be very important to hear from the mortgage brokers to make sure that, as you put it, everyone ought to be covered.

Mr. DINHAM. That is correct.

Mr. KUCINICH. If someone is going to try to put some guidelines into law, then it ought to be expanded so that you are not the only one that is covered.

Mr. DINHAM. That is correct.

Mr. KUCINICH. Because, as you pointed out, this goes all the way to Wall Street.

Mr. DINHAM. Yes it does.

Mr. KUCINICH. It is very important for you to be here to say that.

Mr. Turner, do you have any questions you want to ask?

Mr. TURNER. Not at this time.

Mr. KUCINICH. We are going to go to that second panel momentarily.

Mr. Davis, do you have any questions you want to ask?

Mr. DAVIS OF ILLINOIS. Mr. Chairman, I have no further questions.

Mr. KUCINICH. I want to thank all of you for participating in what has been one of the most comprehensive discussions we have had on this subject of foreclosures, subprime loans, the industry, how this all fits together. Each one of you has made a contribution to this discussion, and your very presence here and your testimony will enable this committee to make recommendations to the Congress about the direction that we can take to remedy some of the abuses that are present. I want to thank each of you for your participation.

The first panel has now been completed, and we will ask the second panel to prepare to testify.

Thank you.

At the request of Congressman Turner, we have added Mr. McCarthy to the panel. Welcome.

I would like to thank all of the members of the second panel for coming forward. This next panel concerns payday lending and alternatives to payday loans.

Before we begin, I would like to ask that we watch a video, a short video, about one woman's experience with payday lenders and how she broke the cycle with the help of an alternative created by one of our witnesses.

[Videotape presentation.]

Mr. KUCINICH. Thank you very much.

I would like to take the liberty of further introducing a member of the panel who was part of this solution, and that was Mr. Ed Jacob, who is the manager of the Northside Community Federal Credit Union, a 33-year-old community development credit union with assets of $8 million. The credit union is a certified CDFI. It has a low income service designation from the National Credit Union Administration.

Northside offers checking and savings accounts, ATM cards, small consumer loans, Visa credit cards, new and used auto loans, as well as home equity and home mortgage loans. It provides an alternative to the payday and predatory lenders who take advantage of low income people to its 4,000 members. Prior to leading the credit union, Mr. Jacob was a vice president of the Community Reinvestment Department for Bank One Corp. and its predecessor banks, First Chicago and First Chicago NBD, where he was responsible for Illinois programs.

Rita Haynes is joining us. Rita Haynes is the CEO of the Faith Community United Credit Union in Cleveland, OH, and chairwoman of the Board of National Federation of Community Development Credit Unions. Faith is a community development credit union established in 1952. Ms. Haynes also served as the chairwoman of the National Federation of Credit Unions. Faith is based on the faith and vision of the members of the Mt. Sinai Baptist Church. Ms. Haynes is a recipient of the Peak Career Lifetime Achievement Award of the African American Credit Union Coalition. Welcome.

David Rothstein is a researcher at Policy Matters Ohio. Mr. Rothstein researches tax, wage, and consumer policy, including the earned income tax credit, the living wage, and predatory lending. Policy Matters Ohio is a nonprofit policy research organization founded in January 2000, to broaden the debate about economic policy in Ohio. Policy Matters Ohio provides analyses focused on issues pertaining to low and middle-income workers in Ohio. It makes its findings accessible to the public, the media, and to policymakers.

Ms. Fran Grossman is the executive vice president of ShoreBank Corp. ShoreBank is a community development and environmental bank serving Chicago, Cleveland, and Detroit. Established in 1973, ShoreBank has been a pioneer of economic equity. ShoreBank was created to demonstrate that a regulated bank could be instrumental in revitalizing the communities being avoided by other financial institutions based on racial and economic discrimination. In 2000, ShoreBank expanded its focus to include environmental issues, believing that communities cannot achieve true prosperity without also attaining environmental well-being.

Jean Ann Fox serves as a director of consumer protection for the Consumer Federation of America and leads the organization's efforts to assure that the privacy rights of American consumers are protected, whether it is in the traditional or the electronic marketplace. She has extensive experience in representing consumer interests in privacy-related policy issues.

The Consumer Federation of America [CFA], is an advocacy, research, education, and service organization. As a matter of fact, I believe my good friend, Senator Metzenbaum, has had a long association with the Consumer Federation of America. The CFA has provided consumers a voice in decisions that affect their lives. The CFA's professional staff gathers facts, analyzes issues, and disseminates information to the public, policymakers, and the rest of the consumer movement.

I want to thank all of you for being here. Also, I am going to introduce Mr. McCarthy, who is part of this panel.

Mr. Jim McCarthy is the president and CEO of the Miami Valley Fair Housing Project, which seeks to eliminate housing discrimination. In furthering this goal, the Miami Valley Fair Housing Project engages in activities designed to encourage fair housing practices through educational efforts, assists persons who believe they may have been victims of housing discrimination, identifies barriers to fair housing in order to help counteract and eliminate discriminatory housing practices, works with elected and governmental officials to protect and improve fair housing laws, and takes all appropriate actions necessary to ensure that fair housing laws are properly and fairly enforced through the Miami Valley. Mr. McCarthy is one of the architects of the Predatory Lending Solutions Project, a project that addresses the epidemic problem of predatory mortgage lending in Montgomery County, OH.

Thank you to all members of the panel.

Mr. TURNER. Mr. Chairman, if I might, I just want to thank you. As you know, Mr. McCarthy was on your third panel, and I appreciate you putting him on the second. His topic is not payday lending, but is predatory lending. They are an organization that has been instrumental in trying to address both education on predatory lending and assist those who have been victims, so thank you for including him.

Mr. KUCINICH. And also, in deference to Mr. Turner, Mr. Turner wants very much to be here while the gentleman who he has worked with testifies, so in deference to my colleague what I am going to do is just announce the order of speakers. All of this will go into the record. I just want to facilitate Mr. Turner's schedule here. Jean Ann Fox will go first, then Mr. McCarthy, Ms. Haynes, Mr. Jacob, Mr. Rothstein, and Ms. Grossman. That will be the order.

Mr. TURNER. Thank you.

Mr. KUCINICH. OK. Thank you.

As with panel one, I am going to ask that all the witnesses rise and raise your right hands.

[Witnesses sworn.]

Mr. KUCINICH. Thank you. Let the record reflect that all of the witnesses answered in the affirmative.

As with panel one, I am going to ask that each witness give an oral summary of his or her testimony and to try to keep the summary within our 5-minute time period. I want you to bear in mind that your complete written statement will be included in the hearing record.

Let's start with Jean Ann Fox. Again, thank you. Please proceed.

STATEMENTS OF JEAN ANN FOX, CONSUMER FEDERATION OF AMERICA, WASHINGTON, DC; RITA L. HAYNES, CEO, FAITH COMMUNITY UNITED CREDIT UNION, CLEVELAND, OH; ED JACOB, NORTHSIDE COMMUNITY FEDERAL CREDIT UNION, CHICAGO, IL; DAVID ROTHSTEIN, POLICY MATTERS OHIO, CLEVELAND, OH; FRAN GROSSMAN, SHOREBANK CORP., CHICAGO, IL; JIM MCCARTHY, PRESIDENT, MIAMI FAIR HOUSING, DAYTON, OH

STATEMENT OF JEAN ANN FOX

Ms. FOX. Thank you, Chairman Kucinich and members of the committee. I represent Consumer Federation of America, but I am also testifying today on behalf of Consumers Union, publisher of Consumer Reports, and the National Consumer Law Centers on behalf of their low income clients.

I have worked on studying the high cost small loan market now for my 10-year career at CFA, and we have published numerous studies and reports about payday lending. I can assure you that this is a national predatory lending problem for consumers. Payday lending is legal in 39 of the 50 States, and it is a $5 billion cost to American consumers for about $28 billion worth of very small loans every year. This is based on a study done by the Center for Responsible Lending, which sets a more conservative figure on this industry than industry investment advisors do.

Academics tell us about 5 percent of the population uses payday loans which are made through about 25,000 storefront outlets around the country and are available online, as well.

These are small cash loans that you take out by writing a personal check on your own bank account or signing over electronic access to your bank account for the amount you want to borrow. It tends to be $300, $500, certainly less than $1,000.

The cost of the loans is expressed by the industry as dollars per hundred, so they will say they charge $15 per $100 or $20 of $25 or $30. The annual percentage rate for a 2-week loan runs at 390 percent and up. These are balloon payment loans. They are due in full on your next payday or the check that you wrote and left behind with the lender will be deposited in the bank. It is likely to bounce, because a family that can't make it to payday without borrowing a few hundred dollars at 400 percent interest is hard pressed to have enough money in the bank to cover the check on payday, and then the payday lender will charge you a bounced check fee, as well as your bank, each time that transaction is presented.

These loans are made without asking the kinds of questions that let you determine ability to repay. Just as you heard with the mortgage issue, payday loans are made without pulling a credit report, without asking who else you owe or how much you owe. All you have to have is an open bank account, a source of income, and a form of ID. Every payday loan is based on a prospective bad check, so these loans put bank account ownership at risk. And they function as the modern day equivalent of wage assignments, and that form of lending was ruled years ago by the Federal Trade Commission as an unfair trade practice. Our modern equivalent today is you write a check on your account that you expect to have covered by the deposit of your next pay check in order to repay the loan.

We view these loans as predatory. As we have mentioned, they are made without regard to the leader of pay. They are exorbitantly expensive. They are too big to be repaid in one balloon payment. A $500 cap is typical for State payday loan laws, and the average customer makes about $24,000 a year, so these are low to moderate-income borrowers.

So if you are borrowing $500 plus the $75 to $150 finance charge that has to be repaid on your next payday, if you are in that average income range you are agreeing to pay 75 percent of your take-home pay to keep that check from bouncing to get that loan paid. Not very many middle class people pay a lot more than the minimum payment on their credit card, but we expect payday loan borrowers to pay it all back on their next payday.

If this is an electronically processed loan, we have heard testimony that the debt is presented over and over, each time triggering a bounced check fee. There was testimony before the Senate Banking Committee last fall of a service member whose Internet lender bounced electronic payday loan 11 times in 1 day.

Given these loan terms and the lack of underwriting, it is no surprise that these loans create a debt trap for cash-strapped families. This data on what is going on in this industry comes from regulators. The Colorado Attorney General's office has been collecting data for years from loan applications. They tell us that 60 percent of the borrowers come from the lowest three income brackets, that they make around $25,000 a year. Other States have even lower incomes. These are minority borrowers, as well.

A North Carolina academic study found that African American consumers are twice as likely to use them. A study in Texas of 145,000 customers showed that, although African American consumers make up 11 percent of the adult population in Texas, 33 percent of the payday loan borrowers are African American consumers. As Representative Issa pointed out, they cluster around military bases. They also cluster in minority neighborhoods and low to moderate-income high traffic commercial areas.

The proof of the debt trap is that the average borrower has 8 to 13 loans per year. These are not one-time emergency loans when your car breaks down. This is perpetual debt.

We think that Congress needs to step in here, because the States have failed to protect consumers. We would urge you to enact legislation to prohibit basing loans on a personal check written on a federally insured depository account or mandatory electronic access to the account, and to amend the Electronic Funds Transfer Act to extend the prohibition against conditioning credit on electronic payment to the single payment loan. Lenders can't make you pay it back electronically if it is a periodic payment loan. We need the same protection for the single payment loans.

And, of course, we need for you to close once and for all the rent-a-bank tactic that has been used in the past by lenders to evade State law by partnering with a bank. It has been stopped by the bank regulatory agencies for now, but we need to have that as a matter of law.

I would be glad to answer any questions. Thank you.

[The prepared statement of Ms. Fox follows:]

Consumer Federation of America

Consumers Union

NATIONAL CONSUMER LAW CENTER INC

Testimony of

Jean Ann Fox
Director of Consumer Protection

On Behalf of
Consumer Federation of America
Consumers Union
National Consumer Law Center
(on behalf of its low income clients)

Before the Subcommittee on Domestic Policy of the
House Committee on Oversight and Domestic Reform

Hearing on Foreclosure, Predatory Lending and Payday Lending in America's Cities

March 21, 2007

Mr. Chairman, Representative Issa, and Members of the Subcommittee, my name is Jean Ann Fox and I am the Director of Consumer Protection for the Consumer Federation of America (CFA).[1] I am testifying today on behalf of CFA, the national consumer organization; Consumers Union[2], the publisher of Consumer Reports; and National Consumer Law Center[3] on behalf of its low income clients. I appreciate the opportunity to offer our comments on predatory payday lending and recommendations for state and federal reform.

Payday lending provides easy access to quick cash for families that run short on money before payday. The catch is that these small loans come with triple-digit interest rates and often trap borrowers in a cycle of debt. Cash-strapped consumers are paying about $5 billion a year to borrow against their next paycheck. Balloon payment loans can take up to 75 percent of bi-weekly paychecks from the typical borrower. Loans secured by personal checks or electronic access to the borrower's bank account endanger the banking status of borrowers, foster coercive collection tactics, and function as unfair wage assignments.

My testimony describes how payday loans work, the size and structure of the industry, and what makes these loans predatory debt traps. We will explain where payday loan outlets cluster and describe the consumers most likely to use these products. The testimony describes the state legal status of payday lending and explains tactics used by lenders to evade state consumer protections. It also provides examples of the abuses rampant in this industry, as identified by the enforcement actions taken by states and litigation by consumers who have been harmed. We conclude by explaining why industry public relations efforts fail to correct abusive payday lending practices and recommend federal and state reforms needed to prevent payday loans from preying on vulnerable consumers.

A. Payday Product and Industry

Payday loans are small cash advances for less than $1,000, typically in the $300 to $500 range, based on the borrower's personal check or electronic access for the

[1] The **Consumer Federation of America** is a nonprofit association of over 280 pro-consumer groups, with combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interest through advocacy, research and education.

[2] **Consumers Union** is a nonprofit membership organization chartered in 1936 under the laws of the state of New York to provide consumers with information, education and counsel about goods, services, health and personal finance, and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers union's income is solely derived from the sale of Consumer Reports, its other publications, and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports with more than 5 million paid circulation, regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[3] The **National Consumer Law Center** is a non-profit organization specializing in consumer issues on behalf of low-income people. NCLC works with thousands of legal services, government and private attorneys, as well as community groups and organizations, who represent low-income and elderly individuals on consumer issues.

amount of the loan and the finance charge. Loans are due and payable in full on the borrower's next payday and typically cost 390 to 780 percent APR for two-week terms. Finance charges are typically expressed as dollars per hundred borrowed, in the $15 to $30 per $100 range. On the next payday, a borrower can bring in cash and "buy back" the check, the check can be deposited for payment, or the borrower can pay only the finance charge and renew the loan for another pay cycle without reducing the principal. Most checks are never deposited and are bought back by customers who are then encouraged to take out another loan. Industry analysts estimate that about five percent of American consumers have taken out at least one payday loan.[4]

Competition does not drive the price of payday loans. An FDIC report found that "payday advance stores tend to charge an effective APR near the applicable statutory limit."[5] A Colorado Attorney General's review of licensed lenders found that 93 percent of all loans are priced at the maximum permitted level. Annual filings by publicly traded payday lenders to the Security and Exchange Commission show consistent rates, even in saturated markets, indicating that competition does not impact rates charged.

Few questions are asked of loan applicants by payday lenders. Borrowers are only required to have a source of income, identification, and an account open at a bank or credit union. No ability to repay questions are asked. Lenders may check a specialized reporting service, such as TeleTrack, to score applications but usually do not get a regular credit report. Most lenders do not report positive payment to credit reporting services, so payment of payday loans does not improve a borrower's credit rating. Failure to pay is reported, however.

The modern payday loan industry emerged in the last decade but dates back to "salary-buying" in the early 20th Century.[6] Payday loans are made by mono-line payday lenders; by check cashers, pawn shops and rent-to-own stores; and online through electronic funds transfer. Recent analysis of state regulatory and industry data by the Center for Responsible Lending found that 24,803 payday loan outlets made over $28.2 billion in loans in 2005, up over 100 percent in five years. Consumers paid almost $5 billion for loans.[7] Industry analysts report a larger volume of business and higher fees paid by borrowers.

States with the largest total loan fees paid by consumers in 2005 include California ($405 million), Missouri ($352 million), Louisiana ($346 million), Texas ($288 million), Alabama ($250 million), Illinois ($244 million), and Ohio ($233 million).[8] The states most saturated with payday loan outlets include South Dakota, New

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[4] Michael A. Stegman, "Payday Lending," *Journal of Economic Perspectives* , Vol. 21, No 1, at 170.
[5] Flannery & Samolyk, "Payday Lending: Do the Costs Justify the Price?", FDIC, June 2005, endnote 34 at 9.
[6] Jean Ann Fox, Testimony, Lieberman Payday Loan Forum, December 1999. On file with author.
[7] Uriah King, Leslie Parrish and Oxlem Tanik, "Financial Quicksand: Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year," Center for Responsible Lending, Nov. 30, 2006, 9-11.
[8] "Financial Quicksand," at 17.

Mexico, Louisiana, Missouri, Alabama, South Carolina, Tennessee, Idaho, Nevada and Mississippi.[9]

B. Payday loans meet the criteria for predatory lending

The essential features of a payday loan meet all the definitions of predatory lending, making them hazardous to borrowers.[10] Loans are made without consideration of the borrower's ability to repay. Interest rates are exorbitant, starting at around 400 percent annual interest. Loans come with balloon payments, due in full on the borrower's next payday, not in affordable installments. In fact, payday lenders do not allow installment payments, recent proposals notwithstanding, because their business model is predicated on forcing people to pay their entire loan balance plus fees. Every payday loan involves a check or debit authorization for money that may not be in the bank on the borrower's next payday. And, finally, check/debit holding sets up coercive collection tactics as some lenders threaten or imply that the borrower will be "in trouble" for failure to make good on the check.

A key characteristic of a payday loan is the use of a personal check or electronic access to a bank account as security, payment device, and collection tool. Elliehausen notes that the postdated check used to get a payday loan provides an incentive to repay the loan, reducing the probability of default and the expected value of collection costs.[11] While check holding benefits lenders, this device puts bank account ownership at risk for consumers, as well as the ability to write checks at retailers if repeat defaults are reported to ChekSystems where black marks stay on the record for five years. Every loan involves a potential bad check/debit that will trigger a bounced check fee at both the payday lender's outlet and the consumer's bank. Checks can be re-deposited to trigger multiple fees. A Jacksonville Area Legal Aide attorney testified to the Senate Banking Committee last fall that an online payday loan was presented to the bank eleven times in one day, triggering a bounced check fee each time.[12]

Securing payment of a debt by the borrower's next paycheck to be deposited in the bank is the modern banking equivalent of a wage assignment. Federal law makes void any loan with a wage assignment to an enlisted Service member. The Federal Trade Commission ruled decades ago that a wage assignment that could not be withdrawn was

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[9] Ferris Baker Watts, "PayDay Industry Overview," March 2006 presentation, using 2005 data.
[10] FDIC's Office of the Inspector General (OIG), Challenges and FDIC Efforts Related to Predatory Lending, Audit Report No. 06-011, June 2006. "Characteristics potentially associated with predatory lending include, but are not limited to, (1) abusive collection practices, (2) balloon payments with unrealistic repayment terms, (3) equity stripping associated with repeated refinancing and excessive fees, and (4) excessive interest rates that may involve steering a borrower to a higher-cost loan." Payday lending is listed "Payday Loans are small-dollar, unsecured, short-term advances that have high fees relative to the size of the loan. When used frequently or for long periods, the total costs can rapidly exceed the amount borrowed."
[11] Gregory Elliehausen, "Consumers' Use of High-Price Credit Products: Do They Know What They Are Doing?" Working Paper, Networks Financial Institute at Indiana State University, May 2006 at 5.
[12] Lynn Drysdale, Jacksonville Area Legal Aide, Testimony before the Senate Committee on Banking, Housing, and Urban Affairs, September 14, 2006, at 8.

an unfair trade practice under the Credit Practices Rule. The Electronic Funds Transfer Act prohibits conditioning the extension of credit on requiring electronic payment for periodic payment loans, but is silent on the single payment electronic payday loan model.

Bankruptcy Risk Heightened by Payday Loan Use

There are some indications that the use of payday loans increases the likelihood that a consumer will file for bankruptcy. Skiba and Tobacman report that there is suggestive but inconclusive evidence that payday loans increase Chapter 13 bankruptcy filing rates. They found an increase of 27 percent in Chapter 13 bankruptcy petitions within two years of an approved payday loan application, probably because payday loans compromise the borrower's financial stability over the long term due to repeated finance charges. "With sufficient repeated borrowing behavior, the interest payments would slowly take a toll on the agents' ability to stay solvent during a future shock and thus in the longer run lead to increased bankruptcy filings."[13]

Payday loan customers are viewed as highly credit constrained. An industry-funded study in 2001 reported that payday loan borrowers are four times more likely to have filed for bankruptcy in the past than the average adult.[14] Loyola University professor Robert Mayer examined a sample of 500 bankruptcy filings in Milwaukee County, Wisconsin in 2004 and described bankruptcy petitions as "a window into the sweatshop of payday lending." While the Mayer study notes the difficulty of isolating the impact of payday loan debt as a cause of bankruptcy, he noted that the industry may bear some responsibility for the increasing vulnerability of working families. In the petitions he examined, seventy percent of the filers who listed any payday loan listed more than one. Nearly 30 percent had four or more payday loans at the time they filed for bankruptcy. One debtor with four loans totaling $5,150 owed seven times as much as his net monthly income when he filed for bankruptcy. Just the fees to renew payday loans ate up 30 percent of each paycheck for the median individual with two or more loans.[15]

C. Payday Lenders Harm Vulnerable Borrowers

Payday lenders cluster around military bases with large populations of relatively low wage young workers with steady pay and required bank accounts, as documented in the Peterson/Graves study published by the Ohio State Law School.[16] Major General Mike Lehnert, commander of Marine Corps Bases (West) noted in a speech in 2006 that payday lenders outside the gates at Camp Pendleton (CA) "are parasites, bottom feeders

[13] Paige Marta Skiba and Jeremy Tobacman, "Measuring the Individual-Level Effects of Access to Credit: Evidence from Payday Loans," *Job Market Paper*, January 19, 2007 at 26.
[14] Gregory Elliehausen and Edward C. Lawrence, "Payday Advance Credit in America: An Analysis of Consumer Demand," Monograph 35, Georgetown University, Credit Research Center, 2001.
[15] Robert Mayer, "One Payday, Many Payday Loans: Short-Term Lending Abuse in Milwaukee County," Working Paper, Loyola University Chicago, undated.
[16] Christopher Peterson and Steven Graves, "Predatory Lending and the Military: The Law and Geography of 'Payday' Loans in Military Towns," *Ohio State Law Journal*, Vol. 66, No. 4, 2005.

and scumbags."[17] The Department of Defense issued a report to Congress in August that predatory payday lenders are prevalent around military bases and concluded that "Predatory lending undermines military readiness, harms the morale of troops and their families, and adds to the cost of fielding an all volunteer fighting force."[18]

The Center for Responsible Lending found that African-American neighborhoods in North Carolina have three times as many payday lending stores per capita as white neighborhoods and that the disparity increases as the proportion of African-Americans in a neighborhood increases. When characteristics of income, homeownership, poverty, and unemployment are taken into account, the same disparities remain.[19] Payday loan stores are almost twice as likely to be in African American population centers than white in Washington, according to a Zip-code-level analysis conducted for the Seattle Post Intelligencer. The report also found evidence associating payday loan outlets with high-poverty zip-codes, even after adjusting for race and education.[20]

Who Borrows from Payday Lenders?

Lenders claim that their customers are middle class and middle income.[21] However, the evidence suggests that the bulk of payday loan consumers earn low or moderate incomes and are often minorities. The most reliable data on borrowers comes from customer applications collected by regulators as licensees are inspected, not from industry-funded telephone surveys drawn from customer lists provided by lenders. The Colorado Attorney General's office supervises licensed payday lenders and collected a sample of customer records over five years of inspections. Borrower demographics of over 10,000 applications collected during over 680 compliance examinations show that the typical payday loan customer is a thirty-six year old single woman, making $2,186 per month. Consumers earning less than $2,500 per month ($30,000 per year) make up nearly two-thirds of all borrowers. The majority (62.8 percent) of all Colorado borrowers occupy the lowest three income occupations of laborer, office worker, or benefit recipient. While Service members make up only one percent of the adult population of Colorado, military personnel are over four percent of payday loan customers. Despite CFSA's claim that their 25 percent of their customers have average incomes in excess of $50,000, Colorado regulators found only 0.24 percent of loan applicants in this bracket.[22]

[17] American Thinker, "General Lehnert speaks," July 11, 2006.
[18] Department of Defense, "Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents," August 9, 2006.
[19] Uriah King, Wei Li, Delvin Davis, and Keith Ernst, "Race Matters: The Concentration of Payday Lenders in African-American Neighborhoods in North Carolina," Center for Responsible Lending, 2005.
[20] Assaf Oron, "Easy Prey; Evidence for Race and Military Related Targeting in the Distribution of Pay-Day Loan Branches in Washington State," Consulting Report for the Seattle Post-Intelligencer, March 2006 at 2.
[21] Community Financial Services Association, "Payday Advance Customer Profile," at www.cfsa.net/govrelat/pdf/Payday_Advance_Customer_Profile.pdf
[22] Paul Chessin, "Borrowing from Peter to Pay Paul: A Statistical Analysis of Colorado's Deferred Deposit Loan Act," *Denver University Law Review*, Vol. 83, No. 2, 2005, page 405-407.

An academic 2001 survey of low-income families in Charlotte, North Carolina's largest city, found that African Americans were about twice as likely to have borrowed from a payday lender in a two-year period as whites and that African Americans were five times more likely than whites to take out multiple payday loans, controlling for many socioeconomic characteristics. The same study found that payday lenders clustered in working-class neighborhoods and disproportionately favored high-minority neighborhoods.[23]

Texas payday loan borrowers are disproportionately African American and Hispanic, according to an academic study based on analysis of a database of 145,000 payday loan applicants during 2000-2004 from a "large payday and pawn lender" in Texas. While only 11 percent of Texas adults are Black, 43 percent of payday loan borrowers were. Despite lower bank account ownership by Hispanic families (24 percent nationally are unbanked compared to ten percent for the population as a whole, according to the Federal Reserve's Survey of Consumer Finances[24]), 34 percent of payday loan borrowers were Hispanic, compared to 29 percent of Texas adults. The Skiba/Tobacman study also found that 62 percent of borrowers were female and that the median annual pay was $18,540, compared to Census data for Texas of $19,617. Only 34 percent of borrowers own their own home.[25]

D. Payday Loans are Debt Traps

Payday loans were sold to state legislators as "once-in-a-blue-moon" emergency cash flow tools. The reality that has emerged is that payday loans foster repeat borrowing and become long term or frequent obligations. The Texas study mentioned above found that the average borrower had 9.8 loans per year, indicating that payday loan behavior is unlikely to be driven by temporary shocks to consumption needs. Assuming a two-week loan term and an average $245 loan, borrowers paid $350 in interest payments for the use of $245 for less than twenty weeks out of the year.[26] The Skiba/Tobacman study concludes that "the repeated and persistent borrowing we observe appears difficult to reconcile with temporary shocks to consumption needs," in contrast to industry claims that payday loans are only used to cover emergencies such as car repair or doctor visits.

A loan is "rolled over" when a payday loan is extended for another pay cycle before the loan is again due. The lender collects the finance charge, but the loan principal is not reduced. Some states ban rollovers, but that is easily circumvented. Lenders can allow borrowers to pay off one loan and immediately take out another one, sometimes called back-to-back transactions or serial loans. Although this is nominally a new loan, it

[23] Michael A. Stegman, "Payday Lending," *Journal of Economic Perspectives, Vol. 21, Number 1, Winter 2007,* at 174.
[24] Maude Toussaint-Comeau, "Changing Hispanic demographics: Opportunities and constraints in the financial market," Chicago Fed Letter, No. 192, August 2003, at 3.
[25] Paige Marta Skiba and Jeremy Tobacman, Table 1.
[26] Paige Marta Skiba and Jeremy Tobacman, at 3. Study reports 9.8 loans for a total of $2400 and $350 in interest payments per year. CFA calculated that $2400 divided by the total number of loans reveals the amount of credit outstanding at one time. Multiplied by the typical two week loan term results in the length of time the average $245 loan was outstanding.

has the same financial impact as renewing a loan. Borrowers can effectively roll over a loan by borrowing from a second lender to repay the first or by taking out multiple loans to keep checks from bouncing at loan outlets.

Limits on Loan Renewals Fail to Prevent the Payday Loan Debt Trap

State payday loan laws attempt to limit rollovers by limiting the number of times a loan can be renewed or extended, by prohibiting one loan to repay a prior loan at the same lender, or imposing short cooling off periods between paying off one loan and getting a new one. None of these work to prohibit repeat borrowing, as they do not help borrowers work their way out of the payday debt trap. Cooling off periods are typically 24 to 72 hours and still leave borrowers unable to afford lump sum repayment without having to borrow again prior to the next payday. Florida limits borrowers to one loan at a time from all lenders in the state, with a 24-hour cooling off period between loans. In Florida, 89 percent of loans go to borrowers with five or more transactions per year and 57 percent of loans go to borrowers with 12 or more loans per year. Florida borrowers average 8 per year, even with the strictest renewal limits on the books.

E. Legal Status and Enforcement

While small lenders are subject to federal credit laws, such as Truth in Lending Act, Fair Credit Reporting, and Equal Credit Opportunity Act, the industry is typically licensed and supervised at the state level. In the early 1990's, payday lenders started pursuing industry-friendly safe-harbor state laws, following litigation that challenged these loans for violating state usury and small loan rate caps in Tennessee and Kentucky, with the goal of achieving payday loan authorizing laws in all fifty states. Payday lending is currently legal in 37 states while another two states permit licensed lenders to charge deregulated rates. In eleven states, payday lenders have not won exemption from state usury or small loan rate caps and payday lending is either explicitly prohibited or rates are not high enough to attract the industry. These states include New York and New Jersey whose criminal usury caps of 25 percent and 30 percent APR respectively thwart lending at triple-digit rates.[27]

The industry has run into stiff resistance in the last year or so, stalling the march of states that legalized payday lending. North Carolina experimented with legal payday lending and let the law expire in 2001 when information reported by the Banking Commissioner demonstrated that payday loans were a debt trap for many borrowers. Georgia enacted tough anti-payday loan enforcement tools in 2004, including racketeering sanctions for persistent violation of its rate cap, and closed all the loopholes being employed by rogue lenders. The industry tried and failed to persuade Pennsylvania to legalize payday lending.

[27] See www.paydayloaninfo.org, Legal Status.

State Enforcement and Litigation Illustrates Consumer Protection Issues

Payday lenders have a track record of evading state protections, exploiting loopholes, and using sham transactions to disguise usurious lending.[28] Enforcement and litigation actions in 2006 illustrates the many consumer protection failings of payday lending.

Q.C. Financial, Inc: A class action lawsuit was filed in Circuit Court of St. Louis County charging QC Financial Services, Inc., dba Quik Cash, of violating the Missouri payday loan law by renewing loans more than six times, failing to evaluate ability to repay the loans, and charging more than 75 percent of the original loan amount in interest and fees. The head of Q. C. Financial is President of the industry trade organization, and is featured in CFSA's national TV advertising campaign, urging borrowers to use payday loans responsibly.

John A. Gill, Jr., a payday lender with a long career of using a variety of shams and ruses, including catalogue and Internet "rebate" deals to cloak illegal lending, was convicted by a Pensacola, FL jury in August. He was found guilty of criminal usury violations of the Florida racketeering statute, was remanded into custody and is facing up to thirty years in jail and up to three million in criminal restitution. Mr. Gill ran a variety of payday loan businesses since 1992 which ran afoul of state regulators in Alabama, Colorado, Florida, Georgia, Louisiana, New York, North Carolina, South Carolina, Texas, Virginia, and Washington.[29] For example, the Texas Attorney General froze Gill's assets in a deceptive practices case against Advance Internet and Texas Advance Internet, alleging loans at 782 percent interest for payday loans. Gill's Texas companies charged $30 for a $100 advance, disguised as a rebate on an Internet access contract.[30]

Washington Department of Financial Institutions: Check 'n Go of Washington, Inc. was charged by the Washington Department of Financial Institutions of collecting multiple checks from borrowers to secure single payday loans (in violation of a 2004 DFI policy), charging excessive fees, and collecting personal identification numbers without the borrower's knowledge. When multiple checks for a single loan were returned unpaid by the bank, the lender imposed multiple NSF fees on the borrower, in violation of Washington's maximum one-time fee of up to $25 for an unpaid check on a single payday loan. DFI announced in August 2006 that it intended to revoke Check 'n Go's license to make payday loans and to impose fines of $333,700.[31]

Florida: EZCorp Inc.'s Florida outlets, EZPawn and EZPawn Money Payday Loan Stores, were charged by the Florida Office of Financial Regulation with unlawfully

[28] For more information, see Jean Ann Fox, "Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury," CFA, March 2004.
[29] Duwayne Escobedo, "Loan Shark Predator: Tale of Alabama Man's Payday Lending Schemes," Independent News, Vol. 6, No. 29, July 20, 2006.
[30] Mike Anderson, "AG Sues Loan Company, Citing Sky-High Lending Rates," Waco Tribune-Herald, May 24, 2006.
[31] Washington Department of Financial Institutions, Press Release, "State Files Largest Case Against Payday Lender," August 16, 2006.

blocking examiners from inspecting its loan records. The State is trying to determine if the 18 outlets should be licensed in Florida.[32]

Washington: Expressit, Inc. was banned and ordered to pay over $304,000 in restitution to Washington borrowers. The Washington State Department of Financial Institutions found that the Lacey, WA company made loans without a license, failed to provide borrowers with written agreements or disclosures, exceeded state limits on fees and loan size, and refinanced loans with proceeds from other loans. The settlement resolved a case dating back to February 2005 when DFI issued a temporary cease and desist order. Expressit permitted loan roll-overs, with one borrower paying over $19,500 in interest on a series of small loans ranging from $600 to $1,875 between 1997 and early 2005 and still owed $1,875.[33]

Arkansas Internet Access cases were brought by the Attorney General against companies that cloaked their usurious loans as the sale of Internet access with a rebate. Money in a Flash.net required borrowers to make monthly or biweekly payments of up to $60 for "rebates," which translated to 520 percent APR loans. Some contracts required borrowers to pay $1,500 in a year for a $300 "rebate." Payment was made by electronic access to the consumer's bank account.[34] A survey by Arkansans Against Abusive Payday Lending (AAAPL) identified seventeen outlets that used this ploy early in 2006 to make payday loans.[35]

Arkansas Enforcement Cases: As a result of the well documented reports from AAAPL, the Arkansas Board of Collections brought a series of highly publicized enforcement cases against payday lenders operating without complying with the highly questionable check cashing law. The Arkansas State Board of Collection Agencies ordered C. Michael Stout, the former owner of Cash Advance and Check Mart Inc. to personally pay $173,050 in fines and almost $44,000 in refunds to customers. He was accused of using a Missouri entity as a screen for loans that violated Arkansas rules. In June the Board fined Dennis Bailey of Fordyce more than $1.3 million for operating 14 payday loan stores without licenses.[36] The Board ordered all his stores closed and voided all transactions between Fast Cash stores and consumers who have no obligation to repay the loans. Mr. Bailey is appealing the agency's order.[37]

California Department of Corporations brought a series of cases against unlicensed payday lenders. Check Exchange in Lomita was accused of making more than 3,000 payday loans without a license and falsifying an application for a license.[38] The California Attorney General filed charges of deceptive business practices and fraud

[32] Richard Burnett, "State Files Suit to Open EZPawn's Records," Orlando Sentinel, July 19, 2006.
[33] Washington Department of Financial Institutions, Press Release, "DFI Bans Payday Lender from the Industry and Orders Restitution to Consumers," September 11, 2006.
[34] Rob Moritz, "AG Lawsuit Alleges Payday Lending Scam," Arkansas News Bureau, Mar. 1, 2006
[35] AAAPL, "Payday Lenders in Arkansas: The Regulated and Unregulated, Enclosure 6, Internet Rebate-Payday Lender List, February 2006
[36] David Smith, "Regulators fine lender $173,050," Arkansas Democrat-Gazette, Nov. 15, 2006.
[37] Joanne Bratton, *Baxter Bulletin*, Oct. 27, 2006.
[38] City News Service, "State Bars Lomita Payday Loan Shop," *DailyBreeze.com*, Feb. 8, 2006.

against now defunct Fast Cash loan service in Arcadia. The complaint filed in Pasadena Superior Court sought $2 million in civil penalties, including $350,000 in restitution for borrowers. The Attorney General said that Fast Cash threatened lawsuits, tried to squeeze settlements from borrowers and deceived the courts about the checks written to secure loans. In violation of California law, Fast Cash sued more than 400 individuals for treble damages for checks passed on insufficient funds.[39]

Illinois Department of Financial Institutions fined violators about $500,000 in 2006 as the new payday loan law was implemented. Illinois regulators fined **Illinois Title, Inc.** $55,000 for non-compliance with the requirement to report payday loans to the state-run database; **Cottonwood Financial Ltd.** $10,000 for misleading advertising to divert payday loan customers into a 140-day loan not covered by the new law; accused four **Payday Loan Stores of Illinois** of falsifying signatures, making loans to people with invalid Social Security numbers, and failure to make required disclosures. In May, Illinois fined **Advance America** $77,500 for violating the PLRA. Affinity Credit Services has been fined $273,000 since the PLRA went into effect. The Illinois Attorney General and the Department of Financial and Professional Regulation issued an order July 6, 2006 against **AmeriCash Loans LLC**, fining the company $190,000 for allegedly charging higher interest rates than the law sets. Examiners identified loans made at 521 percent APR, 28 percent higher than state law permits.

In 2006, state regulators also stepped up enforcement actions against Internet payday lender violation of state laws.

Colorado settled a case against Quik Payday, Inc. of Logan, Utah for $2 million in restitution to about 15,000 Colorado consumers who got illegal loans via the Internet from the company. Quik Payday charged higher fees than Colorado allows and permitted loan renewals more than one time. The company agreed not to make loans to Colorado residents without a license.[40]

California took enforcement action in September 2006 against four unlicensed Internet payday lenders doing business in California. Ameriloan.com, USFastCash.com, PreferredCashLoans.com and UnitedCashLoans.com were named in cease-and-refrain orders. Internet Cash Advance Marketing, Inc., of Vancouver, B.C. and its President were ordered not to offer or arrange loans for online companies without a state license.[41]

Sonic Payday.com: California regulators issued a desist and refrain order to Sonic Payday Limited dba Sonic Payday, LTD with an address in Dublin, Ireland. The online lender was cited for unlicensed payday lending, failure to provide a written contract, and charging fees exceeding 25 percent per two-weeks (650 percent APR).[42] (Nevada

[39] Gary Scott, "Payday Loan Firm Faces Charges," *Pasadena Star-News*, August 2, 2006.
[40] Press Release, "Attorney General Suthers Announces $2 Million Settlement with Internet 'Payday' Lender," December 23, 2005.
[41] Press Release, "California Department of Corporations Orders Payday Loan Stores to Stop Lending in State," California Department of Corporations, September 8, 2006.
[42] California Department of Corporations, Desist and Refrain Order, Joanne Turner and Sonic Payday Limited, May 10, 2006.

regulators notified Clark County Legal Services that it, too, had "issued the appropriate action as required" when its investigation found that Coastline Credit Ltd. Dba:Sonicpayday.com was an unlicensed payday lender in Nevada.)[43] Three Florida consumers filed a class action lawsuit against Sonic Payday and Coastline Credit for charging excessive interest rates, approving loans even though borrowers have outstanding loans with other lenders, refusing to provide Florida's required grace period for repayment, and harassing borrowers with calls at work. The plaintiffs were charged 607 to 817 percent APR for loans made via the Internet.[44]

District of Columbia Attorney General settled a case against Utah-based Yourcashbank.com, a company that made payday loans via the Internet. The DC investigation found that the unlicensed lender was charging excessive interest rates and fees on loans collected through automatic withdrawals from consumers' bank accounts. DC laws permit only check-based lending, not electronic funds transfers to repay loans.[45]

Massachusetts Commissioner of Banking issued 91 cease activity orders to Internet payday lenders in February 2005 following an investigation of loans marketed to Massachusetts consumers. Massachusetts caps annual rates for small loans at 23 percent with fees capped at $20, far lower than payday loan rates. In May 2006, Massachusetts regulators issued an additional 48 cease activity orders against out-of-state payday lenders marketing illegal loans via the Boston Craig's List website and in the Boston Herald. The Commissioner of Banks asked the website and newspaper to stop accepting advertising from payday lenders.[46]

Community Legal Services in Philadelphia filed a lawsuit late in 2005 against Cash Today, a large check-cashing company that allegedly operated an illegal payday loan scam. Cash Today claimed to refer its customers to Cash Today of Delaware, accessed by a computer at their check cashing outlets to the Internet site, www.cashtoday123.com that made loans to Pennsylvania consumers. Cash Today of Delaware charged Pennsylvania consumers $20 per $100 or 520 percent APR for two week loans and used electronic access to borrowers' bank accounts to deliver and collect on loans. The loans automatically renewed unless borrowers notified the lender of a payoff three days prior to the due date.[47] Cash Today filed for bankruptcy protection early in 2006.[48]

West Virginia Attorney General brought numerous actions against illegal Internet payday lending, based on consumer complaints in West Virginia, a state that caps rates for licensed lenders at 36 percent APR. On November 6, 2006, the Office announced

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[43] Letter from Deputy Commissioner, Nevada Financial Institutions Division, to Clark County Legal Services Program, Inc, July 3, 2006, on file with author.
[44] David Bauerlein, "Lawsuit Targets Payday Lenders," *The Florida Times-Union,* September 11, 2006.
[45] Press Release, "DC's Attorney General Investigates Payday Lender: Yourcashbank.com," District of Columbia Office of Attorney General. April 5, 2006.
[46]
[47] Press Release, "CLS Sues to Stop Illegal Payday Lending Scheme," Community Legal Services of Philadelphia, December 21, 2005. Complaint, Turner v. Frascella Enterprises, Inc. D/B/A Cash Today, et al., Court of Common Pleas , Philadelphia County, December Term, 2005.
[48] Todd Mason, "Check-Cash Firm Seeks Protection," Philadelphia Inquirer, Feb. 1, 2006.

eighteen settlement agreements with Internet payday lenders. An additional eight companies have provided written confirmation that they will cease making loans in the state. Suit was filed in Circuit Court in Charleston against fourteen Internet lenders to enforce investigative subpoenas. West Virginia officials reported that consumers are being charged 600 to 800 percent APR, more than 44 times the maximum for unlicensed loans in the state. Companies sued include Apple Fast Cash Personal Loans; Cash Advance Network, Inc.; Cash Advance USA; Cash Advance Marketing, Inc. d/b/a Cash back Values; Cash Net/ American Interweb Marketing d/b/a/ CASHRebateOnLine.com; Leads Global, Inc. d/b/a/ Cash Today Limited, and d/b/a/ Cash2day4your.com; GECC d/b/a Cashdirectnow.com; Americash Hotline, LLC d/b/a Direct Cash Express, LLC; Magnum Cash Advance, Inc.; Ambassador Financial Services d/b/a Nationwide Cash; PayDay OK d/b/a PayDay Select; Quik Payday.com Financial Solutions; and USA Cash Center.[49]

Colorado Attorney General subpoenaed unlicensed internet lenders Cash Advance and Preferred Cash Loans in early 2005 following consumer complaints. The Court awarded contempt citations when lenders failed to provide information, after which the lenders moved to dismiss the proceedings alleging lack of jurisdiction. The payday lenders in the Colorado cases claim that they are Indian tribal corporations (Miami Tribe and Santee Nation), and that they are not part of the Fontano C.B. and Executive businesses based in Carson City, Nevada, and have sovereign immunity from state law. According to Colorado's Response, "This evidence suggests that, at some point after the State's investigation, the tribes joined with the Fontano entities in a 'rent-a-tribe" scheme by which the tribal entities act as straw man, pass through fronts to shield the Fontano entities' illegal loan making behind the 'impenetrable' wall of tribal immunity, and thereby circumvent state consumer credit protection laws."[50] The District Court in Denver ruled that claims of tribal immunity do not prohibit a state from investigating violations of its own laws occurring within its own borders and noted that tribal activities conducted outside of tribal lands are subject to state regulation. The Court denied the Tribal Entities' motion to dismiss.[51]

Colorado court filings state that in earlier Kansas litigation, Fontano testified that Cash Advance and United Cash Loans were wholly-owned by five off-shore entities located in Charlestown, Nevis, St. Georges, Grenada, and Basetterre, St. Kitts. The owner of these Internet payday loan websites is a convicted felon, currently serving time in a federal penitentiary for felony tax evasion. "As detailed in the Government's Sentencing Recommendations, his plea arose out of his role as a promoter of and conspirator in 'the

[49] Press Release, "Attorney General Darrell McGraw Reaches Settlement Agreements with 18 Internet Payday Lenders and Sues 14 Internet Payday Lenders to Enforce Investigative Subpoenas and to Enjoin Usurious Lending Activities," West Virginia Office of Attorney General, November 6, 2006.
[50] State of Colorado v. Cash Advance and Preferred Cash Loans, Applicant's Response to Respondents' Motions to Dismiss, Case No.: 05CV1143 (consolidated with Case No. 05CV1144), Nov. 16, 2006, p. 11.
[51] Order, District Court, City and County of Denver, Colorado, in State of Colorado v. Cash Advance and Preferred Cash Loans, Case Number 05 CV 1143, March 12, 2007.

nation's major offshore tax evasion organization' with operations 'in Nevis and Grenada.'"[52]

F. Evading State Limits

Despite winning legal authorization in thirty-nine states, payday lenders use a variety of tactics to evade state limits on small lending. These include "renting" bank charters, finance companies or Indian tribes; claiming to be credit services organizations arranging credit-improving loans for borrowers, and restructuring into installment lenders to get around limitations on payday loans.

Rent-a-Bank Lending

Last year, almost all store front payday lenders stopped partnering with state-chartered banks, following FDIC action to stop banks from renting their charters to facilitate payday lending in states with restrictive laws. Earlier the Office of Comptroller of the Currency, the Federal Reserve Board, and the Office of Thrift Supervision stopped their charters from participating directly in payday lending through a combination of guidelines, safety and soundness compliance, and law enforcements. As a result of the end of this tool, the industry sought new ways to stay in business without complying with state usury or small loan laws or, even, with state payday loan authorization laws that were viewed as too restrictive by some in the industry. A few payday lender-bank operations persist, including loans made by First Bank of Delaware and ACE Cash Express in Arkansas.[53]

Credit Services Organization Model

Stegman describes the switch from rent-a-bank payday lending to credit services organization model as a "through-the-looking-glass metamorphosis for payday lenders".[54] All payday lending in Texas now operates under the Credit Services Organization model, with payday lenders claiming that they are just brokering loans for other lenders in an effort to improve their customers' credit standing. Texas does not license, regulate or supervise credit services organizations, leaving borrowers unprotected from rate gouging. The combination of fees and interest make CSO loans even more expensive than the old rent-a-bank payday loans made in Texas and far higher than the Texas small loan rate cap of 48 percent annual interest plus a $10 per loan fee. Advance America collects three fees for its CSO loans, including a $20 per $100 borrowed "referral fee," a $10 per $100 "application" fee for filling out the paperwork, plus interest on the loan from a separate limited liability company capped by the Texas small loan law.

[52] Colorado Attorney General, Applicants' Response to Respondents' Motions to Dismiss, State of Colorado v. Cash Advance and Preferred Cash Loans, Nov. 16, 2006 at 8.
[53] Press Release, "ACE Cash Express Reports Fiscal 2006 Third Quarter Results," ACE Cash Express, April 27, 2006. Electronic communication from AAPL in Arkansas, July 6, 2006, reporting that ACE and First Bank of Delaware offer $1,000 loan with 10 bi-weekly payments of $199.97 for a total of $1,999.70 repaid at 390 percent APR.
[54] Stegman, at 180.

According to Motley Fool, Advance America carries the default risk which is just two percent of gross loans receivable.[55]

Cash America uses the CSO model in Florida and Michigan, states where payday loans are authorized by state laws. In Florida, Cash America charges 18 percent annual interest paid to the nominal lender NCP Finance Limited Partnership plus $18 per $100 for the "broker fee" paid to its wholly-owned subsidiary, Cash America Financial Services, Inc., which acts as a "credit services organization." A $500 CSO loan, repaid in two weeks, costs almost 500 percent annual interest, compared to the 287 percent APR maximum for a $500 loan under Florida's payday loan law.[56]

Open-end Credit

As of March 27, 2006, Advance America's 100 Pennsylvania outlets stopped issuing payday loans through its bank partner, following enforcement action by the FDIC. In June, Advance America started marketing a new form of payday lending in Pennsylvania, a state with a 24 percent APR small loan rate cap. The "Choice" product is an open-end line of credit for up to $500 with a periodic rate of 5.98 percent APR plus a monthly participation fee of $149.95. Truth in Lending Reg Z excludes participation fees from the definition of the finance charge which is used to compute the annual percentage rate.[57] Since the fee is not used to compute the APR, the borrower will never be told the true cost of 370 percent APR of using Advance America's latest product. As with a payday loan, a "Choice" borrower leaves as "security" a personal check made out for the full payment of the account balance.

When the Pennsylvania Department of Banking filed a complaint against Advance America's Choice product, Governor Rendell said that a person who borrows $500 and makes the minimum payments ends up paying back $4,000 over about two years. The Governor described Advance America's product as "outrageous," and stated that payday lenders "prey on people who live paycheck to paycheck."[58] The Pennsylvania Banking Department charged the company with operating as an unlicensed lender, with making a loan or advance of money or credit under the meaning of the Consumer Discount Company Act, and with charging more than six percent interest, the state limit for unlicensed lenders. The Department alleged that the Monthly Participation Fee is a sham to charge illegal, usurious interest in violation of the maximum allowable annual rate of interest under the Loan Interest and Protection Law. The State asked for a declaratory judgment that Advance America's "Monthly Participation Fee" is not authorized by Pennsylvania law and violates the Consumer Discount Company Act and

[55] Lawrence Meyers, "Payday Lenders Strike Back," Motley Fool, July 29, 2005.
[56] "Payday Loan Companies May Exploit State Credit Repair Acts to Evade Usury Laws," NCLC Reports Consumer Credit and Usury Edition, Vol. 25, July/August 2006, at 1.
[57] Federal Reserve Board, Reg. Z A§ 226.4(c)(4)
[58] Press Release, "Governor Rendell Announces Lawsuit to Protect PA Consumers Against Payday Loan Company," Office of the Governor, Commonwealth of Pennsylvania, Sept. 27, 2006.

the Loan Interest and Protection Law; and asked for a permanent injunction and other relief.[59]

Installment Lending

Oregon enacted payday loan rate caps, effective July 2007. During debate at the special session of the legislature, industry spokesman Mark Thompson, representing MoneyTree, told lawmakers that the Payday Loan Reform Act won't stop loan abuses as lenders develop new products that are unregulated.[60] The new law does not apply to installment lenders making loans for longer than 60 days. As of November, a fourth of payday lending stores had bought conventional lender licenses which are not subject to the new rate caps. The Oregon Department of Consumer and Business Services told a Senate committee that it is planning to propose legislation to cap annual interest rates for conventional loans at 36 percent annual interest.[61] A bill to cap all small loans at 36 percent is pending.

Illinois is the "poster child" for lenders that use installment loans to evade state limits on payday loans, defined under the Payday Loan Reform Act as being loans for 120 days or less. There is no rate cap for lenders licensed under the Consumer Installment Loan Act, providing an incentive for payday lenders to institutionalize loan flipping into "installment" contracts. These 121-day installment loans are based on checks and wage assignments but do not conform to fee caps or comply with rules on loan roll-overs or collection practices.

The Monsignor John Egan Campaign for Payday Loan Reform report, "Hunting Down the Payday Loan Customer: The Debt Collection Practices of Two Payday Loan Companies," examined the court records of borrowers taken to court by Americash and Cottonwood d/b/a The Cash Store in 2005 and 2006. These two companies formerly made payday loans but are now using installment loans to evade the Illinois Payday Loan Reform Act. The new "payday installment loans" appear to be payday loans with built-in renewals. The Cash Store offers a 140 day loan with nine biweekly interest payments and a final balloon payment of the entire principal, essentially a 14-day loan with 10 built in rollovers.[62]

G. Momentum is growing to protect consumers from payday loans

In 2006 Congress enacted the John Warner Defense Manpower Authorization Act ("Military Lending Act" or "MLA") which included protections against predatory

[59] Complaint for Declaratory and Injunctive Relief, Pennsylvania Department of Banking vs. NCAS of Delaware, LLC, d/b/a Advance America Cash Advance Centers, Commonwealth Court of Pennnsylvania, Sept. 27, 2006.
[60] Oregonians for Payday Loan Fairness, www.paydayloanfairness.org/loophole/, visited June 13, 2006
[61] Bill Graves, "Payday Lenders Look for Ways Around Cap," The Oregonian, July 2, 2006.
[62] Press Release, "Major Follow Up Study of Payday Loan Practices Since Implementation of Important Reform Legislation Shows New Method for Evading the Law," Monsignor John Egan Campaign for Payday Loan Reform, Chicago, IL, October 16, 2006. Report posted at www.woodstockinst.org.

lending for Service members and their families. Congress capped loan rates at 36 percent annual interest, inclusive of fees, and outlawed loans secured by personal checks or required electronic debits. The Department of Defense is currently writing regulations to implement the law which takes effect October 1. While the MLA does not only apply to payday lending, passage of federal usury protections started a national dialogue about protecting all low-wage workers from triple-digit rate payday loans.

In about a dozen state legislatures so far this year, bills to cap payday loan rates at 36 percent APR or to repeal payday loan carve-outs from usury or small loan laws were introduced. Former supporters of payday lending are now calling for repeal or reform, including the original sponsor of the Virginia payday loan law. Virginia Senator Saslaw killed his weak industry bill to prevent Governor Tim Kaine from inserting a 36 percent annual rate cap to the bill. In South Carolina, home to industry giant Advance America, almost 90 House members co-sponsored a bill to cap payday loan rates at 36 percent plus a $5 loan fee. Last year Oregon enacted a moderate rate cap which will take effect in July. Repeal or reform bills are being heard from New Hampshire to California. The Attorneys General of Missouri and Montana called for 36 percent small loan rate caps for payday lending.

Cities and towns are fighting back against the glut of neon-lit fast cash outlets, using zoning laws and permits to slow down the proliferation of lenders. A recent report compiled by a Utah religious organization identified 58 jurisdictions with local zoning or ordinances on the books or in process, up from 39 jurisdictions just fifteen months ago. Jurisdictions limit payday lending outlets most commonly by special zoning and density restrictions.[63] California's San Francisco declared a moratorium on new check cashers or payday lenders and Oakland requires a special use permit and distance restrictions. Tucson and the Salt Lake City suburbs have adopted zoning ordinances that treat payday loan outlets as nuisances. Just this week, City Council in Overland Park in Kansas voted to impose a one-mile limit between new payday loan stores and to require existing ones to register with the city and pay a yearly $1,000 licensing fee. Payday loan and car title loan stores will be restricted to at least 200 feet from residential areas.[64]

H. Industry Public Relations Fails to Reform Payday Loan Product

When threatened, the payday loan trade group adopts voluntary industry best practices instead of reforming their product or supporting meaningful consumer protections. Industry "best practices" do not protect consumers and do not address any of the hazardous features of loans. Every time the payday loan industry is criticized, it updates its "best practices." When Consumer Federation of America and US PIRG criticized "rent-a-bank" payday lending, CFSA issued best practices for partnering with banks. Those meaningless efforts did not stop the Comptroller of the Currency, the Office of Thrift Supervision and, later, the FDIC, from issuing and enforcing compliance standards that put a halt to banks aiding and abetting the evasion of state usury laws.

[63] Linda Hilton, 2007 Local Payday Ordinances Summary, Coalition of Religious Communities, March 2007.
[64] Brad Cooper, "Overland Park adopts payday loan regulations," The Kansas City Star, March 20, 2007.

When witnesses in uniform began testifying in opposition to payday lending at state hearings, CFSA issued its military "best practices." That ineffectual code did not stop the Department of Defense from calling for protections to stop payday lending to Service members or stop Congress from enacting a 36-percent annual rate cap in the John Warner National Defense Authorization Act for Fiscal Year 2007.

And, now that payday lending has been labeled "financial quicksand," and a "debt trap" by consumer groups, civil rights organizations, military associations and financial regulators, the industry is offering an extended payment plan as another "best practice" to be adopted as legislation in some states. This is a tacit admission by the industry that their product is a debt trap. But, rather than restructuring loans to be affordable at the outset, the industry offers a once-a-year escape hatch that will not solve the problem.

Payment plans do not prevent the payday loan debt trap. The details of CFSA's extended payment plan have not been made public, but state legislation that the industry supports illustrates why after-the-fact payment plans do not prevent payday loans from trapping unwary borrowers in a cycle of debt. Bills filed in Texas, Arizona, Washington, Colorado, and Arkansas require a borrower to request, sometimes in writing, an extended payment plan the day BEFORE the loan is due in order to be eligible for more time to pay. Only one plan per year is offered by the industry, although the average borrower has eight or more loans during the year.

Repayment plans already in state laws are optional, not required, and are seldom used due to obstacles and lender incentives to discourage use of the plans. States with these laws include Alabama, Alaska, Florida, Illinois, Michigan, Nevada, Oklahoma and Washington. Less than half of one percent of loans in Oklahoma are paid through an extended payment plan while the average Oklahoma borrower has nine loans per year. In Washington, 90 percent of loans go to borrowers with five or more loans per year, borrowers' average eight loans per year, and less than 0.8 percent of loans employ the payment plan option.[65]

I. Federal and State Reforms Needed to Protect Consumers

1. Congress should enact legislation to prohibit the relatively new practice of holding a check or electronic access to bank accounts as security for a loan. Using the check/debit as security for the payment of a payday loan is the key to the coercive collection tactics used by lenders. Consumers are often forced to choose among three untenable options at the end of a short-term loan because lenders are holding their check: 1) allow the check to be debited from their bank account where it will deplete money needed for food and other living necessities; 2) allow the check to bounce, triggering bounced check fees from both the lender and the consumer's bank, exposing the borrower to coercive collection tactics when lenders threaten civil or criminal prosecution for unpaid checks, and risking the loss of their bank account or check-writing privileges, or 3) renew the loan at an increased cost. Basing loans on personal checks/debits that will

[65] "Protecting Working Families from Abusive Payday Loans: Lessons from Other States," VaPERL, January 2007, www.VirginiaFairLoans.org.

be deposited to repay the loan on the next payday is the modern equivalent of securing loans through wage assignments, a disreputable credit practice that violates Federal Trade Commission rules.

2. Legislation should also extend Electronic Funds Transfer Act protections to single payment loans that require consumers to sign over electronic access to their bank accounts. For almost thirty years, creditors have been prohibited from conditioning the extension of credit on electronic payment of installment loans. Payday loans made by some companies and via the Internet use mandatory electronic access to borrowers' bank accounts as security for the loans. Legislation should track EFTA requirements by prohibiting single payment loans based on required electronic access to an account in a federally insured depository institution or insured credit union.

Congress provided these protections to military borrowers in 2006 by enacting the John Warner National Defense Manpower Authorization Act. In addition to capping rates for loans to Service members, the Military Lending Act prohibited loans secured by personal checks and electronic access to bank accounts. We believe that these protections should be provided to all consumers. Irrevocable electronic access to borrowers' bank accounts is especially problematic for loans made via the Internet. We have seen contracts that make it impossible for consumers to withdraw account access authorization, allowing lenders to repeatedly withdraw funds for loan renewals.

3. Congress should forbid federally insured institutions from serving as a front for payday lenders by partnering with them in rent-a-bank arrangements. Although this practice has largely stopped, there are some holdouts, and there is currently no law or regulation prohibiting it.

4. States should revoke the special treatment of payday lending and impose an effective usury limit to protect necessitous borrowers from rate gouging. Bills to repeal payday loan exemptions from rate caps or to apply a universal small loan rate cap would provide to all consumers the protections Congress has conferred on Service members and their families.

5. Mainstream financial institutions should offer affordable, responsible small loan products to their depositors. We applaud FDIC Chairman Sheila Bair's leadership in proposing guidelines for responsible small loans and her call for military banks to develop products that meet the test of the Military Lending Act predatory lending protections. Banks and credit unions should extend their line of credit overdraft protection to more account holders.

6. Banks and credit unions should encourage emergency savings accounts for low and moderate income consumers. Emergency savings are essential to keep low income consumers out of the clutches of fast cash outlets. CFA's analysis based on Federal Reserve Board and other survey data found that families earning $25,000 per year with no emergency savings were eight times as likely to use payday loans as families in the same income bracket who had more than $500 in emergency savings. We urge banks and credit unions to make emergency savings easy and attractive for their customers.

Mr. KUCINICH. Thank you very much for your testimony.
Mr. McCarthy.

STATEMENT OF JIM MCCARTHY

Mr. MCCARTHY. Thank you.

Mr. Chairman, Congressman Turner, and members of the subcommittee, I appreciate this opportunity to discuss the subprime lending problem as faced by borrowers and ways in which the cities are affected by the rise in foreclosures.

My name is Jim McCarthy and I am president and CEO of the Miami Valley Fair Housing Center. I also currently serve as the Chair of the Board of Directors of the National Fair Housing Alliance, which is based here in Washington, DC, and is a consortium of more than 200 private, nonprofit fair housing organizations, State and local civil rights agencies, and individuals from throughout the country.

Since 2001, my agency has been implementing the Predatory Lending Solutions Project in Montgomery County, OH. Through the PLS Project, we assist residents of Montgomery County by providing outreach and education on the dangers of predatory mortgage lending and providing intervention and rescue services to the victims of predatory mortgage lending.

Fair housing enforcement is the most important fair housing issue facing our Nation; however, there is no strong commitment by the Federal Government to enforce the fair housing laws that we have. Fair lending, which is covered by the Fair Housing Act, is a key part of ensuring equal housing opportunity in our communities.

While the subprime lending market offers credit to high-risk borrowers at higher interest rates and fees, some lenders have capitalized on this extension of credit by steering vulnerable individuals, often on the basis of the borrower's race, ethnicity, age, or gender, to take loans whose terms they cannot possibly repay, and thus are not suitable to the borrower.

This practice of predatory lending is a serious fair housing concern. Our work suggests that homeowners were targeted by subprime lenders because they had significant equity in their homes, and their credit needs have been ignored by depository lending institutions. So the same neighborhoods that have been subjected to years of homeowner insurance redlining and mortgage lending redlining have now also been targeted as vineyards ripe for harvesting of the hard-earned equity in their homes.

This is having a devastating effect on our cities and our counties. In the past 6 years, the number of mortgage foreclosure filings in Montgomery County has more than doubled. In 2006, we had in excess of 5,075 mortgage foreclosure filings, which accounted for approximately 50 percent of all of the civil actions filed in Montgomery County Common Pleas Court.

Fair housing and consumer advocates have been sounding warnings regarding Ohio's subprime lending and foreclosure problems for years. In Ohio, foreclosed-upon homes often sit vacant for months or years, and once they are abandoned by their homeowners they become a huge cost to society.

The costs of abandonment are enormous. Even one or two abandoned properties force neighbors to tolerate eyesores that attract crime, arson, vermin, and dumping. Derelict buildings present safety and fire hazards, reduce property values, and degrade community quality of life. But perhaps most importantly it erodes the tax base and it inhibits the municipalities from providing basic services that we all expect, like police, fire, and schools.

Since the launch of our project, the need for our services has far exceeded our capacity to provide the services with the limited resources available. For those clients that we are able to assist, given our resources, we have been exceedingly successful in keeping them in their homes and getting them into appropriate loan products.

I would like to share with you just a few of those real quickly.

In one case we had a caucasian American married couple with adult children who were living outside of the home. When they came to us, their original loan amount was for $144,500. The value of their home, according to the Montgomery County auditor, was $97,470. Their interest rate on their original loan was 10 percent. We negotiated a short payoff to the offending lender for $89,600 and secured refinancing for the clients on a loan amount of $92,600 at a 6.375 fixed interest rate for 30 years. What is important to know is that in order to accomplish that it took us 113.5 staff hours.

One more example is an African American single female with three children who we assisted. Her original loan amount was $80,992.80, with an 11.051 percent interest rate and a monthly payment of $796.84. Her monthly payment did not include escrow or taxes and insurance. We negotiated a short payoff with the offending lender and secured refinancing for the client on a loan amount of $53,300, which is what the house was valued at, with a 6.5 percent interest rate fixed for 30 years and a monthly payment of $336.89, which included an escrow for her insurance and taxes. The staff time required to resolve this case was 124.5 hours.

As the work of our project clearly demonstrates, when consumers have effective advocates who are armed with the appropriate time and resources, intervention that keeps the homeowners in their homes and paying their mortgages is possible. Our clients are not deadbeat mortgage borrowers. They are hard-working individuals and families who are chasing the American dream of homeownership as it has been marketed by some of the largest and most wealthy residential mortgage lenders and brokers in the United States.

No matter what regulatory or legislative steps are taken to address the problem of predatory mortgage lending and its subsequent foreclosures, there absolutely must be resources designated to provide for legal and advocacy assistance to those individuals and families who have already fallen victim to some of the most pernicious practices ever seen in the residential lending market.

There is one other thing I wanted to say about legal representation, and that is our legal aid society can't help these folks. These are not folks who qualify at 100 percent of poverty, 200 percent of poverty, or 300 percent of poverty. These are folks who own their home, usually outright, and are working people who are just trying to improve their standard of living and make sure they have something to pass on to their children.

Legal Services Corp. is a great function, but they can't help these folks because of the constraints on who they are able to assist.

I would like to end by saying there are a couple of recommendations that Congress should implement and/or oversee. Congress should allocate at least $26 million to HUD's fair housing initiatives program in order to increase the education and enforcement efforts on the part of local fair housing organizations. Fair housing organizations, when properly funded, can serve as the infrastructure through which a lot of this could be addressed.

Congress should support and pass anti-predatory lending legislation that contains the following provisions: effective rights and remedies, prohibitions against steering, a suitability standard, designating high cost as including all the loan fees, no Federal preemption, and an advanced disclosure of all the costs and fees.

Congress needs to create a rescue fund to help people who have received discriminatory loans, predatory loans, or loans that were not suitable for their situations to convert those problematic loans into appropriate loan products.

And Congress should require Federal Government agencies, including HUD, the Department of Justice, and the Federal Trade Commission to undertake more aggressive, effective, and expansive fair lending enforcement activities. These agencies should consult with experts in fair housing enforcement and the organizations who provide it so that the Federal examination and enforcement programs best reflect the practices and state-of-the-art investigation techniques and litigation strategies that are being realized in private lawsuits that are being brought by fair housing agencies.

Thanks again for the opportunity. I am ready for any questions.

[The prepared statement of Mr. McCarthy follows:]

Testimony before the

HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM SUBCOMMITTEE ON DOMESTIC POLICY

"Foreclosure, Predatory Mortgage and Payday Lending in America's Cities"

March 21, 2007

Jim McCarthy
President/CEO
Miami Valley Fair Housing Center, Inc.
21-23 East Babbitt Street
Dayton, OH 45405
(937) 223-6035
jim.mccarthy@mvfairhousing.com

Testimony before the House Committee on Oversight and Government Reform
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I. Introduction

Good afternoon. Mr. Chairman and Members of the Subcommittee, thank you very much for this opportunity to discuss the subprime lending problem faced by borrowers and the ways in which cities are affected by the rise in foreclosures. My name is Jim McCarthy, and I am the President and CEO of the Miami Valley Fair Housing Center in Dayton, Ohio. I also currently serve as the Chair of the Board of Directors of the National Fair Housing Alliance.

The Miami Valley Fair Housing Center (MVFHC) is the only private, non-profit fair housing organization in the Dayton, Montgomery County, Ohio area, and an operating member of the National Fair Housing Alliance. Our mission is to eliminate housing discrimination and ensure equal housing opportunity for all people in our region. MVFHC works to educate the public and local housing professionals about their rights and obligations under fair housing laws and it conducts investigations into discriminatory rental, real estate sales, mortgage lending and homeowners insurance practices.

Founded in 1988 and headquartered in Washington, DC, the National Fair Housing Alliance is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights agencies, and individuals from throughout the United States. Through comprehensive education, advocacy and enforcement programs, NFHA protects and promotes residential integration and equal access to apartments, houses, mortgage loans and insurance policies for all residents of the nation.

Since January 2001, the Miami Valley Fair Housing Center has been implementing the Predatory Lending Solutions (PLS) project in Montgomery County, Ohio. PLS project is a multi-component project developed by the Fair Housing Center and its collaborative partners and has been used by other communities as a model in creating a program to address the problem of predatory lending. Through the PLS project, we assist residents of Montgomery County by providing outreach and education on the dangers of predatory mortgage lending, and providing intervention and rescue services to those residents who have been victims of predatory mortgage lending.

II. Fair Housing

The federal Fair Housing Act prohibits discrimination in the provision of housing and housing-related services on the basis of race, color, national origin, familial status, sex, religion or disability. Examples of discriminatory behavior include refusing to sell, rent or negotiate for housing; setting different terms, conditions or privileges for sale or rental of a dwelling, for a loan or for homeowner's insurance; and making housing or housing-related services unavailable, including mortgage loans, appraisals and homeowner's insurance. The National Fair Housing Alliance estimates that nearly four million violations occur annually against African-Americans, Latinos, Native Americans and Asian Pacific Islanders alone. Millions more violations are committed against people in all of the seven protected classes.

Fair housing enforcement is the most important fair housing issue facing our nation. However, there is no strong commitment by the federal government to enforce fair housing laws. In the past four years, the number of cases that the US Department of Justice's Housing and Civil Enforcement Division has filed overall has precipitously decreased by 29 percent. One major drop off in case handling has been with race cases; in the past four years, the number of race cases the section has filed has fallen drastically, by 43 percent. There is also a lack of commitment on the funding side. The US Department of Housing and Urban Development's Fair Housing Initiatives Program (FHIP), the primary avenue for federal funding of non-profit fair housing work, has not received its authorized level of $26 million in funding since 1995. Even the authorized amount will not come close to tackling the problem of housing discrimination in our country today.

III. Fair Lending

Fair lending, covered by the Fair Housing Act, is a key part of ensuring equal housing opportunity in our communities. Examples of lending discrimination include denying loans to African-American and Latino applicants who are similarly qualified as – or better qualified than – their White counterparts, offering less favorable loan terms and conditions, as well as higher points, to minority loan applicants and women; and engaging in disproportionate marketing efforts in minority and White communities. Research has found that African-Americans and Latinos encounter discrimination in their efforts to secure home loans.[1]

NFHA conducted its own fair lending investigation that revealed discrimination based on race or national origin in two-thirds of almost 600 tests conducted. The testing was conducted from 1993 to 1995 in eight cities: Boston, Chicago, Oakland, Atlanta, Dallas, Denver, Detroit, and Richmond. In two-thirds of the tests, Whites were favored over African Americans and Latinos; in only 3 percent of the tests, minority testers were favored over White testers. In all cases, the minority testers were better qualified for the loans than their White counterparts.

The testing revealed that:

- Whites were steered to superior loan products while African-Americans and Latinos were steered to FHA loans, even when their loan amounts exceeded the FHA loan limit.
- African-American and Latinos were told that the qualification standards were more stringent than those quoted to White borrowers.
- Closing costs were typically higher for minority testers.

[1] Turner, M., et.al., *All Other Things Being Equal.* April, 2002. Retrieved at www.huduser.org.

- Whites were given significant assistance in qualifying for loans while their minority counterparts were not and Whites received more information in writing than their counterparts.

Private lawsuits have historically been important to the effort to eliminate lending discrimination. Currently, most fair lending cases are brought by private fair housing organizations and individual attorneys. While these private efforts are very important, the full engagement of the responsible federal government agencies is an essential component of any serious effort to combat lending discrimination in all of its many, evolving forms.

Private organizations do not have the resources needed to undertake investigation, analysis and litigation of fair lending violations on a routine basis. This requires review and analysis of a wide range of documents related to marketing practices, underwriting and loan servicing policies, confidential personal data from actual loan files, and a variety of other information that lenders deem proprietary. While fair housing organizations provide a vital service in conducting testing and research activities to uncover fair lending violations, for both policy and practical reasons, the federal government must also be an integral partner the effort to enforce fair lending laws.

If the government fails to pursue such cases or does not engage in a competent effort to uncover lending discrimination by the lenders under its authority, then most lending discrimination will go unchecked. Indeed for the entire history of our country, it has. Lack of forceful federal enforcement actually provides a form of safe harbor for those in the industry engaging in discriminatory practices.

IV. How Fair Housing and Fair Lending Are Related to Predatory Lending

While predatory lending practices can occur in both the prime and subprime markets, the overwhelming number of predatory practices uncovered by fair housing organizations exist in the subprime market. While the subprime lending market offers credit to high-risk borrowers at higher interest rates and fees, some lenders have capitalized on this extension of credit by steering vulnerable individuals, often on the basis of the borrowers' race, ethnicity, age or gender, to take loans whose terms they cannot possibly repay.

This practice of predatory lending is a serious fair housing concern. Fannie Mae estimates that between 35% and 50% of subprime borrowers could have qualified for lower-cost market loans, but were instead targeted with sub-prime loans.[2] In a recent multi-state analysis of higher cost mortgage lending, researchers found that African-Americans in six metropolitan areas were 3.8 times more likely to obtain a higher cost loan than their White counterparts. The same study found that Latinos are 3.6 times more likely than their White counterparts to receive a higher cost loan[3].

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[2] Carr, J., et al., *Financial Services in Distressed Communities: Issues and Answers.* Fannie Mae Foundation. August 2001.

[3] Campen, Nafici, rust, Smith, Stein, Kerkhove; Paying More for the American Dream: A Multi-State Analysis of Higher Cost Home Purchase Lending, March, 2007. A Joint Report By: California Reinvestment Coalition,

Characteristics of predatory lending involve aggressive or targeted marketing to financially vulnerable households with unreasonable and unjustifiable loan terms and excessive fees; basing loan values on inflated appraisals; mandatory arbitration clauses that restrict the borrower's private right of action; pre-payment penalties offer no benefit to the borrower; and repeated refinancing that does not benefit the borrower and often jeopardizes his or her property.

Although predatory lending has become shorthand term for a variety of practices that include car title lending, payday lending and check cashing businesses, my work and thus my testimony is focused on residential real-estate transactions that involve financing a home or refinancing home-equity. Common abuses seen at my local agency include taking advantage of a homeowner's inexperience and lack of financial sophistication, manipulating a borrower into a loan that he or she cannot afford, inflating the appraisal value of a home to maximize broker/lender profit, steering prime borrowers to subprime lenders and charging points and fees, interest rates and prepayment penalties that are in excess of the borrower's actual risk to the lender.

Predatory lending becomes a fair housing and fair lending issue when lenders and/or mortgage brokers target specific populations, such as elderly, minority and low to moderate-income homeowners, particularly those with substantial equity in their homes; and/or aggressively market loan products that are not suitable to the borrower. At my agency, we define a predatory loan pretty simply as: any loan that is inappropriate for the borrower.

Predatory Lending in Montgomery County, Ohio

The pattern of predatory mortgage lending in the Dayton/Montgomery County area certainly bears this out. When we first began dealing with the issue at my agency, the majority of our clients were elderly individuals residing in inner-city minority neighborhoods. Many of them had owned their homes free of debt for a number of years, until they became involved with a subprime lender. Our work suggests that these homeowners were targeted by subprime lenders because they had significant equity in their homes, and their credit needs had been historically ignored by depository lending institutions. So the very same neighborhoods that have been subjected to years of homeowner insurance and mortgage lending redlining, have now also been targeted as vineyards ripe for harvesting of hard-earned equity.

Attorneys working on the Predatory Lending Solutions (PLS) project use these guidelines to identify loans that could be predatory:

- If the borrower is in foreclosure or has missed a payment or is struggling to make payments because of how inappropriately high the payments are, that is a predatory loan;

- Unless there was an unforeseen life event, like a job loss, major health problem, divorce or death of a spouse, borrowers should always be able to afford the loan they are given. If they can't, that loan was inappropriate for them;

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community Reinvestment Association of North Carolina, Empire Justice Center, Massachusetts Affordable Housing Alliance, Neighborhood Economic Development Advocacy Project, Woodstock Institute.

- If the borrower has a 2/28 Adjustable Rate Mortgage (ARM), and that borrower is not reasonably expecting to have a significant increase in income within the next 2 years, or planning on moving, that loan is inappropriate for the borrower and is a predatory loan;.

- If the borrower was lied to about any material (i.e. important) term of the loan, that is a predatory loan. (*Examples: interest rate, monthly payment amount, payment amount including amounts for taxes and insurance, fixed vs. adjustable rate, they would be refinanced in a year*);

- If the borrower was loaned more money than their house is worth, that is a predatory loan. This traps the borrower in that loan, because they will be unable to refinance or sell and they will not have equity;

- If the borrower was charged excessive closing costs, that is a predatory loan. Unfortunately, there is no maximum amount set in this regard. If a loan has points and fees that are 8.0% or more of the total loan amount, then it is a high cost loan and subject to the Home Ownership and Equal Protection Act (HOEPA), but just being a HOEPA-covered loan is not a violation.

Most predatory mortgage loans are made by subprime lenders, those lenders that specialize in loans to borrowers with less than perfect credit. While some subprime lenders represent a viable source of capital and credit to those who legitimately do not have access to the prime market, others have used unfair and deceptive tactics to harvest equity out of our neighborhoods for enormous profits.

The Devastating Effects on Our Cities

Predatory mortgage lending and its subsequent foreclosures result in a myriad of devastating and extremely costly consequences to our cities. Vacant, boarded-up homes lead to neighborhood destabilization, increased criminal activity, urban sprawl, declining property values and thus an eroding tax base. This dynamic diminishes the local government's capacity to provide basic services, such as education and police and fire protection, to its citizens.

Early in the PLS project, we commissioned a study of subprime lending in the Miami Valley area and the subsequent foreclosures. The study found that mortgage foreclosure filings in Montgomery County, Ohio increased from 1,022 to 2,451 over the period from 1994 to 2000, and that subprime lenders were responsible for a disproportionately high share of that increase. A substantial number of the subprime foreclosures sampled showed signs of predatory lending, including high interest rates, pre-payment penalties and balloon payments.

In addition, as the volume of loan foreclosure filings increased throughout the County, the relative share of filings in suburban jurisdictions increased. The City of Dayton's share decreased from 48 percent to 40 percent. This clearly identified the problem as more widespread than originally thought.[4] In the years since the study was completed, mortgage foreclosure filings in Montgomery County, Ohio have continued to skyrocket. In 2006, there were in excess of 5,075 mortgage foreclosure filings in Montgomery County alone, accounting for approximately 50 percent of all civil actions filed in Montgomery County Common Pleas Court.

V. Ohio's Foreclosure Problem

Fair housing and consumer advocates have been sounding warnings regarding Ohio's subprime lending and foreclosure problem for years. Ohio has been and is experiencing unprecedented levels of residential foreclosures that are having devastating effects not only on the individuals and families losing their homes to foreclosure but also for their neighbors and the cities they live in. For more than two years now, the Mortgage Bankers Association (MBA) has said that Ohio has the highest foreclosure rate in the country. The MBA found that the percentage of loans in Ohio that were somewhere in the process of foreclosure in the third quarter of 2006 was 3.3 percent. That gave Ohio the highest foreclosure rate, which was about three times the national average. The bankers group based its rankings on a sample of 43 million loans serviced nationally by banks and other financial institutions. The sample represented about 80 percent of all loans serviced nationally.[5]

The Cleveland/Lorain/Elyria/Mentor area had one foreclosure for every 40 households. Akron ranked 16th with one for every 43 households. Other Ohio cities in the top 100 were Dayton, which ranked 15th with one foreclosure for every 43 households and Columbus, which ranked 19th with one foreclosure for every 45 households. Cincinnati ranked 49th and had one foreclosure for every 87 households.[6]

In Ohio, foreclosed upon homes often sit vacant for months, sometimes years, once abandoned by their former homeowners. The societal costs of abandonment are enormous. Even one or two abandoned buildings force neighbors to tolerate eyesores that attract crime, arson, vermin, and dumping. Derelict buildings present safety and fire hazards, reduce property values, and degrade community quality of life.[7]

Because of the foreclosure crisis in Ohio, a task force consisting of the Cuyahoga County Foreclosure Prevention Office, Fannie Mae, the Federal Reserve, Freddie Mac, Miami Valley Fair Housing Center, National City Bank, NeighborWorks, Option One, and led by the Toledo Fair Housing Center worked throughout 2006 gathering information on foreclosures in the state and in November 2006, hosted the Ohio Foreclosure Summit in Toledo, Ohio. The purposes of the Summit were to: a) effect a reverse-catalyst to reverse the trend of increasing foreclosure filings in the state of Ohio; b) address some of the major issues effecting foreclosure rates by

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[4] *Predation in the Subprime Lending Market,* by: Richard D. Stock, Ph.D., Director, Center for Business and Economic Research, University of Dayton, with assistance from Marvin F. Hatsfield, Patrick S. Rooney, Ryan A. Cook (October 2001), available at *http://myfairhousing.com/cber/.*

[5] Ibid.

[6] Ibid.

[7] *Reinventing Dayton and the Miami Valley through Vacant Property Revitalization and Reclamation,* A National Vacant Properties Campaign Assessment Report by Joseph Schilling, John Kromer, and Jessica Millman (May 2005), *available at http://www.vacantproperties.org/latestreports/ReinventingDayton_Final.pdf*

providing substantive takeaways for Summit participants; and c) continue efforts begun by the Federal Reserve in its ground-breaking Foreclosure Conference. The Summit was also followed by a two-day foreclosure counseling workshop.

Prior to the Foreclosure Summit, a series of Foreclosure Workshops were held throughout the state in six locations: Youngstown, Cleveland, Bowling Green, Columbus, Dayton and Athens. We have a matrix that we would be happy to share with the committee that gives a breakdown of the responses to a series of questions that were posed at each location. The responses provided the four major themes addressed at the Summit: Predatory Lending; Policy and Legislation; Education for Counselors; and Improved Communications between the Borrower and Lender.

VI. The Predatory Lending Solutions (PLS) Project in Dayton and Montgomery County, Ohio

The Predatory Lending Solutions (PLS) Project was designed to offer prevention and intervention services to Miami Valley families who are current or potential victims of predatory mortgage lending practices. The project has been and is a collaborative effort of multiple non-profit community organizations and has been supported by our local Montgomery County, Ohio government, our local affordable housing trust, as well as the U.S. Department of Housing and Urban Development, Fannie Mae, and Freddie Mac. During the initial implementation of the PLS project, MVFHC was designated as the lead agency.

The Predatory Lending Solutions Project's design, as originally conceived, included the following four components: Community Education & Outreach; Intervention & Rescue Services; Community Impact Research; and Legislative Support. The project has been successful in reaching extraordinary numbers of consumers through education and outreach activities over the life of the project

Since the launch of the project, the need for our services has far exceeded our capacity to provide services with the limited resources available. Despite our success, blatant abuses continue to occur to Dayton and Montgomery County, Ohio residents. Following is a story that was related to me by an attorney in private practice in Dayton, Ohio just last week.

> "Jim, I want to share this with you. Even though I'm not a stranger to the practice of predatory lending, I found it disturbing. A week or so ago I was contacted by a title company in Chula Vista, CA. They said they needed an attorney to notarize a document in connection with a real estate transaction. It turned out I was to conduct a complete mortgage closing with an enormous stack of documents to be initialed, signed, witnessed, etc."
>
> "Finally the would-be borrower, a woman of 78, and her daughter came in to my office. The facts of the transaction amazed me. The woman is supposedly borrowing $290,000 to keep her deceased daughter's home in Atlanta, GA. Another daughter, who lives in CA, is to be a co-borrower. It turns out that the woman's only source of income is Social Security, and less than $600 per month. She owns her home in Dayton, together with a son & daughter-in-law who live in

North Carolina. The three of them borrowed about $37,000 on the Dayton property a few years ago. Her monthly expenses for the Dayton house are more than she receives from Social Security, but the daughter who came to the closing lives there, too, and helps with bills."

"The mortgage deal: She is to borrow $290,000 in two separate loans, one for $232,000, a second for $58,000. Payments on the first loan are $1,522 per month, INTEREST ONLY, for the first 10 years, the payments then go up about $500 more for the remaining 20 years. I can't remember amount of payments on the $58,000 part of the loan. Some of the facts of her financial situation were included in the loan documents, but there was also a form which was like a "don't ask, don't tell" disclaimer, saying she asserts she has the resources to make these payments and doesn't have to disclose all the information. I didn't let her sign that – I just couldn't."

Ultimately, the attorney who shared this story with me decided that she couldn't be part of this sham any more, notified the title company and sent the documents back un-initialed, and unsigned. But this story is not unique.

PLS Project Success Stories

For those clients we are able to assist, given our limited resources, we have been exceedingly successful in keeping them in their homes, and getting them into appropriate loan products. Below are some brief summaries of successful case resolutions accomplished by the PLS project to date.

Caucasian American married couple, with adult children who live independently.
Original loan amount $144,500
Home value = $97,470
Original loan Interest rate = 10.0%

PLS project negotiated a short-pay off of $89,600 to the lender, and secured refinancing for the clients on a loan amount of $92,600, with a 6.375% interest rate, fixed for 30 years.

Staff time required to resolve this case = 113.5 hours

African-American male, no children.
Original loan amount $35,000
Adjustable rate mortgage, for which he paid nearly $5,700, or more than 16% in closing costs.
Client was in foreclosure when he came to the PLS project, but he did have quite a bit of untapped equity.

PLS project negotiated a loan modification that waived all past-due payments, interest, late fees and litigation costs and received a fixed-rate loan that he could afford.

Staff time required to resolve this case = 53.0 hours

African-American male, 2 children
Client had two mortgages, one for $74,000 with a 10.15% interest rate and monthly payment of $657.62, which was 50% of his income. Second mortgage for $8,039 with a 17.99% interest rate and monthly payment of $184.72. The house was over-appraised.

PLS project negotiated loan modifications on both loans. First loan balance was reduced to $72,482.08, with a 6.50% fixed interest rate and monthly payment of $458.14. Second loan balanced was reduced to zero and lien released on property.

Staff time required to resolve this case = 102.5 hours

African-American married couple, 2 children
Original loan amount = $48,000 with a 12.079% interest rate and monthly payment of $523.11, with no escrow for taxes and insurance

PLS project negotiated loan modification down to the actual value of the house, $30,000.00, with a 9.0% interest rate fixed for 30 years, and monthly payment of $324.79, including escrow for taxes and insurance

Staff time required to resolve this case = 201.25 hours

African-American single female, 3 children
Original loan amount = $80,992.80 with a 11.051% interest rate and monthly payment of $796.84, with no escrow for taxes and insurance

PLS project negotiated a short payoff to the lender, and secured refinancing for the client on a loan amount of $53,300.00, with a 6.5% interest rate fixed for 30 years, and monthly payment of $336.89, including escrow for taxes and insurance

Staff time required to resolve this case = 124.50 hours

As the work of the PLS project clearly demonstrates, when consumers have effective advocates with appropriate time and resources, intervention that keeps the homeowners in their homes, and puts them in appropriate mortgage loan products, is possible. Our clients ***are not*** deadbeat mortgage borrowers. They are hardworking individuals and families chasing the "American Dream" of homeownership as marketed by some of the largest and most wealthy residential mortgage lenders and mortgage brokers in the United States. No matter what regulatory or legislative steps are taken to address the problem of predatory mortgage lending and its subsequent foreclosures, there absolutely must be resources designated to provide legal and advocacy assistance to those individuals and families whom that already fallen victim to some of the most pernicious practices ever seen in the residential mortgage lending business.

VII. Federal Regulators Must Improve Fair Lending and Predatory Lending Oversight

The federal agencies that regulate insured depository institutions, particularly the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the Federal Reserve Board (Fed), have the authority to conduct an effective process for fair lending examinations; however, their record of enforcement falls short of the mark and has not been effective at eliminating discrimination in the mortgage market. Disclosure is a valuable tool for the evaluation of lending practices, but it cannot replace forceful and effective enforcement activities undertaken by federal agencies. Financial regulatory agencies have referred some lending discrimination cases to the Department of Justice for enforcement actions; however, they are few in number.

We applaud the regulators for their recent proposed guidance that would extend their joint guidance on non-traditional mortgages to hybrid adjustable-rate loans, including 2/28s. This is an important move. However, regulators must become more aggressive about conducting systemic analysis of lenders' portfolios to ferret out fair lending violations. For example, regulators must conduct regression analyses of lender files that are inclusive of the lenders' subprime and prime books of business. More specifically, regulators need to perform regression analyses to specifically look at the occurrence of yield-spread premiums stratified by various protected class characteristics.

Foreclosures disproportionately affect minority communities that have traditionally not had access to main stream and prime lenders. From a fair lending perspective, when examining a lending institution that makes both prime and subprime loans, it is critical to review the institution's marketing and application procedures to ensure that all applicants have equal access to all reasonable products for which they qualify. It is also critical to look at the lenders distribution system. Does the lender have retail brick and mortar operations in predominately White, suburban communities while not having brick and mortar retail operations in predominately African-American and Latino neighborhoods? Does the lender, when considering its entire books of business, rely on mortgage brokers as its primary originators in predominately African-American and Latino neighborhoods?

While looking at these areas, it is also important to not forget more traditional analyses. For example, it is still important to look at origination and declination rates for Latinos and African-Americans versus Whites.

In addition, federal regulators are only looking at potential discrimination in loans through underwriting procedures, rather than more general fair lending and safety and soundness issues. The lending industry has convinced regulators that underwriting systems are completely objective and free of discrimination; however, that is not the case. For example, credit scoring, which is a key factor in underwriting programs, has been shown to have a disparate impact on people of color, women, and others.

Credit scoring systems are based upon data primarily culled from credit repositories. It is important to note that a significant number of African-Americans and Latinos currently and have historically obtained loans outside of the financial mainstream from lenders who do not report credit information to the repositories. This means that millions of bits of important information about the way African-Americans and Latinos obtain and maintain credit is not included in the data sets that are used to help build credit scoring systems.

This is a significant problem that the National Fair Housing Alliance has been addressing with lenders, regulators, rating agencies and the GSEs. To date, there is no fix. The reality is that current credit scoring systems may be good at assessing risk for consumers who operate within the financial mainstream. However, they are probably not as adept at assessing risk for consumers who operate outside of the financial mainstream.

Case Study in Lending Discrimination: Flagstar Bank, FSB

Because there are no public documents about the results of fair lending exams, it is difficult to assess the quality of the fair lending examination process. Community Reinvestment Act (CRA) evaluations are supposed to contain comments on whether the regulator found any evidence of discriminatory lending practices. However, statements in these public disclosures do not always contain accurate information of the findings of the fair lending exams.

The recent case of Flagstar Bank, FSB, represents that rare exception where we actually have proof of fair lending violations that we can compare to the public comments of the institution's regulator and to the CRA ratings given to the bank before and after the violations occurred. This case illustrates the disconnect between some lending institution behavior and the fair lending examination process by the federal financial institution regulatory agencies.

- Between February of 1994 and November of 2005, during which time the OTS gave Flagstar Bank "Satisfactory" and "Outstanding" CRA ratings, this lender was sued numerous times in federal court for issues related to discrimination in lending. Most lending cases are either dismissed by the courts or settled. Flagstar, in contrast, was found liable for discrimination at trial or by the court in at least two of these cases.

- In 1999, a jury in Detroit found Flagstar liable for discrimination against minority borrowers, and plaintiffs were awarded damages. In 2003, in a national class action suit, a federal court in Indianapolis found a written pricing policy developed by Flagstar management in 2001 so overtly discriminatory that the court ruled against Flagstar on summary judgment. The policy explicitly stated that pricing would be different for minority and non-minority borrowers. It appears that the discriminatory pricing policy was developed and implemented by Flagstar *while* the OTS was conducting its consumer compliance examination.

- The OTS conducted five CRA examinations and never found Flagstar in violation of discrimination laws. During this time period, Flagstar was given a "Satisfactory" CRA rating four times and was elevated to an "Outstanding" rating after the summary judgment finding in 2003.

This took place despite the seemingly extensive fair lending examination procedures (see the Interagency Fair Lending Examination Procedures). These procedures call for the review of "lending policies, marketing plans, underwriting, appraisal and pricing guidelines" (page 6) and for the review of "complaints alleging discrimination in residential loan pricing" (page 8). The procedures call for the review of possible indicators of overt discrimination, "including explicit prohibited basis identifiers in underwriting or pricing" (page 7). Clearly, these core examination factors were either ignored or the examiners for the OTS who were assigned to review one of the largest mortgage lenders in the nation did not understand the most basic tenants of fair lending.

Flagstar was one of the nation's twenty largest mortgage lenders during the period covered by this litigation. It sold loans to both Fannie Mae and Freddie Mac and was one of the largest underwriters of FHA loans through certification granted by HUD. After the judicial findings of lending discrimination, no sanctions were applied by the OTS, HUD, Fannie Mae, or Freddie Mac.

In fact, Flagstar was allowed to expand significantly during this time period by opening numerous branches, expanding into a new state and to additional metropolitan areas. The approval of its applications to expand was based, in part, on its CRA ratings. As a result, during the period from 1994 through 2005, Flagstar grew from just over $500 million in assets to nearly $13 billion in assets.

The Flagstar case raises serious concerns about the adequacy and effectiveness of the regulatory agencies' fair lending enforcement efforts.[8]

No Agency Regulates Independent Mortgage Companies for Fair Lending Compliance

To help alleviate the problems in the subprime market, the Federal Reserve should exercise its discretion as the agency with rule-making authority under the Home Ownership and Equity Protection Act (HOEPA) to limit the use of subprime exploding ARM mortgages.[9] HOEPA provides broad authority to prohibit unfair or deceptive mortgage lending practices and to address abusive refinancing practices on all mortgage

8 The section regarding Flagstar is from testimony by Calvin Bradford, Ph.D. before the House Financial Services Committee on Financial Institutions and Consumer Credit, "Home Mortgage Disclosure Act: Newly Collected Data and What It Means", June 13, 2006.

9 (l) DISCRETIONARY REGULATORY AUTHORITY OF BOARD.--

(2) PROHIBITIONS.--The Board, by regulation or order, shall prohibit acts or practices in connection with--

(A) mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section; and

(B) refinancing of mortgage loans that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower." 15 USC Section 1639(l)(2).

loans, not only high-cost loans; however, the Federal Reserve has never exercised this authority. By issuing a regulation under HOEPA, the Federal Reserve would ensure that all subprime mortgage loans in the country were subject to the same rules.

Although there are a few notable cases of state attorneys general who have used consumer protection statutes effectively to eliminate unfair and deceptive lending practices, on the whole, state regulation has not proven adequate to the task of fair lending enforcement. This is a gap that must be filled.

HUD has the authority as the lead agency in fair housing enforcement to initiate investigations and enforcement activities in this area, but, aside from some minimal cases of closing cost violations of the Real Estate Settlement Procedures Act (RESPA), it has not brought any fair lending enforcement actions against independent mortgage companies.

VIII. Federal Agencies Must Increase Their Fair Lending and Anti-Predatory Lending Enforcement Efforts

HUD, as the lead enforcement agency under the Fair Housing Act and the administrator of the Federal Housing Administration, has a critical role to play in fair lending enforcement. However, it has undertaken very little fair lending enforcement activity. Aside from the recent settlement between HUD and Fifth Third Bank, the level of fair lending enforcement activity by HUD has been negligible. Assistant Secretary Kim Kendrick has made a commitment to improving enforcement efforts at HUD and to reinvigorating the Secretary-initiated complaint process.

During the 1990s, the Department of Justice was a leader among government agencies in fair lending enforcement. These DOJ investigations set in operation a process by which both HUD and the financial regulatory agencies could refer pattern and practice cases to DOJ for investigation and litigation. These cases have set out legal strategies and formats for investigation and litigation in a wide range of lending issues from redlining to retail and wholesale pricing. Historically, the decade of the 1990s can be seen as the high point in federal enforcement efforts. As listed on its website, DOJ has filed twenty-three lending discrimination cases since the early 1990s, two of which are in the form of amicus briefs. Three of those cases allege discrimination in non-mortgage consumer credit transactions. Of the remaining eighteen cases, three have been filed since 2000. About half the DOJ cases have been referrals from OTS, OCC, or the Fed. DOJ cases filed since 2000 appear to be based on analysis of HMDA data from the late 1990s and early 2000s.

The Federal Trade Commission has authority over non-regulated lenders under the Equal Credit Opportunity Act (ECOA), but it has pursued almost no lending discrimination cases, although the FTC had an enforcement plan as far back as 1978 (See Discrimination in Real Estate Finance: The Role of the FTC Enforcement – A Report to the Federal Trade Commission, Pottinger and Company, 1978).

IX. Recommendations for Anti-Predatory Lending Legislation and Fair Housing Legislation

Congress, the Administration, and federal agencies must use their authority to undertake much stronger anti-predatory lending and fair lending activities, including investigations and enforcement. The following are recommendations that Congress should implement and/or oversee.

Fair Housing: Increased Appropriations and New Legislation

- Congress should allocate at least $26 million to HUD's Fair Housing Initiatives Program in order to facilitate increased education and enforcement efforts on the part of local fair housing organizations. A special component should be set aside for qualified fair housing organizations (QFHOs) to conduct activities to specifically address fair lending issues.

- Congress should support and pass fair housing legislation that contains the following provisions: an increased authorization level for HUD's Fair Housing Initiatives Program; a commitment of at least $20 million annually for fair lending and fair housing enforcement testing and actions; a commitment of at least $5 million annually to fund studies of the effects of housing segregation on our nation's communities. Draft legislation is currently circulating in both Houses.

Anti-Predatory Lending: New Legislation

- Congress should support and pass anti-predatory lending legislation that contains the following provisions: effective rights and remedies; prohibitions against steering; a suitability standard; designating "high-cost" as including all loan fees; no federal preemption; advance disclosure of costs and fees. (A detailed discussion of these provisions is in an attachment to this testimony entitled, "Leadership Conference on Civil Rights Position Paper on Predatory Lending Legislation.")

- Congress needs to create a rescue fund to help people who have received discriminatory loans, predatory loans or loans that were not suitable for their situations to convert those problematic loans into appropriate loans.

Aggressive Fair Lending and Anti-Predatory Lending Oversight and Enforcement

- Congress should require federal government agencies, including HUD, DOJ, and the FTC, to undertake more aggressive, effective and expansive fair lending enforcement activities. These agencies should consult with experts in fair lending enforcement organizations so that the federal examination and enforcement programs reflect best practices and state of the art investigation techniques and litigation strategies.

- Congress should require that HUD improve the quality of its training programs to increase the capacity of its investigators and Fair Housing Assistance Program (FHAP) investigators to investigate lending complaints.

- Congress should require that federal agencies that regulate insured depository institutions, particularly the OCC, the FDIC, the OTS, and the Fed, use their authority to undertake stronger oversight and enforcement activities to eliminate discrimination from the mortgage market. Any cases that regulators resolve with lenders on behalf of a few consumers should also be referred to DOJ for a pattern and practice investigation.

- Congress should ask the Fed for a status report on the 270 institutions that it flagged in 2005 and 2006 for additional investigation because of their pricing data and other issues.

- Congress should move to regulate all financial institutions active in lending. To fill the vacuum of fair lending enforcement activity for non-depository institutions, the Fed should use its authority to ensure that these institutions are in compliance with the fair lending laws. If this authority is lacking, Congress should grant the needed authority.

Changes Regulators Must Implement

- Regulators need to examine lenders in a holistic fashion reviewing data from retail and wholesale divisions as well as prime and subprime divisions together.

- Regulators should contract with private, qualified fair housing organizations to conduct comprehensive testing programs.

- Regulators need to run regression analyses on lender portfolios looking at origination, pricing, point of origination, costs, pre-payment penalty, and yield spread premium issues stratified by key protected class characteristics. Regulators are in a unique position to do this as they have access to full records and data.

Changes Investors Must Implement

- The securities industry and investors need to develop and implement effective screening programs and procedures to filter out predatory and discriminatory loans. Loans identified as having excessive fees, inflated appraisal issues, yield spread premiums, pre-payment penalties and other problematic provisions should be tagged for additional review.

- Investors need to be more flexible in offering work-out solutions for troubled consumers. They also need to make these solutions more accessible and transparent to consumers and counseling agencies.

Changes Lenders Must Implement

- Lenders need to change their platforms to make all of their loan products and services available to all consumers. Lenders need to concentrate efforts on making prime loan products accessible to consumers who qualify who come to the lender through the subprime door.

- Lenders need to expand their retail prime operations into historically under-served communities.

- Lenders should increase their efforts to partner with fair housing organizations and counseling agencies to expand counseling and loan education activities to consumers.

Changes Loan Servicers Must Implement

- Servicers need to abdicate a "dialing for dollars" and "collections" mentality for a "homeownership preservation" mentality.

- Servicers should base workout decisions leading to a long-term resolution of the consumer's delinquency on factual information, the availability of different options, and borrower qualifications.

- Servicers should provide superior consumer accessibility to information and assistance by using multiple methods of communication and by promoting financial literacy through partnerships with consumer groups, housing counseling agencies, government agencies and regulators.

- Servicers should provide a toll-free number, answered by loss mitigation specialists, for all counseling agency calls.

Thank you once again for the opportunity to testify before this Committee. I am available to answer any questions and assist in any way that we can to assure that this Committee, Congress and the government as a whole fulfill their duties to enforce fair lending nationwide.

Attachment to this testimony:

- *Leadership Conference on Civil Rights Position Paper on Predatory Lending Legislation*

Leadership Conference on Civil Rights

1629 K Street, NW
Suite 1010
Washington, D.C. 20006

Phone: 202-466-3311
Fax: 202-466-3435
www.civilrights.org

LCCR POSITION PAPER ON PREDATORY LENDING LEGISLATION

October 2006

Threats to the Homeownership and Financial Security of Diverse Populations

Today, too many individuals and families are targeted for abusive home loans that strip away their hard-earned home equity and put their homes at a high risk of foreclosure. People of color are at greater risk of losing hard-earned wealth—and even their homes—as a result of high-cost, risky lending and abusive servicing. These predatory practices also disproportionately impact the disabled, seniors and female headed-households.

Many people of color could qualify for more affordable and fair loans that would enable them to maintain and build additional wealth. Unfortunately, many prime lending institutions continue to underserve people of color. Although some in the subprime lending industry have claimed that factors such as income and credit histories account for racial disparities, credible reports and studies which control for these factors refute these claims. As early as 2000, HUD found that African-American families living in upper-income neighborhoods were more likely to receive subprime loans than White families living in low-income neighborhoods.[i] Fannie Mae and Freddie Mac report that as many as a third of the families who receive subprime loans actually qualify for prime loans.[ii] Two reports issued in May this year have shown that African-American and Latino individuals and families are much more likely to receive high interest rate loans than White individuals and families, even with the same credit profile.[iii]

While clearly not all subprime lending is predatory, a significant share of predatory lending takes place in the subprime market. Although there are predatory lenders in the prime market as well, predatory lending in the subprime market is particularly destructive to minority and other vulnerable communities. Subprime loans not only cost more over time, but can strip away wealth that has already been earned. Large fees and prepayment penalties, which are rare in the prime mortgage market, are much more common on subprime loans. Many subprime homeowners are put into loans they cannot possibly afford to repay by lenders and mortgage brokers.[iv] This happens in part because both have strong market incentives to push such loans. For example, mortgage brokers receive large bonuses—called yield spread premiums—for putting families in loans with higher interest rates when they qualify for lower-cost loans.

All of these onerous terms and abusive practices dramatically increase the risk of foreclosure. According to a study by the University of North Carolina, one in five families that received a subprime refinance home loan in 1999 had entered foreclosure at least once by 2004. In jurisdictions where lenders are permitted to begin foreclose without judicial review (roughly half the states[v]) borrowers have little to no recourse to protect themselves other than to delay the foreclosure process by declaring bankruptcy.

Essential Elements of Predatory Lending Legislation

Any predatory lending law should include these essential provisions:

Effective rights and remedies: These include: (1) the availability of a private right of action and class actions, which are often the only effective way to gain appropriate remedies to these abusive practices and deter bad actors; (2) strong remedies and penalties for abusive acts; (3) effective assignee liability so that borrowers can bring their claims against those who buy, service, securitize or collect (including foreclose) on their loans; and (4) prohibitions on mandatory arbitration clauses that weaken victims' legal rights and prevent them from bringing claims to a court of law. Without these fundamental procedural protections, any substantive consumer protection rules are unenforceable. There needs to be greater accountability for all players in the mortgage industry.

Prohibitions against steering: Steering borrowers to loans with interest rates far higher than they qualify for is very costly for people of color, and must be prohibited for all home loans.

A suitability standard: Many borrowers are being placed in loans they cannot possibly afford to repay. Lenders and mortgage brokers should ensure that a loan is suitable for the borrower's objectives and circumstances.[vi]

"High-cost" must include all loan fees: Predatory lending laws typically define high-cost loans and provide protections for those loans that are the most likely to be subject to abuse. To provide effective protections for these loans, the definition of a high-cost loan must include all of the different loan fees that lenders and brokers charge, including prepayment penalties and yield spread premiums.

No federal preemption: The majority of states have passed laws to address predatory lending. Many of these laws have been highly effective in reducing abusive lending without impeding access to credit. In order to protect states from increasing claims of preemption, any federal law must permit states to enforce their own laws. State protections have a proven track record, such as requiring counseling before borrowers are sold a high-cost loan and curbing prepayment penalties on subprime loans. Historically, federal laws have set floors for protections, and states have been able to build on these federal protections.[vii] In this area of mortgage lending it is especially important that state authority be preserved, as abusive lenders rapidly develop new abusive tactics that will not be addressed by any federal law.

Advance disclosure of costs and fees: Too often borrowers discover at the closing table that the terms and conditions of their loan have changed. At this point, it is often difficult for the borrower to negotiate a return to the original deal or to postpone the closing to allow for further discussions with the lender. All lenders should be required to provide at least seven (7) days prior to closing, the final terms, conditions and costs of the loan to the borrower. This disclosure should also include any costs and fees associated with servicing.

[i] For example, one study by HUD in 2000 found that as much as one-half of refinance loans made in predominately black neighborhoods are subprime. U.S. Department of Housing and Urban Development and U.S. Treasury Department. 2000. *Curbing Predatory Home Mortgage Lending.* Washington, DC: U.S. Department of Housing and Urban Development.
[ii] See, e.g. Freddie Mac. Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families. Washington, D.C. September 1996. See also Anthony Pennington-Cross, Anthony Yezer, and Joseph Nichols, Credit Risk and Mortgage Lending: Who Uses Subprime and Why? Washington, D.C.: Research Institute for Housing America, Working Paper 00-03 (finding that probability of Afriean American borrower receiving subprime loan increased by 1/3 compared with white borrower, controlling for risk).
[iii] Debbie G. Bocian, Keith S. Ernst and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, Center for Responsible Lending (May 31, 2006); Allen J. Fishbein, Patrick Woodall, *Exotic or Toxic? An Examination of the Non-Traditional Mortgage Market for Consumers and Lenders*, Consumer Federation of America (May 2006)
[iv]The most common subprime loan, known as a "2/28," has a low rate for the first two years and then monthly payments increase by 40-50%, even if market interest rates do not go up. Most families cannot absorb this large payment shock, and their homes are put at risk of loss.
[v] NCLC Repossessions and Foreclosures Manual, Appendix (5th ed. 2002 and Supp. 2004).
[vi] Many professions require practitioners to serve their clients best interests. For example, investment advisors are required to sell only suitable products to their clients. Similarly, state-licensed real estate agents work explicitly for the seller or buyer.
[vii] For example, the Fair Housing Act states that "nothing in the Act will be construed to invalidate or limit any law of a State or political subdivision of a State." 42 U.S.C. § 3615.

Mr. KUCINICH. Thank you very much.
Ms. Haynes.

STATEMENT OF RITA HAYNES

Ms. HAYNES. Thank you, Mr. Chairman and to the committee. My name is Rita Haynes, and I am the manager/CEO of Faith Community United Credit Union in Cleveland, OH, and I am past chair of the National Federation of Community Development Credit Unions.

Faith Community Development Credit Union, popularly known as Faith, is a community development credit union with 6,000 members and approximately $10 million in assets. We are a certified CDFI, chartered in the State of Ohio to serve anyone who lives, worships, or works in Cuyahoga County.

In the credit union's 55 years of operation, Faith has been in the forefront of creating and implementing financial products and programs that assist lower-income residents in building wealth. One of our more successful products is the Faith-developed Grace loan. The Grace loan is an alternative to the predatory payday loan initiated in 1999 to combat the flow of our membership to predatory payday lenders who moved into our area when most banks vacated the inner city.

In our research, we found that our members needed a product that was fast, simple, and a convenient way to obtain cash when an emergency arose. We named our product the Grace loan because it is based on unmerited favor, and therefore no credit report was required.

The payday lenders require a pay stub and a post-dated check. We disagree with this. In our financial literacy training, we have taught against using an instrument that was basically no good.

Since our electronic records detailed the information that we received from the member's application, no check is required for the Grace loan. This shortens the time and simplifies the process.

The Grace loan requires that a resident have a share account of at least $50 and an electronic deposit to their transactions or savings account for 3 months before they can apply for a Grace loan.

Whereas the payday lenders charge an application fee of $17.50 to $22 per hundred, we charge a flat $15 application fee for up to $500, which must be paid in advance. By not financing the application fee, the member receives the full amount that they borrowed.

After explaining to them that they are saving $72.50 to $95.00 in fees, we get their commitment to save at least $10 with the repayment of their loan, that they must leave in a savings account for at least a year. The Grace loan must be repaid in full with a 17 percent interest rate, which averages around $7 for 30 days on a $500 loan. Payments can be paid in one or four payments within a month, depending on their pay cycle.

We will allow up to 12 loans a year, but we try to wean them off of this product by lowering the amount they get monthly or skipping a month to only use this product when it is truly an emergency.

After a year of positive history, members can apply for a regular loan at a lower interest rate or an amazing Grace line of credit, which requires less paperwork. The member's credit history is reported to the credit bureau in either case.

In 2006 we made 2,023 Grace loans totaling $697,755, and we only charged off seven loans totaling $1,922.53.

Here is what some of our members have said about our program: "I have saved money without even using checks, and I have also improved my credit history with Faith."

"When it came to repairing my car to get to work, I had no choice but to borrow before payday. I am so glad the Grace loan was available."

"It was worth using my Grace line of credit when I ran short to pay my mortgage on time, avoiding the $55 late charge and damaging my credit."

I thank this committee for this opportunity to testify, and I would be happy to answer any questions that you might have.

[The prepared statement of Ms. Haynes follows:]

TESTIMONY BEFORE THE
HOUSE SUBCOMMITTEE ON DOMESTIC POLICY
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

Wednesday, March 21, 2007
2154 Rayburn House Office Building
Washington, DC

Rita Haynes
Manager and CEO, Faith Community United Credit Union

Good afternoon, my name is **Rita Haynes**, and I am Manager and CEO of **Faith Community United Credit Union** and I am honored to have been asked to provide this testimony before this Subcommittee on Domestic Policy.

Faith Community United Credit Union, popularly known as "Faith," is a community development credit union chartered in the State of Ohio to serve anyone who lives, worships, or works in Cuyahoga County.

In the credit union's fifty-five years of operation, Faith has been in the forefront of creating and implementing financial products and programs that assist lower income residents build wealth. One of the more successful of these products is the Faith-developed **"GRACE LOAN"**. The Grace Loan is an alternative to the predatory payday loan, initiated in 1999 to combat the flow of our membership to predatory payday lenders who moved into our area when most banks vacated the inner city.

In our research, we found that members needed a product that was fast, simple and a convenient way to obtain cash when an emergency or the need for extra cash arose. We named our product a "**GRACE LOAN**" because it is "unmerited favor "and therefore, no credit report is required. Payday lenders require a pay stub and a postdated check. Since our electronic records are detailed, we can verify the members income source with their application and no check is required. This shortens the time and simplifies the process. Furthermore, we teach against the use of postdated checks in financial literacy training.

The **"GRACE LOAN"** requires that the resident have a share account of at least $50.00 and an electronic deposit to their transaction or savings account for three months or more before they can apply for a Grace Loan.

Whereas the payday lenders charge an Application Fee of from $17.50 - $22.00 per hundred dollars, we charge a flat $15.00 application for up to $500.00, which they must pay in advance. By not financing the application fee, the member receives the total amount they borrow.

After explaining to them that they are saving from $72.50 - % 95.00 on fees, we get their commitment to save $10.00 with the repayment of the loan that must remain in the savings account for a year.

The **"GRACE LOAN"** must be repaid in full in a month with interest of 17% APR, which averages around $7.00 for the 30 days on $500.00. Payments can be paid in one to four payments within the month, depending on their pay cycle.

We will allow up to twelve loans a year but try to wean them from the product by a lower monthly amount or skipping months and truly using in case of emergency. After a year of positive history, members can qualify for a regular loan at a lower interest rate or an **"AMAZING GRACE LINE OF CREDIT"**, which requires less paperwork. The member's credit history is reported the credit bureau in either case.

In 2006 we made 2,023 Grace Loans totaling $ 697,755.00, and charged off 7 loans totaling $1,922.53.

Here's what some of our members have said about the program:

"I've saved money without even using checks and also improved by credit with Faith's Grace Loan."

"When it came to repairing my car to get to work, I had no choice but to borrow before payday. I'm so glad the Grace Loan was available."

"It was worth using my Grace Line when I ran short, to pay my mortgage on time, avoiding the $55.00 late charge and damaging my credit."

Thank you for this opportunity to testify before your committee. I would be happy to answer any questions you may have.

Mr. KUCINICH. Thank you very much. I would like to say that we are in the middle of another vote. We are going to recess until 7. I would appreciate it if you can remain.

Is there any witness here who has to catch a plane right now? Sir, what time is your flight?

Mr. JACOB. It is at 7:55.

Mr. KUCINICH. I am going to ask Mr. Jacob, why don't you testify right now? Why don't you testify, and then you can go. I am going to ask Mr. Jacob if he could testify briefly, and I am going to invite the gentleman from the other panel to come forward and we will swear you in. This has been an extraordinarily long day. Some of you came in around noon. I don't want you to miss your flight, so let's see if we can all accommodate each other here, and then I will dash. Congressman Davis, I will be shortly behind you.

If you could proceed, Mr. Jacob, and if you could keep your testimony a little bit limited we will get it on the record. We will put your full statement in.

STATEMENT OF ED JACOB

Mr. JACOB. Thank you, Chairman.

Chairman Kucinich, members of the subcommittee, I appreciate the opportunity to testify today. You will hear from others about the payday lending industry. I would like to focus in on our product, our payday alternative loan [PAL].

We developed this loan in mid-2002, and we did that as a result of the story that you saw in the video with one of our members. We received support for this product from the National Credit Union Administration. They were very supportive, both on the regulatory and examination side, and also from the CDFI fund of the U.S. Department of Treasury.

We structured our loan as a $500 loan, 16.5 percent, payable over 6 months. The reason we structured it as a term loan is, as Congressman Cummings noted earlier, the payday lending industry really structures their loan in a way to encourage rollovers, in a way that is really not able to be repaid in 2 weeks or in 1 month. The goal is to bring new members into the credit union.

We have made over 4,200 of these loans over the last few years, totaling over $2 million. To date we have had to charge off about $140,000, or about 6 percent of these loans, and our 60-day delinquencies are about 5 percent. While this is higher than the rest of our portfolio, it is manageable for us and sustainable in that way.

There are other financial institutions that are offering alternatives to payday loans, to which I say the more the merrier. I don't want to corner this market. The more banks, the more credit unions that are involved in this, certainly the better, including Southside Community Federal Credit Union in Congressman Davis' District is offering an alternative product.

We have learned three lessons from our work in this area. First, in general, the product is not used for one-time emergencies. You will often hear the stories from the payday lenders about somebody's car breaking down and they need to fix their car to get to work. Our experience is that these are people who are living paycheck-to-paycheck, week-to-week, really in some cases living a week-before-paycheck-to-week-before-paycheck. That is why the traditional payday loan is so destructive. There is no way for them to get out of that cycle of debt, and so they continue to roll it over.

The second thing that we have learned is an issue of profitability. We structure this product to be sustainable, not a profitable product but a sustainable product, and we have gotten to the case where that is the case for us now. One way to certainly increase the sustainability is to reduce the transaction cost, and there are banks that are larger than I am and credit unions that are larger than I am that can use technology and other ways to cut the transaction cost.

The second thing is to view profitability on a relationship basis. The individual who comes in and joins the credit union to take out a payday alternative loan will later be with us when they need an auto loan or when they need the mortgage loan, and we need to view profitability on a longer timeframe than just that one initial loan.

So far we have made over 150 loans totaling over $600,000 to what we call PAL graduates, people who started out with a payday alternative loan and graduated to larger loans with us.

I don't want to be the cheapest payday lender. That is not why I am in business. In some ways the most important difference between the work we do and Ms. Haynes does and a payday lender is that we want to move people out of these products. We don't want them stuck in an endless cycle of debt with us, and that is the important thing.

You saw the story of the woman who is a member of ours who paid $3,000 to borrow $3,000. Every dollar that she paid to a payday lender is a dollar that was drained from our community. For the 4,200 payday alternative loans we have funded so far, our members have saved over $3 million compared to traditional payday loans.

I am a small $8 million credit union sitting on the north side of the city of Chicago, and I have saved my community $3 million. If I can do that from my 2,500 square foot location on the north side, think what other larger banks with better technology, better knowledge, better expertise can do. I encourage other traditional financial institutions, good financial institutions to get into this marketplace.

Thank you very much.

[The prepared statement of Mr. Jacob follows:]

Testimony of Edward H. Jacob, Manager/CEO
North Side Community Federal Credit Union
Before the House Oversight and Government Reform Committee
Subcommittee on Domestic Policy

Chairman Kucinich, Ranking Member Issa, and distinguished members of the Subcommittee, I appreciate the opportunity to testify before you today on the issue of payday lending.

I am Edward Jacob, Manager of North Side Community Federal Credit Union in Chicago. Before coming to North Side since 1999, I worked at Bank One and its predecessor banks, First Chicago and First Chicago NBD in lending and Community Reinvestment positions.

North Side is a 33 year-old community development credit union with assets of $8 million and loans totaling over $3.5 million. We are certified as a Community Development Financial Institution (CDFI) by the U.S. Treasury, and have a low-income service designation from the National Credit Union Administration (NCUA). North Side offers savings and checking accounts and ATM cards to 3,000 members. Loan products include small consumer loans, VISA credit cards, new and used auto loans, and a small number of home equity and mortgage loans.

North Side serves individuals who live or work in the Chicago neighborhoods of Lakeview, Uptown, Edgewater and Rogers Park. These neighborhoods, while undergoing revitalization over the past decade, continue to be economically and ethnically diverse with many individuals who are unable to utilize traditional financial service institutions. For these community residents, North Side serves as an alternative to the many predatory financial institutions operating in the neighborhood.

Throughout our 33-year history, North Side has focused our efforts on helping low- and moderate-income people build wealth through basic financial service products. We focus our products and services on the low-income and unbanked segments of our community, offering savings and checking accounts with no minimum balance, and invest heavily in financial literacy programs for people to better understand how to budget and save. Our loan products target specific unmet needs where we can add value for individuals and the community.

THE PAYDAY LENDING INDUSTRY

If there is one thing the booming payday business in the last 15 years has proven, it is that there is demand for small, short-term loans. The industry has grown from 200 outlets in 1993 to over 25,000 outlets today, and now increasingly, payday loans are also available on-line. They do roughly $48 billion in annual business, with over $8 billion in annual fee income, have over 20 million customers, and process over 160 million transactions annually. According to the Community Financial Services Assoc. of America, 68% of their customers are under 45 years old, 75% have incomes over $25,000 and 25% have incomes over $50,000, and 42% own their own home. All have checking accounts (if accessing a traditional payday loan, the customers typically write a post-dated check or repay the loan from an ACH withdrawal from an existing account).

One of the reasons the industry has enjoyed this rapid growth is that they offer convenience – a borrower can walk in and have their loan 15 minutes later. But of course this convenience comes at a price. When we have members come into the credit union who are in trouble with payday loans, we ask to see a copy of their loan note. We have seen notes with APR's ranging from 300% to over 900%.

DEVELOPMENT OF THE NORTH SIDE PRODUCT

Prior to the development of our Payday Alternative Loan (PAL), North Side offered a small, $500 credit builder loan for our members, but required membership for one year for the loan. As we worked to develop our Payday Alternative Loan (PAL), we had the assistance of many private and public sector partners. The National Credit Union Administration has been supportive of our work both on the regulatory and examination side, and with their Office of Small Credit Union Initiatives (OSCUI). The CDFI Fund of the

U.S. Department of the Treasury provided initial financial support. We participated in the National Community Investment Fund's Retail Financial Services Initiative, which helped us measure profitability of the loans. Local banks have also provided support – both financial and technical as we developed and studied the product.

We developed our Payday Alternative Loan (PAL) in mid-2002. What prompted us to get involved is what you just saw in the video, when one of our members brought in her sister who was in trouble with payday loans. She'd taken out seven payday loans, owed about $3,000, and was using every paycheck just to pay the rollover fees on her loans.

While she paid $3,000 in interest and rollover fees on these loans for a few months, she had not paid a penny of principal on her loans. Not only that, when we ran her credit report, none of the payments showed on her credit report. Not only was there $3,000 gone that she couldn't spend on her kids, or on investing, or on a downpayment for a home, but she wasn't building up a positive credit history. Her story, and similar stories from other community residents pushed us to act.

STRUCTURE AND UNDERWRITING

We structured our Payday Alternative Loan as a $500 loan, at 16½%, for a six-month term. We structured it as a six-month term loan because we felt the structure of a traditional payday loan (with the entire balance due in one month) encouraged rollovers. Realistically, few borrowers have the ability to re-pay the entire loan after two weeks or one month – so they begin to be caught in the trap of an ongoing cycle of debt. Initially, we offered the PAL with no minimum credit score. The goal was to bring new members into the credit union, and then work with them to improve their financial situation.

We made an underwriting changes in December of 2004, when we instituted a minimum credit score of 580 for new PAL borrowers. If the applicant doesn't meet the minimum credit score, we will still make the loan, but we require that they go through our financial training program. We want to work with them, but they also have to show us a commitment that they want to improve their financial knowledge and their financial future.

In some ways, North Side PAL borrowers are similar to those of the payday lending industry noted earlier. Credit scores (which were run initially for statistical purposes only) averaged 532, and only 10% had scores over 600. Many people had previously taken out payday loans, but over 25% were unbanked, and never had a checking or savings account. Of the borrowers, 60% were African-American, 17% Latino, 14% Anglo, 5% Asian. Over 60% of the borrowers were female, and 95% made under $40,000/yr in income. Over 40% of the borrowers identified the use of the funds as "paying bills," although in some cases we made loans to pay off existing payday loans.

We have made over 4,200 of these loans over the last five years, totaling over $2.1 million. To date, we have charged-off about $140,000, roughly 6.7%. As of the end of February, our 60-day delinquencies are 5%. While obviously higher than other loan products, PAL is a sustainable product with this portfolio performance.

OTHER FINANCIAL INSTITUTIONS OFFERING ALTERNATIVE TO PAYDAY LOANS

I am pleased that North Side is not alone in working to develop alternatives to payday loans. Over the past four years, other banks and credit unions have also developed and tested products in this area. In 2004, the National Federation of Community Development Credit Unions (NFCDCU), with the support of JP Morgan Chase, created the Alternative Products to Payday Lending (APPLE) program, through which seven credit unions in six states were selected to create and develop alternatives to high-cost "payday" loans.

The credit unions selected include ASI Federal Credit Union in Harahan, LA, Bethex Federal Credit Union in the Bronx, NY, Faith Community United Credit Union (in Chairman Kucinich's district in Cleveland, OH), Lower East Side People's Federal Credit Union in New York, NY, Northeast Community FCU, Mission Area FCU and Patelco CU in San Francisco, CA, South Side Community Federal Credit Union in Chicago, IL, and West Texas Credit Union in El Paso.

State Employees Credit Union in North Carolina has also been a leader in providing small, short-term loans to it's members. Through it's salary advance program, it provides over $20 million a month in short-term, affordable (12%) loans to it's members, and in 2003, it developed a savings enhancement, whereby 5% of the loan proceeds are deposited into a savings account to help the borrower break the cycle of ongoing debt.

Banks are also working to serve this market. In Chicago, Austin Bank of Chicago offers a payday alternative product, and First Bank of Oak Park has partnered with a community organization in West Garfield Park to offer a product. LaSalle Bank, partnering with the Local Initiatives Support Corporation, also offers small emergency loans in 11 Chicago communities.

LESSONS LEARNED

I believe here are three key lessons we have learned over the past four years with our Payday Alternative Loan product.

1. The product is not used for a one-time emergencies.

In a large percentage of instances, people are not taking out these loans for a one-time emergency. If I had a dime for everyone who told me the car broke down, and they needed to fix the car to get to work, I would be a wealthy man. Someone once asked me once what was the solution to payday lending problem in our country. I said it is simple - build better cars. But the reality is that many people face ongoing cash flow problems. They are not just living week-to-week and paycheck-to-paycheck, but living a week **before** paycheck to a week **before** paycheck. That is the reality of many Americans. And that is why the traditional payday loan is so destructive. They are being offered to customers who continually roll them over because they are unable to pay the loan back when it is due. The repeat customer is the payday lenders most profitable customer. The purpose of our PAL is to get our member out of the cycle of debt, and to move on to other wealth-building products.

2. Issues of profitability

I am often asked about the profitability of our PAL product. In late 2002, we were fortunate to be chosen to participate in the Retail Financial Services Initiative (RFSI), sponsored by the National Community Investment Fund. Through RFSI, six banks and six credit unions who were working on products to serve low-income and unbanked markets received assistance in product development, underwriting, and measuring profitability. This was a three-year project to try new products to reach out to the unbanked and to measure profitability of the products.

The goal for our PAL is to have a sustainable product. A $500 loan at 16½% for six months generates only $25 in interest income. As a federally chartered credit union I have an interest rate cap of 18% on my loans. State chartered credit unions and banks can charge a higher APR.

North Side has not structured the product to make money on it on a product basis. As payday lenders have shown, they can be tremendously profitable at 400%, even with high charge-offs. But I believe small consumer loans, appropriately underwritten and done efficiently, can be profitable on a stand-alone basis at between 20% and 30%.

One way to increase profitability is to reduce the transaction costs as much as possible. Use of technology and offering an electronic product can cut the transaction costs significantly, and improve product profitability.

At North Side, we view profitability on a relationship basis. Over time, how many PAL borrowers are staying with us, moving on to better products for themselves and for us as a financial institution. We measure a number of things with our PAL borrowers – the use of other deposit products (and balances), and whether they later take out larger loans (eg. Auto loans) that are profitable.

So far we've made over 150 loans totaling over $600,000 to what we call PAL "graduates", members who started with a payday alternative loan, and were able to move on to larger loans. As members take out auto loans and mortgage loans, those are loan we can make some money on.

3. Moving people out of the cycle of debt is a difficult issue.

I don't want to be the cheapest payday lender. I'm pleased that we are saving our members and the community so much money, and providing an alternative to the payday lenders, but the most important difference between North Side and a payday lender (even more important than the interest rate) is that I want to move people **out** of my payday alternative loan product. This is often the most difficult thing for us. It is not my mission and vision in life to have members come in and take out this loan every six months. And that is where I think the really hard work is, is to take people along a better financial path. Alternatives Credit Union in New York has developed a model called the Credit Path, a model of how to help people build net worth and build assets. All of us, banks and credit unions, have got to do a better job of this.

CONCLUSION

We are pleased with the results of our work over the past few years in this area. It has been a successful product for North Side - we have established it in a sustainable way, and it has helped us grow our membership and provided ancillary marketing benefits. But more importantly, it has been a successful product for the community and our members. Every dollar that is paid in interest and fees to a payday lender represents a drain on the local community. As seen earlier in the video, one of our members who had taken out 7 payday loans paid over $2,900 in interest and rollover fees over a 4-month period. When she refinanced this loan with us, and successfully paid off the loan in 6 months, she paid less than $85 in interest. This left over $2,800 in additional funds to meet the needs of housing expenses, food, clothing or savings, all of which can be recycled in the community to boost the neighborhood economy.

For the 4,200 Payday Alternative Loans we have funded so far, our members have saved over $3 million compared to interest and fees which would have been paid on typical payday loans. These are funds which, instead of being stripped from the neighborhood economy, can be used to build community wealth.

I'm a small, $8 million credit union on the north side of Chicago, and I've saved my members and my community about $3 million compared to traditional payday loans. If I can do that from my 2,500 square foot storefront, think of what other larger financial institutions can do with their expertise, their knowledge, and their technology. We all can do more, and we must.

Thank you very much.

Mr. KUCINICH. Thank you very much, Mr. Jacob. Your full statement will be in the record, as well as a transcript of the video. We are very grateful. If you wish to leave right now so you can get your flight, you certainly have permission of the Chair.

I want to ask Mr. FitzGibbon to come forward.

[Witness sworn.]

Mr. KUCINICH. Let the record reflect that the witness answered in the affirmative. You may proceed.

STATEMENT OF THOMAS FITZGIBBON, JR., MB FINANCIAL BANK, ROSEMOUNT, IL

Mr. FITZGIBBON. Thank you very much.

Just a quick briefing. I am the executive vice president of a commercial bank that is traded on the NASDAQ Stock Exchange. We are an $8.3 billion bank. But my love is in community development. I head up the Community Development Corp. for the bank and am very active in community development activities, including being chairman of the NHS of Chicago and several other nonprofit organizations.

With that as a background, with my testimony in writing in place here, you asked about and Congressman Davis asked about resolutions. I think there are some things.

I served for 3 years on the Consumer Advisory Council to the Board of Governors to the Federal Reserve during the time up until 2004, when they were exploring ways in which they could change, amend the rules for CRA. Out of that came a lot of controversy with the OTS going off on its own to come up with its own rules, and several other controversial things that went on for years after that.

The real challenge here is that we have a dual financial system here. We have financial feed, if you will, in this country, with the wholesale or limited purposes banks that are allowed to do certain things that suck deposits out of markets where those deposits are needed by the regulated depositories to put into work in our communities. That needs to be changed. We need to work on that.

That discussion and debate went on for 3 years while I was there, and no real resolution came out of it. We need to get back to that CAC and tell them they need to come back with some more look at that wholesale unlimited purpose charter that is out there.

I have not seen one single community development investment or deal that has been done by ING Direct in Chicago while we hear the sucking sound of deposits going out of that market.

[The prepared statement of Mr. FitzGibbon follows:]

Hearing on Sub-prime Mortgage Issues March 21, 2007

Testimony of **Thomas P. FitzGibbon, Jr.**, Executive Vice President MB Financial Bank, President of MB Financial Bank Community Development Corporation and President of Neighborhood Housing Services of Chicago, Inc.

Thank you for the opportunity to present for discussion the issues that face our nation's banking industry and the communities that we serve with access to quality credit and financial services. I also come here representing some of the non-profit intermediaries that help the regulated depositories reach into the low- and moderate-income markets within the communities that the depositories serve.

Since 1997 I and many of my peers in the regulated depository banking industry have raised the issue of how many of our neighbors and neighborhoods have been systematically preyed upon by the unscrupulous and many cases predatory practices imbedded in the mortgage lending delivery system. Often, although not always, the delivery system has been plagued by mortgage brokers and others driven only by commissions and fees and not in the best interests of the consumer. Recognizing this problem the banking industry and the City of Chicago Housing Department in 2000 established the NORMALsm loan program in partnership with Neighborhood Housing Services of Chicago, Inc. (NHS) to provide capital to refinance customers out of improvident and imprudent loans that their mortgage broker had talked them in to. Often these borrowers were unsophisticated in financial matters. Often these customers were elderly or had challenges with the English language. I cite for example a case (Cook County, Illinois) #04 C 0120 Hernandez v. Euromex Mortgage in which the borrower had been convinced to refinance a mortgage just short of the expiration of a prepayment penalty that cost them an additional $7,000.00 along with other onerous fees and charges that were not fully disclosed to the borrower. Transcripts of the opinion and settlement will be provided upon request.

So, although the problem is just now coming to the attention of Wall Street investment community and the bank regulators, those of us who have seen the "train wrecks" impacting individual home owners in our communities have been dealing with these issues for years. Many of us in the banking community have advocated at the state level to provide more aggressive supervision of the delivery system. The fact is that the state agencies have only recently enacted modest licensing and supervision controls over a burgeoning market of individual brokers. Some states don't even have any regulations that govern the business. The current mortgage delivery system, if properly supervised, can add to the efficiency, lower cost and easier access to mortgage capital for the consumer. Unfortunately the trade-off to efficiency and ease of access has often been to abuse that efficient access to mortgage capital by adding onerous terms and inappropriate, if not outright predatory products that do not fit the "suitability" of the customer's financial condition. Add to that volatile mix the access to exotic mortgage products and you have a formula for financial disaster that only the mortgage broker as originator of the loan benefits from. As I said in open testimony on Predatory lending hearings conducted by then Assistant Secretary for HUD Bill Apgar in 2000 that "the mortgage lending industry has connected the crooks with the capital markets".

There are three major themes that I would like to address with the previous information as a backdrop:

- Where does the capital come from to fuel this problem?
- Do the CRA rules that govern regulated depositories impact capital access?
- Would expansion of the Community Reinvestment Act to other industries in the consumer finance business improve access to quality mortgage products?

Capital Access

Investors have been chasing the buzz of ever higher yields as more conservative similar investment yields have dropped or remained stagnant.

In the last three years, for example, big banks and brokerage firms almost doubled the amount of residential loans they issued, going to $1.1 trillion in 2006 from only $586 billion in 2003 and much less than that in previous years.

To remarket these individual loans the syndicators have moved these loans into collateralized debt obligations and then sold them to pension funds, hedge funds, banks and insurance companies. In 2005 nearly 81 percent of the $249 billion in collateralized debt obligation pools consisted of residential mortgage products.

These obligations contain segments (tranches) that are based on credit quality. The syndicators developed securities that included high yield tranches a large portion of which included sub prime residential mortgage loans.

What used to be imbedded in the sub prime collateralized debt obligations were loans to professionals early in their careers (doctors, lawyers, etc.) where the prospect for future income was somewhat predictable is now surpassed by what the industry refers to as "affordables", loans to home buyers where the anticipation in the increase in home value is the underlying source of quality. Most of these loans are what one would consider exotic (adjustable-rate interest-only loans, 40-year loans and piggy-back second mortgage loans, payment option loans).

So what I see is a mortgage market driven by capital access from Wall Street syndicators driven to provide enhanced rates of return for their investors. The conventional (GSE) market programs have focused on driving capital into low- and moderate-income communities in partnership with community based organizations and local depositories where the prospective home buyer has access to good information that enables them to make informed decisions.

Do the CRA rules that govern regulated depositories impact capital access?

The Community Reinvestment Act (Regulation BB) was designed to address access to credit by all consumers, small businesses and small farms. The fact that the rating system designed in the early 1990's and implemented in 1995 as the "Performance Context" examination rules gives greatest weight to lending in the banks' assessment area (50% of the Large Bank test and more in the new Intermediate Small Bank CRA test).

The Q&A on CRA rules promulgated by the FFIEC give Lending Test credit for loans originated by others. Often the demand in LMI communities for home purchase and small business are in markets where the regulated depository has difficulty penetrating.

Over the years the lenders who were successful in originating loans in those markets found willing investors in and through Wall Street where a business that aggregated loans in CRA-qualifying markets developed. Major nation-wide mortgage wholesale firms, the conventional secondary markets (GSE), and other non-profit intermediaries have been successful in filling the orders from CRA-regulated institutions to improve their performance in penetrating LMI communities. The bank regulators do not give as much inherent CRA credit for such transactions unless they can be qualified as part of Community Development Lending (CDL) segments of the examination. Normally the CDL credit is given when the underlying credit qualifies as a Community Development Loan.

Unfortunately the underlying credit loan characteristics have not been considered in the CRA examination, therefore even loans with exotic terms and onerous conditions can qualify for CRA-eligibility. The loan characteristics (i.e., terms, cost, rate, etc.) until recent changes in HMDA reporting rules have been difficult to determine by the examiners. In 2001 the New York State Banking Commission in part issued the following:

The Department has concerns regarding sources of funding for predatory lending activities, and therefore reiterates its position that favorable consideration for CRA purposes will not be given for loans or investments that violate federal or state consumer protection laws, including fair lending regulations. Although institutions may receive a non-binding, advisory opinion from the NYSBD regarding the eligibility of a proposed activity for CRA consideration pursuant to Part 76 of the General Regulations of the Banking Board, these loans and investments should also conform to the following guidelines in order to receive favorable treatment in a Performance Evaluation:

- **High Cost Home Loan originations by supervised institutions, their subsidiaries and affiliates, in order to receive favorable consideration under the CRA, must comply with Part 41 of the General Regulations of the Banking Board. The Banking Department's examiners will routinely sample**

a portion of an institution's originations in order to determine such compliance.

- **Purchases of High Cost Home Loans, if such loans have been made to low and moderate income borrowers or low and moderate income areas and are otherwise eligible for CRA consideration, should be accompanied by documentation in the files of the purchasing lender sufficient to support the fact that a satisfactory due diligence review was performed by it on such loans.**
- **Investments in mortgage backed securities, if such securities include underlying High Cost Home Loans to low and moderate income borrowers or low and moderate income areas and are otherwise eligible for CRA consideration, should be accompanied by evidence documenting the extent to which a due diligence review was performed by the investor on the underlying High Cost Home Loans.**

The current Q&A for CRA rules does not address the quality of the underlying credit.

Would expansion of the Community Reinvestment Act to other industries in the consumer finance business improve access to quality mortgage products?

It has been argued for years that the access to residential mortgage and small business credit has changed dramatically since 1977, the year that the CRA was enacted. In 1977 the mortgage banking industry was in its infancy, the credit unions were mostly very small affinity-based institutions and the thrift industry was alive (barely) and challenged on how to deal with disintermediation and deregulation.

Much has changed since those days. As you know the basic reason for the enhanced CRA in 1991 was FIRREA, the near-collapse of the deposit insurance system and the need to derive some social benefit from the U.S. taxpayer's bailout of FSLIC and to some extent the FDIC insurance fund.

Well times have changed. The vast majority of the residential mortgage lending in this country is driven by the mortgage banking industry. The mortgage banking industry is supported in many ways by the regulated depositories either through warehouse lines of credit, direct loan purchases or outright ownership of the mortgage banking company. The largest small business lender in the country is American Express, only recently replacing The Money Store as the nation's largest small business lender. Many Credit Unions now are the main source of consumer deposit relationships and many now have huge assets and memberships that defy the affinity definition that were once preeminent and enjoy special tax relief that allows them to offer more aggressive deposit pricing as a result. In addition we have seen foreign companies and internet banks under special bank chartering rules eat up local deposits without much return and little direct or indirect investment in local markets. I am still trying to find one community development deal in Chicago that ING initiated while the sucking sound from deposit outflow in Cook County was heard.

It is important for these other players in the deposit and credit business to play a more significant role in local community development. Our little bank has been fortunate to find a way to drive locally-derived capital into our LMI communities while earning a reasonable return on our investment. We feel that it is important for our survival as a strong bank that our community grows economically and that the residents of our community have access to quality credit and deposit products. We do CRA because it is good business. We also believe that the others who benefit from access to government and government-supported programs (deposit insurance, GSE investments, special tax status, etc.) should also be subject to community development and Community Reinvestment Act-like requirements. In that way the access to capital for LMI markets, small business and small forms would lead to a better quality credit product for all.

Mr. KUCINICH. What I would like to do is to ask staff if you would be in touch with the witness so that we can get these observations, Mr. FitzGibbon, because it is very valuable to hear that because of the position you are holding in the industry.

I would like to say this. I must leave immediately to get to vote.

Mr. FITZGIBBON. No problem.

Mr. KUCINICH. There are votes on the floor. I am going to declare the committee in recess until 7:05, at which time we will continue with the testimony. I am very grateful.

Mr. FITZGIBBON. That is OK. Let me ask one more thing. The Alternative Mortgage Instrument Parity Act, you need to look at that. That is another instrument and a congressional act that in the 1970's, which supersedes State law and allowed these alternative mortgage instruments to be done. That is another way in which you can deal with it. OK?

Mr. KUCINICH. Thank you very much. We are in recess until about 7:05. Thank you.

[Recess.]

Mr. KUCINICH. The committee will resume.

We will pick up with Mr. Rothstein. I want to thank all the witnesses for their patience in remaining through these series of votes and say that after this panel and a period of questioning we will go to the other representatives who are here. Thank you so much for participating in this discussion and being willing to wait through this very long day here.

Mr. Rothstein, please proceed.

STATEMENT OF DAVID ROTHSTEIN

Mr. ROTHSTEIN. Thank you.

Chairman Kucinich, distinguished members of the subcommittee, thank you very much for the opportunity to appear before you today. I am David Rothstein, a researcher with Policy Matters Ohio. We are a nonprofit, nonpartisan organization that provides research on economic issues that matter to low and moderate income working families in Ohio.

We appreciate your invitation today to discuss our recent research on payday lending in Ohio. The economic situation for many of Ohio's workers is very difficult. Policy Matters research has shown that Ohio wages have been stagnant, employment has not recovered from the last recession, and those who do work are often without health care or retirement benefits.

This troubling economic climate is worsened by predatory lending from companies who sell loans to working families at egregious rates, often 391 percent for a 2-week payday loan.

In a recent report, Policy Matters found that payday lending locations in Ohio had increased dramatically from 107 in 1996 to 1,562 in 2006. For those 11 years, there was a 1,400 percent increase in lending locations across Ohio. What's more, our analysis found that, while payday lenders were concentrated in mostly urban areas in 1996 in the early part of our study, by 2006 they were in urban, suburban, and rural neighborhoods, alike.

Mr. KUCINICH. If I could interrupt your testimony just for a minute, you know, one of the things that you have in your prepared executive summary, which I think is worth everyone in this room hearing, is that Ohio has more payday lending locations than McDonald's, Burger King, and Wendy's restaurants combined.

Mr. ROTHSTEIN. That is correct, sir.

Mr. KUCINICH. That is an image worth recalling. Please continue.

Mr. ROTHSTEIN. Sure. I suppose I can take that sentence out of my testimony then.

Mr. KUCINICH. Actually, it bears repeating. Go ahead.

Mr. ROTHSTEIN. The report, Trapped in Debt, maps the growth of lending locations from a small number of scattered locations in 1996 to 86 of Ohio's 88 counties in 2006. That means that there were only two counties in Ohio without payday lenders.

Large urban counties had the most payday lenders in absolute terms, but less-populated counties had a greater number of lenders per capita.

Our report found that, as Chairman Kucinich stated, they are so common throughout Ohio that by 2006 there were more payday lending locations than McDonald's, Burger King, and Wendy's restaurants combined.

The sheer volume of payday lenders in Ohio is problematic because of the weak regulation of the industry. Ohio has a maximum limit of $800 per loan, with a maximum allotted charge of $15 for every $100 borrowed. As the Center for Responsible Lending estimates, most borrowers are repeat borrowers, taking out loans between 7 and 14 times per year.

In Ohio, borrowers cannot roll over their loans but can do back-to-back transactions, where after a 24-hour cooling off period they can take out a loan to repay the previous loan.

Payday lending affects various demographic groups. Our analysis, surprisingly, found little relationship between lending locations and areas of low and moderate-income housing where African American census tracks.

A recent study found that lenders who cultivate more repeat business from existing customers will fare better financially than those who do not. I am going to repeat that. A recent study found that lenders who cultivate more repeat business from existing customers will fare better financially than those who do not, so they have an incentive to get repeat borrowers.

In the business of payday lending, all workers in Ohio and other States are potential clients, regardless of race, income, or living area.

Lenders in Ohio are mostly chains or franchises. The two most common locations are Advance America and Cashland Financial Services, with more than 100 locations each. In fact, the top 10 lending companies in Ohio account for more than 55 percent of all payday lenders in Ohio. One lender in Ohio, Buckeye Check Cashing, receives substantial financing in grants and loans from the State of Ohio to expand operations in Ohio.

The lending industry in Ohio is extremely volatile, as well, with lending locations opening and closing frequently within a given year. For instance, in 2005 a total of 113 payday lending locations closed, but 357 new locations opened. That same year, 12 locations opened and then subsequently closed in that year.

A $500 loan in Ohio can carry an origination fee of $50 and interest charges of $25, for an effective APR of, again, 391 percent for the 2-week loan.

Borrowers face an even more difficult situation when the loan comes due because their economic situation is often the same or worse than before, meaning they either need another loan to repay the first loan or they default on the post-dated check. Thus, the cycle of borrowing keeps borrowers trapped in a constant state of debt.

In our report we recommend the protections extended to service members and veterans in the Talent-Nelson Amendment be extended to all working families. Capping lending rates at 36 percent, while still a high effective APR compared to other loans and forms of borrowing, is a vast improvement over loans made in the 300 percent range.

Additionally, credit unions and banks should be offering competitive, fair, and responsible loan products to working families in their communities. We have heard testimony from people at this table who are doing just that.

Fair and responsible lending is an economic and social benefit to the entire community. Members of Congress can play a pivotal role in implementing these policy recommendations, which again benefit the entire community.

Mr. Chairman, distinguished members of the subcommittee, we thank you again for the opportunity to present our findings on the dangerous expansion of payday lending in Ohio. We strongly believe these policy recommendations will lead to a better economic situation for everyone involved. We look forward to working with the subcommittee and to Members of Congress on issues of payday lending and other economic issues.

I look forward to any questions you may have. Thank you.

[The prepared statement of Mr. Rothstein follows:]

POLICY MATTERS OHIO

CLEVELAND: 3631 PERKINS AVENUE SUITE 4C EAST • CLEVELAND, OHIO 44114 • TEL: 216/931-9801 • FAX: 216/361-9810
COLUMBUS: 1372 GRANDVIEW AVE. SUITE 242 • COLUMBUS, OHIO, 43212 • TEL: 614/486-4601 • FAX: 614/486-4603
HTTP://WWW.POLICYMATTERSOHIO.ORG

Testimony of David Rothstein

Researcher, Policy Matters Ohio

"Trapped in Debt: The Growth of Payday in Ohio"

Hearing on Foreclosure, Predatory Lending, and Payday Lending in America's Cities

Before the Subcommittee on Domestic Policy of the
House Committee on Oversight and Domestic Reform

March 21, 2007

SHARES

Chairman Kucinich, Ranking Member Issa, distinguished members of the Subcommittee, thank you very much for the opportunity to appear before you today. I am David Rothstein, a researcher for Policy Matters Ohio, a nonprofit, nonpartisan organization that provides research on economic issues that matter to low- and moderate-income working families in Ohio. Policy Matters provides this research and education with the objective of fostering an economy that works for all Ohioans. We appreciate your invitation to discuss our research on payday lending in Ohio.

The Economy in Ohio

The economic situation for many Ohio workers is difficult. Policy Matters' research has shown that Ohio wages have been stagnant, employment has not recovered from the last recession, and those who do work are often without health care or retirement benefits.[1] This troubling economic climate is worsened by predatory lending from companies who sell loans to working families at egregious rates, often 391% for a two-week payday loan.

Payday Lending Explosion in Ohio

In a recent report co-authored with the Housing Research and Advocacy Center, Policy Matters Ohio found that payday lending locations in Ohio had increased dramatically from 107 in 1996 to 1,562 in 2006. In those 11 years, there was a 1400% increase in lending locations across Ohio. What's more, our analysis found that while payday lenders were concentrated in mostly urban areas at the beginning of our analysis, by 2006 they were in urban, suburban, and rural neighborhoods. The report, "Trapped in Dept," maps the dispersal of lending locations from a small number of scattered locations in 1996 to

[1] Please refer to the report by Amy Hanauer of Policy Matters Ohio entitled "The State of Working Ohio," included with this testimony.

86 of Ohio's 88 counties by 2006. [2] Large urban counties had the most payday lenders in absolute terms, but less populated counties had a greater number of lenders per capita. Payday lenders are so common throughout Ohio, that by 2006, there were more payday lending locations than McDonalds, Burger King, and Wendy's restaurants *combined.*

The sheer volume of payday lenders in Ohio is problematic because of the weak regulation of the industry. Ohio has a maximum limit of $800 per loan, with a maximum allotted charge of $15 for every $100 borrowed. The Center for Responsible Lending (CRL) estimates that most borrowers (99 percent) are repeat borrowers, taking out loans between seven and 14 times a year. In Ohio, borrowers cannot "roll over" their loans but can do back-to-back transactions where after a 24-hour cooling off period, they can take out a loan to repay previous loans.

Payday lending affects various demographic groups. Our analysis found little relationship between lending locations and areas of low- and moderate-income housing or African-American tracts. A recent study found that "lenders who cultivate more repeat business from existing customers will fare better financially than those who do not."[3] In the business of payday lending, all workers are potential clients regardless of race, income, or living area.

[2] Please refer to the report by David Rothstein and Jeffrey D. Dillman entitled "Trapped in Debt: The Growth of Payday Lending," in Ohio included with this testimony.
[3] Michael A. Stegman and Robert Fairs "Payday Lending: A Business Model that Encourages Chronic Borrowing" Economic Development Quarterly (February 2003).

Lenders in Ohio are mostly chains or franchises. The two most common locations are Advance America and Cashland Financial Service, with more than 100 locations each. The top 10 lending companies in Ohio account for more than 55 percent of all payday lenders in Ohio. One lender in Ohio, Buckeye Check Cashing, received substantial financing in grants and loans from the State of Ohio to expand operations in Ohio. The lending industry in Ohio is extremely volatile with lending locations opening and closing frequently within a given year. For instance, in 2005, a total of 113 payday lending locations closed but 357 new locations opened. That same year, 12 locations opened and then closed in that same year.

A $500 loan could carry an origination fee of $50 and interest charges of $25 for an effective APR of 391% for the two-week loan. Borrowers face an even more difficult situation when the loan comes due because their economic situation is often the same or worse than before, meaning they either need another loan to repay the first loan or they default on the post-dated check. Thus, the cycle of borrowing keeps borrowers trapped in a constant state of debt.

Recommendations

In our report, we recommend that the protections extended to service members and veterans in the Talent-Nelson Amendment be extended to all working families. Capping lending rates at 36 percent, while still a high APR compared to other loans and forms of borrowing, is a vast improvement over loans made in the 300 percent range. Additionally, credit unions and banks should be offering competitive, fair, and responsible loan products to working families in their communities. Fair and responsible lending is an economic and social benefit to the entire community. Members of Congress can play a pivotal role in implementing these policy recommendations, which again, benefit the entire economic community.

Conclusions

Mr. Chairman, Ranking Member Issa, distinguished members of the Subcommittee, we thank you again for the opportunity to present our findings on the dangerous expansion of payday lending in Ohio. We strongly believe that our policy recommendations will lead to a better economic situation for everyone involved. We look forward to working with the Subcommittee and to Congress on payday lending and other economic issues.

TRAPPED IN DEBT:
THE GROWTH OF PAYDAY LENDING IN OHIO

A REPORT FROM:

POLICY MATTERS OHIO

Housing Research & Advocacy Center

DAVID ROTHSTEIN

JEFFREY D. DILLMAN

FEBRUARY, 2007

AUTHORS

David Rothstein is a research assistant at Policy Matters Ohio, where he researches tax, wage and consumer policy. David serves on the Steering Committee for the National Community Tax Coalition. He has a B.A. from John Carroll University in Cleveland and a Master's in Political Science from Kent State University, where he is pursuing a Ph.D.

Jeffrey D. Dillman is the Executive Director of the Housing Research & Advocacy Center. He received his J.D. from Boalt Hall School of Law, University of California, Berkeley, and has practiced civil rights, consumer, and immigration law for over 15 years.

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POLICY MATTERS OHIO is a nonprofit, nonpartisan research institute dedicated to researching an economy that works for Ohio. Policy Matters seeks to broaden debate about economic policy by doing research on issues that matter to working people and their families. With better information, we can achieve more just and efficient economic policy. Areas of inquiry for Policy Matters include work, wages, education, housing, energy, tax and budget policy, and economic development.

THE HOUSING RESEARCH & ADVOCACY CENTER is a nonprofit organization whose mission is to eliminate housing discrimination and assure choice in Northeast Ohio by providing those at risk with effective information, intervention, and advocacy. In addition to addressing traditional issues of housing discrimination and segregation, the Housing Center also provides research, education, and analysis of subprime and predatory lending practices and trends in the region.

Executive Summary

The number of payday lending or check cash lending locations in Ohio and nationwide has exploded in the past decade. These shops offer short-term, high-interest loans against a future paycheck. Fees in Ohio are usually $15 for every $100 borrowed for a two-week period, which amounts to an annual percentage rate of 391 percent. This study from the Housing Research & Advocacy Center and Policy Matters Ohio analyzed data on Ohio payday lending locations from the Ohio Department of Commerce. Among the findings:

- The number of payday lending stores licensed in Ohio catapulted from just 107 locations in 1996 to 1,562 locations in 2006, growing by a multiple of more than fourteen.
- Ohio has more payday lending locations than McDonalds, Burger King, and Wendy's restaurants combined.
- In 1996, payday lenders were concentrated in urban communities. Twenty-one Ohio counties had payday lenders and most of these had just a handful of locations. Only Cuyahoga, Franklin, Hamilton and Montgomery counties had more than ten locations, centered in Cleveland, Columbus, Cincinnati and Dayton.
- Payday lending has since become a much more ubiquitous part of the overall Ohio landscape. By 2006 every Ohio county except for Ottawa and Vinton had at least one payday lender. Thirty-five counties had more than ten locations, and nine counties had forty or more locations.
- Franklin (183), Hamilton (123), and Cuyahoga (160) counties each had well over one hundred payday lenders in 2006.
- Large urban counties have the most payday lenders in absolute terms, but less populated counties have a greater number of lenders per capita. Of the ten counties with the highest concentrations per capita, not one is a large urban county. Washington County had the highest concentration, with 3.32 lenders for every 10,000 people. Belmont and Gallia counties ranked second and third with 3.13 and 2.90 per 10,000 people.
- Most payday lending locations in Ohio are chains or franchises. The two most common locations are Advance America and Cashland Financial Services, with more than 100 locations each.
- The Center for Responsible Lending (CRL) has shown that just one percent of payday loans go to borrowers who repay within two weeks and borrow less than once a year, while 99 percent go to repeat borrowers. The average borrower takes out nine loans per year.
- Nationwide, the CRL estimated in 2005 that 7.6 million workers receive 83 million payday loans per year. Of this 7.6 million, two-thirds, or five million, become trapped in this cycle of debt, at an annual cost of $3.4 billion.

The report ends by recommending that Ohio borrowers be provided the same protections that were recently enacted on the federal level for military families. These would ensure reasonable and transparent costs for loans, preserve legal protections, and protect assets of Ohio borrowers.

"You load 16 tons and what do you get? Another year older and deeper in debt."
- Merle Travis

INTRODUCTION

Payday lending has exploded in Ohio and the nation over the past decade, mushrooming from an occasional presence in the most troubled urban neighborhoods to a ubiquitous challenge in nearly every Ohio county. Nationwide, the payday lending industry has doubled since 2000 to 25,000 payday loan stores selling more than $40 billion in loans.[1] Payday lending costs American families more than $4.2 billion in 2005, with Ohioans paying more than $209 million in fees.[2] These numbers do not include the massive growth in the Internet payday loan market, which is difficult to quantify across state boundaries.[3]

Payday loans are short-term, high-interest loans against a subsequent paycheck. The loans are made available to anyone with a checking account and a source of income who is willing to write a post-dated check for the amount of the loan plus the lender's fees. Fees are exorbitant; in Ohio, they are typically at the state maximum of $15 on each $100 borrowed. Since the borrower usually has only two weeks to repay, this fee amounts to an annual percentage rate of 391 percent or more, a fact which is frequently concealed from or not well explained to borrowers.[4] These loans can be difficult to repay, and the lenders make it all too easy to borrow again. Many borrowers quickly find themselves deeper in debt, and still unable to deal with basic or extra expenses.[5]

The short repayment period leaves many borrowers unable to pay off the loan when it comes due. In Ohio such borrowers have two options: "back-to-back" transactions, or default. Ohio, along with other states, attempts to protect borrowers by prohibiting rollovers of loans. Lenders have managed to get around these restrictions by offering "back-to-back" loan transactions. Borrowers who choose this option pay off the first loan and immediately take out a new loan to cover basic expenses until the next paycheck. This requires the borrower to pay the lending fee every two weeks without receiving any new money in return until he or she can repay the full amount of the original loan.[6]

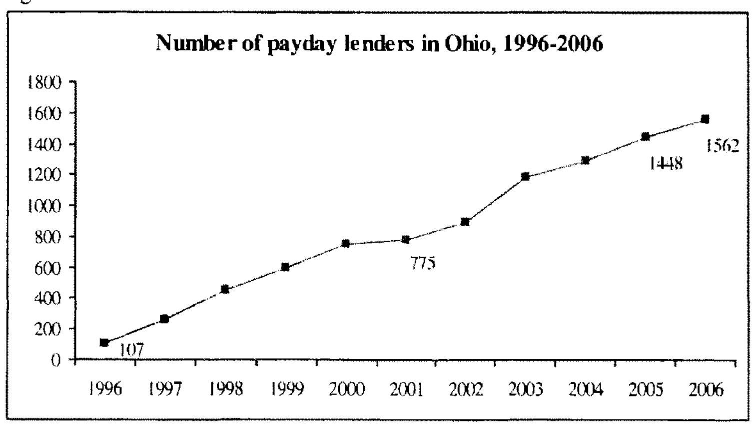
[1] See Sheila Bair, "Low-Cost Payday Loans: Opportunities and Obstacles" Annie E. Case Foundation (June 2005), Christopher Conkey, "Payday lenders strike a defensive pose: Voluntary limits on advertising, new repayment options aim to war off fresh regulations," Wall Street Journal (February 21, 2007).
[2] Uriah King, Leslie Parrish and Ozlem Tanik, "Financial Quicksand: Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year," Center for Responsible Lending (November 30, 2006).
[3] Jean Ann Fox and Anna Petrini, "Internet Payday Lending: How High-priced Lenders Use the Internet to Mire Borrowers in Debt and Evade State Consumer Protections," Consumer Federation of America (November 30, 2004).
[4] Center for Responsible Lending, "Payday Lending Basics" (January 1, 2001).
[5] Center for Responsible Lending, "Predatory Payday Lending Traps Borrowers" (2005).
[6] Keith Ernst, John Farris, and Uriah King, "Quantifying the Economic Cost of Predatory Payday Lending" (February 24, 2004).

LENDING IN OHIO

Payday lending has become much more widespread nationwide and in Ohio. To measure its expansion in Ohio, we gathered data on payday loan stores (referred to as "check cash lenders" in Ohio) from the Division of Financial Institutions, Department of Commerce for the State of Ohio. The data provides names, addresses, and license information for payday loan locations for each of the 88 counties in Ohio from 1996 until 2006. We then overlaid their locations geographically with census tract data. Ohio does not keep records on the number of loans made or the number of dollars lent, so the number of establishments is the best way to measure growth in this practice.

The number of payday lending shops licensed in Ohio has grown exponentially from 107 locations in 1996 to 1,562 locations in 2006.[7] There are more than fourteen times as many payday lending locations than there were a decade ago, spread across a much wider landscape. There are now more check cash lending shops than McDonalds, Burger King, and Wendy's restaurants combined in Ohio.[8]

Figure 1



Source: Authors' analysis of payday lending location data from Ohio Division of Financial Institutions, Department of Commerce.

In 1996, payday lenders in Ohio were concentrated in urban communities. At that time, only 21 Ohio counties had any payday lenders and most of these had just a handful of locations. Only Cuyahoga, Franklin, Hamilton and Montgomery counties had more than ten locations, centered in Cleveland, Columbus, Cincinnati and Dayton. By 2006 every Ohio county except for Ottawa and Vinton had at least one payday lender. Thirty-five counties had more than ten locations, and nine counties had forty or more locations. Franklin, Hamilton and Cuyahoga counties each had well over one hundred payday

[7] Eight of these locations hold Ohio licenses but are physically located outside the state.

[8] There were 1458 total McDonalds, Burger King, and Wendy's restaurants in Ohio as of February 28, 2007. Reference USA database: http://reference.infousa.com.

lenders. In appendix one, we show the number of payday lenders in all 88 Ohio counties in 1996 and 2006. Table 1 below, shows the top ten counties in terms of number of lenders.

Table 1

OHIO COUNTIES WITH THE LARGEST NUMBER OF PAYDAY LENDERS, 2006

Name	Total Population 2000	Number of Payday Lenders	Number of Lenders per 10,000 Residents	Percent of Lenders in African American Census Tracts	Percent in Low and Moderate Income Census Tracts
Franklin	1,068,978	183	1.71	9.8	47.54
Cuyahoga	1,393,978	160	1.15	31.9	47.50
Hamilton	845,303	123	1.46	22.0	34.15
Montgomery	559,062	83	1.48	4.8	30.12
Lucas	455,054	67	1.47	10.4	31.34
Stark	378,098	66	1.75	1.5	25.76
Summit	542,899	65	1.20	7.7	53.85
Mahoning	257,555	42	1.63	9.5	26.19
Lake	227,511	40	1.76	N/A	22.50
Butler	332,807	39	1.17	2.6	43.58

Source: Authors' analysis of payday lending location data from Ohio Division of Financial Institutions, Department of Commerce.

Note: African American census tracts are defined as those with more than 50 percent black residents. Lake County has no census tracts that meet this definition.

As the table above also shows, some counties, such as Cuyahoga and Hamilton, have high proportions of lenders in African American census tracts, and most counties have concentrations in low-income census tracts. However, the concentration is not as high as one might expect. Between about one-quarter and one-half of the lenders in the top ten counties for lender penetration have located in low and moderate-income census tracts. Instead of showing an extremely heavy concentration in poor or black neighborhoods, the data show a wide distribution with lenders making inroads in census tracts with various racial and socio-economic characteristics.

Although the counties with the largest numbers of payday lenders correspond fairly closely to the largest urban counties, there are actually a greater number of payday lenders per capita in some less populated counties. In fact, of the ten counties with the highest per capita concentration of payday lenders, not one is a large urban county. Washington County had the highest concentration of payday lenders per capita, with 3.32 lenders for every 10,000 people in the county. Belmont and Gallia counties ranked second and third among the highest per capita concentration of these lenders, as Table 2 shows.

Table 2

OHIO COUNTIES WITH GREATEST NUMBER OF PAYDAY LENDERS PER 10,000 PEOPLE, 2006				
Name	**Total Population 2000**	**Number of Payday Lenders in County**	**Lenders per 10,000 Residents**	**Percent in Low and Moderate Income Census Tracts**
Washington	63,251	21	3.32	19.05%
Belmont	70,226	22	3.13	22.73%
Gallia	31,069	9	2.90	55.56%
Fayette	28,433	7	2.46	14.29%
Guernsey	40,792	10	2.45	80.00%
Crawford	46,966	11	2.34	0.00%
Lawrence	62,319	14	2.25	28.57%
Hocking	28,241	6	2.12	N/A
Carroll	28,836	6	2.08	0.00%
Champaign	38,890	8	2.06	0.00%

Source: Authors' analysis of payday lending location data from Ohio Division of Financial Institutions, Department of Commerce.

Note: Hocking County has no census tracts defined as low and moderate income.

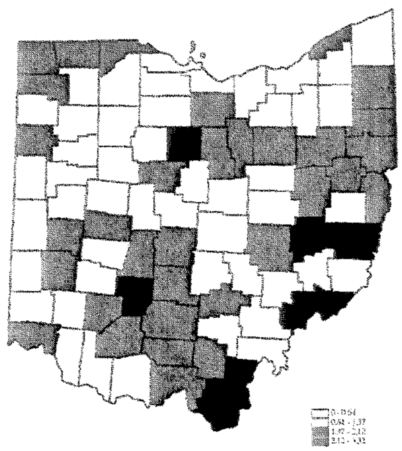
The maps below show the number of locations in 1996 and 2006. The maps show that lending locations in Ohio were once restricted to urban centers in a minority of Ohio counties. They have since spread to nearly every county in the state. Even within counties, lending locations are more widely disbursed and no longer concentrated in urban centers.

Location of Payday Lenders in Ohio - 1996

Location of Payday Lenders in Ohio - 2006

The map below shows the number of payday lenders by county per 10,000 residents. The counties with the highest rates per capita are not urban centers.

Locations of Payday Lenders per 10,000
People by County - 2006



Most payday lending locations in Ohio are chains or franchises. As Table 3 below shows, the most common locations are Advance America, Cashland Financial Services, Check into Cash, Valued Services of Ohio, and Buckeye Check Cashing. In 2006, the top ten payday lending locations represented more than 55 percent of all payday lenders in Ohio.

Table 3

Top Ohio Lenders, 2006	
Top 10 Payday Lending Companies in Ohio	**Number of Locations**
Advance America, Cash Advance Centers of Ohio, Inc.	179
Cashland Financial Services, Inc.	138
Check into Cash of Ohio, LLC	96
Valued Services of Ohio, LLC	96
Buckeye Check Cashing, Inc.	94
Great Lakes Specialty Finance, Inc.	76
McKenzie Check Advance of Ohio, LLC	65
Ace Check Express	51
QC Financial Services, Inc.	44
The Kentucky Check Exchange, Inc.	39
Total	**878**

These annual statistics do not reveal the volatility of the payday lending industry in that many stores open and close within a given year. For instance, in 2005, the most recent year that we have complete year closing data, a total of 113 payday lending locations closed but 357 new locations opened. Also in 2005, 12 locations opened and then closed in that same year. This pattern exists for each year of the analysis.

OHIO LAW

Under Ohio law, payday lenders are classified as "check cash lenders" and are regulated by the Ohio Department of Commerce's Division of Financial Institutions. The check cash lending act first became effective on December 5, 1995, and has been amended several times since that date.

Payday lenders in Ohio are allowed to loan a maximum of $800 at a time.[9] While Ohio law sets maximum rates for both the interest charged and origination fees, few if any lenders set their rates below these "caps." For all loans, the maximum interest rate is 5 percent for each month or fraction thereof.[10]

However, Ohio law also allows origination charges that bring the cost of these loans much higher. Origination fees vary depending on the amount of money borrowed. For loans of $500 or less, lenders may charge an origination fee of $5 for each $50 borrowed. For loans of between $500 and $800, the origination fee remains $5 per $50 for the first $500 borrowed and $3.75 per $50 for amounts between $500 and $800. The total cost and annual percentage rate for different loan amounts is displayed in Table 4.

Table 4

PAYDAY LOAN COSTS IN OHIO, 14-DAY LOAN				
Amount borrowed	**Origination fee**	**Interest charge**	**Total amount due**	**APR**
$100	$10	$5	$115	391%
$500	$50	$25	$575	391%
$800	$72.50	$40	$912.50	367%

Source: Authors calculations, based on Ohio law

While payday lenders are allowed to charge less than these statutory maximums, researchers have not found any lenders who do so. In addition, while the statute allows the maximum duration of a payday loan to be six months, these loans are virtually always made only until the borrower's next paycheck, typically no more than two weeks.[11] When the origination charge is added to the interest rate, the true cost of payday lending is revealed. For Ohio loans, the actual annual percentage rate is between 367 and 391 percent, once fees and interest are calculated.

[9] ORC 1315.39(A)(1).
[10] ORC 1315.39(B).
[11] ORC 1315.39(A)(2).

Ohio law prohibits a check-cashing business from issuing a loan to a borrower if that person currently has an outstanding loan with that business.[12] However, Ohio law does not prohibit borrowers from obtaining several different loans at the same time from different payday lenders, from obtaining a loan from one lender in order to pay off a loan issued by another lender, or even from paying off a loan with a lender and immediately taking out another loan with the very same lender, causing a cycle of indebtedness. In a 2001 study, Professor Creola Johnson and several research assistants obtained loans from payday lenders in Franklin County. Each of the individuals was able to obtain two payday loans in less than two hours by visiting different payday lenders, and one research assistant was able to obtain nine loans in a three-day period before being told that he was "red flagged" for excessive loan activity.[13]

In 2000, the Ohio Legislature amended the payday lending law to make it unlawful for check-cashing lenders to pursue treble damages in civil action cases for the collection of a loan that was returned for insufficient funds.[14] However, a lender may collect a $20 fee if the borrower's check defaults.[15]

A National Cycle of Borrowing

The Center for Responsible Lending (CRL) has shown that only one percent of all payday loans go to one-time emergency borrowers who repay their loans within two weeks and do not borrow again within the year. The other 99 percent of borrowers become trapped in a cycle of debt, with the average borrower taking out nine loans per year.[16]

These repeat borrowers account for the vast majority of payday lenders' revenues. Payday lenders receive 90 percent of their revenue from borrowers with five or more payday loans a year and 56 percent of their revenue from those with thirteen or more loans a year. A recent study found that "lenders who cultivate more repeat business from existing customers will fare better financially than those who do not" (Stegman and Faris, 2003, p. 24). The second largest predictor of higher gross revenues for payday lenders is the percentage of customers who borrow at least monthly.[17]

Nationwide, the CRL estimated in 2005 that 7.6 million workers receive 83 million payday loans per year. Of this 7.6 million, two-thirds, or five million, become trapped in

[12] ORC 1315.41(E).
[13] Creola Johnson, "Payday Loans: Shrewd Business or Predatory Lending?" 87 *Minnesota Law Review* 1, 60-63 (November 2002).
[14] ORC 1315.41(D).
[15] ORC 1315.40(B).
[16] Uriah King, Leslie Parrish and Ozlem Tanik, "Financial Quicksand: Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year," Center for Responsible Lending (November 30, 2006).
[17] Michael A. Stegman and Robert Faris, "Payday Lending: A Business Model that Encourages Chronic Borrowing" Economic Development Quarterly (February 2003). The other predictors in the study were: number of outlets, customers per outlet, subscribes to a screening service, uses a computer data management system, total value of NSF checks as a percentage of the total value of all checks, percentage of NSF checks recovered, minimum average APR, offer check cashing services, and new company.

this cycle of debt, at an annual cost of $3.4 billion.[18] This debt cycle is not just for the cost of the loan. A growing number of payday lenders use incentives such as calling cards, which have additional monthly fees, as sign-up "bonuses" to customers. Payment on these incentives does not count toward the principal balance of the loan. In addition to calling card programs, lenders use target marketing to sell other services and products, which are aggressively sold to lower-income families and minority groups. These include money orders, lottery tickets, public transportation passes, high rate insurance, and office services.[19] The combination of renewing loans from month to month and purchasing these aggressively-marketed services increase the financial instability of low-income families. A 2001 report found that repeat payday lending customers are four times more likely to have filed for bankruptcy than the average adult.[20]

The negative impact of the payday loan industry stretches well beyond these five million workers, affecting the community as a whole. As borrowers try to pay off loans with interest and fees, they often find themselves without sufficient income to cover other basic expenses. In addition to the hardships this involves for the borrower, this can harm other merchants who do not receive payment for their services. Thus, as payday loans consume more and more of borrowers' incomes, the payday loan industry thrives at the expense of other businesses. Payday loan debts are often turned over quickly to credit agencies. These debts can also end in lawsuits, which cost the customer additional funds for attorney fees. A recent study in Chicago found that the average attorney fee ($303) was almost as much as the average payday loan amount ($331) in 2003.[21] Borrowers facing financial crisis frequently turn to social service agencies and faith-based charities for assistance, straining their already overburdened resources.

Although the Ohio lending locations do not reveal excessive concentration in neighborhoods defined as predominantly African-American, national studies show that the black community disproportionately uses payday loans. Ohio data do not allow us to determine what portion of loan sales go to African-American borrowers, but one national study found that African American households were twice as likely to borrow from a payday lender as white households.[22]

Families in the military are also frequent users of payday loans. A 2006 report by the Pentagon found that as many as one in five members of the armed forces, or at least 175,000 people, use payday loans in a year. The report calculates that with annual interest rates between 390 and 780 percent, the average borrower pays back $834 for a $339 loan. Consumer and veterans groups worked with Congress to pass a payday loan rate cap of 36 percent or less on loans to military personnel and their families.[23]

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[18] CRL (2005).
[19] Progressive Policy Institute, "Taking the Poor Into Account" (July 2001).
[20] Gregory Elliehausen and Edward Lawrence, "Payday Advance Credit in America: An Analysis of Customer Demand," Georgetown University, Credit Research Center (April, 2001).
[21] Monsignor John Egan Campaign for Payday Loan Reform, "Greed: An In-depth Study of Debt Collection Practices, Interest Rates, and Customer Base of a Major Illinois Payday Lender" (March 2004).
[22] Stegman and Faris (2003), p. 15.
[23] William Welch, "Law Caps Interest on 'Payday Advances' to Servicemembers," USA Today (November 17, 2006).

NATIONAL GROWTH IN PAYDAY LENDING

Despite the problems attributed to payday lending, Ohio is hardly alone in seeing a growth in this industry. Between 2000 and 2003, the number of payday loan offices in the U.S. increased from between 7,000 and 10,000 to approximately 22,000. Moreover, total sales volume quadrupled in just three years from $10 billion in 2000 to $40 billion in 2003, in non-adjusted terms.[24]

The business model in which borrowers become trapped in a cycle of debt contributes greatly to these high profits. Furthermore, evaluated against prevailing APRs for credit cards and other sources of borrowing, which are exposed to a comparable risk of default, the APRs – usually 390 percent or more – charged by payday lenders are extraordinarily high.

The growth of the payday lending industry cannot solely be measured in storefronts. A newer and explosive sector of the payday loan industry has migrated to the Internet. In an effort to expand lending and avoid regulation, payday lenders now sell loans online where borrowers provide personal information and bank access for quick dollars. Fees are often larger for Internet payday loans based on larger annual interest rates, higher start-up loan fees, bank processing charges, and larger loan amounts.[25] A 2003 study found more than 50 websites offering payday loans (not counting store-based lenders). It is often unclear who the parent companies are for these lenders.[26] Borrowers who use Internet payday lenders may have difficulty finding a real contact person about the loan, often have no consumer protection clauses, may not know exactly who their lender is, and may experience problems because they've provided personal and financial information over the Internet.

WEAK REGULATION

The payday lending industry also profits from a weak regulatory climate. State laws are responsible for regulating payday lending because, as non-bank lending institutions, they are not subject to federal banking regulations.[27] While 34 states including Ohio and the District of Columbia have passed payday loan legislation, these bills are often weak efforts, drafted and supported by the lending industry itself. For example, in Ohio, in 2004, the state legislature *increased* the maximum loan limit from $500 to $800. Ohio has capitulated to payday lenders in other ways, as well, exempting them from the state's 25 percent cap on interest rates and offering to one lending institution, Buckeye Check

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[24] CRL (2005).

[25] Jean Ann Fox and Anna Petrini, "Internet Payday Lending: How High-priced Lenders Use the Internet to Mire Borrowers in Debt and Evade State Consumer Protections," Consumer Federation of America (November 30, 2004).

[26] Jerry L. Robinson, "Update on the Payday Loan Industry: Observations on Recent Industry Developments," Stephens Inc., Sept. 26, 2003.

[27] Charles M. Horn, "Will the Practice Survive? Payday Lending and Consumer Access to Credit," Consumers' Research Magazine (January 2004).

Cashing, more than $7 million in state and local grants and loans.[28] Twelve states, Puerto Rico, and the Virgin Islands maintain usury limits and small loan laws banning all payday lending.[29] Sometimes, lenders are able to get around lending laws. Lenders may offer revolving lines of credit with high interest rates and annual fees even if no money is borrowed. Pennsylvania, which has a ban on payday lending, has seen a large amount of such borrowing.[30]

Some states, including Illinois, Virginia, Pennsylvania, Michigan, and Texas, and cities, such as Portland, Oregon, have recently put in place new limits or acted to enforce existing regulations against payday lenders. These actions include limits on the number of loans a borrower can receive or roll over, caps on interest rates and principals, waiting periods between loans, and inclusion of opt out and payment plan options for borrowers. However, due to the lobbying strength of the lending industry and the ambiguity between financial businesses and regulations, those seeking tougher regulations face an uphill battle.[31]

ALTERNATIVES TO PAYDAY LENDING

Many advocates and legislators argue that consumer education can combat abusive lending practices.[32] Certainly, more can be done to educate low-income workers about alternatives to payday loans, including small savings accounts or rainy-day funds, salary advances from employers, extended repayment plans with creditors, and lower-cost loans from commercial banks.[33] The absence of mainstream financial institutions from some neighborhoods, and the reluctance to use banks, creates an opening for payday lenders that should be closed by ensuring that bank branches are sited in lower-income neighborhoods.[34]

Cleveland-based KeyBank has taken a lead in this effort. In 2004, Key began offering small loans, free financial literacy classes, assistance in opening checking accounts, and check-cashing services at 1.9 percent interest at five inner-city branches. The experiment proved successful both for KeyBank and its customers, and, as of 2005, Key planned to expand the program to 15 more branches. Cleveland Saves, a nonprofit coalition in Greater Cleveland, has also spearheaded efforts to increase financial literacy among low-

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[28] Teresa Dixon Murray, "Payday Loans Don't Have Caps," The Plain Dealer (February 6, 2006); "Payday Lender Gets Ohio's Free Bucks," The Plain Dealer (January 15, 2006).
[29] Consumer Federation of America, www.paydayloaninfo.org (accessed January 1, 2007).
[30] *Ibid.*
[31] Chris Flores, "Trying to Set Spending Limits: Virginia Legislators Will Attempt Again in 2007 to Regulate the Payday Loan Industry," Daily Press (August 13, 2006).
[32] Teresa Dixon Murray, "Education is Key to Getting People to Use Banks More," The Plain Dealer (February 13, 2005).
[33] Center for Responsible Lending, "Alternatives to Payday Lending: Lenders and Products" (August 23, 2005).
[34] Kelly Barron, "Damned If You Do," Forbes (July 9, 2001); "Clevelanders' Payday Squeeze," The Plain Dealer (February 21, 2005); Charles M. Horn, "Will the Practice Survive? Payday Lending and Consumer Access to Credit," Consumers' Research Magazine (January 2004).

income workers, offering free financial classes and free savings accounts through major banks.[35]

Another alternative to traditional payday lending are loans offered by credit unions. These loans are offered to members with low interest rates and service fees.[36] Some of the fees that are collected are put into a saving account for the member. A recent report by the Annie E. Casey Foundation indicates that credit unions and FDIC banks are well suited to offer small loans because they have the staff, infrastructure and other financial services that enable low rates and fees.[37] Credit unions that have instituted pilot programs offering alternative loans have found positive results with their members.[38]

CONCLUSION AND POLICY RECOMMENDATIONS

The number of payday lending locations in Ohio has catapulted from just over 100 to more than 1,500 in the past decade. This form of lending results in extremely high costs for borrowers, can trap borrowers in a cycle of debt, and can drain resources out of local communities.

The federal government has taken action to protect military personnel and their families from this exploitative form of lending, passing the Talent-Nelson amendment in 2006. While national groups advocate for extension of these protections to all borrowers, Ohio legislators should move ahead in providing these protections to Ohio borrowers. This would guard the hard-earned assets and earnings of Ohio workers. Enacting a bill in Ohio with the provisions of the Talent-Nelson amendment, applied to all families, would protect Ohio borrowers by ensuring:

- **Reasonable and Transparent Costs**: Cap the annual percentage rate of interest at 36%. Interest is defined to include all extra charges or fees of any kind. Disclose to borrowers what the APR and loan payment clauses are, as per the Truth in Lending regulations at the federal level. Allow borrowers to repay the loan early with no prepayment penalties.
- **Legal Protections:** Forbid waivers of state or federal rights and prohibit lenders from requiring borrowers to agree to mandatory arbitration[39] or other onerous obstacles to legal action.

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[35] Murray (2005).
[36] See Kenneth Temkin and Noah Sawyer, "Analysis of Alternative Financial Service Providers," Fannie Mae Foundation by the Urban Institute (February 2004).
[37] Sheila Bair, "Low-Cost Payday Loans: Opportunities and Obstacles," Annie E. Casey Foundation (June 2005).
[38] Sue Kirchloff, "Breaking the Cycle of Payday Loan 'trap,'" USA Today (September 19, 2006); Gloria Irwin, "Payday Loans Not Only Option," Akron Beacon Journal (January 12, 2006).
[39] Mandatory arbitration requires that disputes be resolved through a private arbitrator, rather than in court. It is often more costly to consumers and tends to favor businesses over consumers or employees. Clauses enforcing mandatory arbitration typically prohibit consumers from participating in class action lawsuits and do not allow appeals of arbitrator decisions, even if the decisions are clearly against the law. We recommend that the Ohio General Assembly ban the use of mandatory arbitration as a dispute resolution mechanism for complaints arising out of payday loans.

Enacting these protections to all Ohio borrowers would prevent the exploitative and destructive forms of lending that have proliferated in Ohio.

In addition to extending the provisions of Talent-Nelson to all Ohio borrowers, several more modest changes should be put in place immediately, whether separate from or in addition to the more fundamental protections above. These include:
Make development policy accountable: Regardless of our regulatory climate, the Ohio Department of Development should not subsidize payday lenders as the state did when it provided $7 million in state grants and loans to Buckeye Check Cashing;
Require thorough reporting: Require lenders to report on loan amounts, repeat borrowing, and customer demographics. This tracking of lending activity will enable better assessment of how this industry affects our communities;
Encourage traditional financial services: Encourage Ohio financial institutions to offer fair, low-interest loans to their customers, and to locate in under-banked neighborhoods, to ensure that lower-income borrowers have access to traditional lending sources.

By ensuring reasonable and transparent costs, preserving legal rights and protecting assets, all Ohio consumers can count on the protections that federal lawmakers provided to our military personnel. Borrowers in Ohio deserve nothing less.

Appendix 1: Payday Lending Locations by County in Ohio

NAME	Number of Payday Lenders in 1996	Number of Payday Lenders in 2006	Payday Lenders per 10,000 people in 2006	Rank by Number of Locations in 2006	Rank by Rate per 10,000 in 2006
Adams	0	2	0.73	76	75
Allen	2	12	1.11	29	54
Ashland	0	9	1.71	39	19
Ashtabula	0	11	1.07	31	56
Athens	0	6	0.96	53	66
Auglaize	0	6	1.29	53	46
Belmont	0	22	3.13	13	2
Brown	0	3	0.71	71	76
Butler	4	39	1.17	10	51
Carroll	1	6	2.08	53	9
Champaign	0	8	2.06	43	10
Clark	4	15	1.04	21	58
Clermont	0	18	1.01	18	61
Clinton	0	6	1.48	53	35
Columbiana	0	19	1.70	16	23
Coshocton	0	4	1.09	67	55
Crawford	0	11	2.34	31	6
Cuyahoga	13	160	1.15	2	53
Darke	0	5	0.94	62	69
Defiance	0	7	1.77	47	14
Delaware	0	7	0.64	47	78
Erie	0	8	1.01	43	61
Fairfield	2	11	0.90	31	71
Fayette	0	7	2.46	47	4
Franklin	28	183	1.71	1	19
Fulton	0	6	1.43	53	39
Gallia	0	9	2.90	39	3
Geauga	0	3	0.33	71	85
Greene	2	14	0.95	26	67
Guernsey	0	10	2.45	36	5
Hamilton	14	123	1.46	3	38
Hancock	0	9	1.26	39	48
Hardin	0	4	1.25	67	49
Harrison	0	1	0.63	83	79
Henry	0	4	1.37	67	41
Highland	0	7	1.71	47	19

NAME	Number of Payday Lenders in 1996	Number of Payday Lenders in 2006	Payday Lenders per 10,000 people in 2006	Rank by Number of Locations in 2006	Rank by Rate per 10,000 in 2006
Hocking	0	6	2.12	53	8
Holmes	0	2	0.51	76	82
Huron	0	10	1.68	36	27
Jackson	0	5	1.53	62	31
Jefferson	0	15	2.03	21	12
Knox	0	7	1.28	47	47
Lake	0	40	1.76	9	15
Lawrence	0	14	2.25	26	7
Licking	2	17	1.17	19	51
Logan	0	6	1.30	53	44
Lorain	1	30	1.05	12	57
Lucas	6	67	1.47	5	37
Madison	0	7	1.74	47	18
Mahoning	2	42	1.63	8	30
Marion	0	10	1.51	36	34
Medina	0	15	0.99	21	63
Meigs	0	3	1.30	71	44
Mercer	0	4	0.98	67	64
Miami	2	15	1.52	21	32
Monroe	0	2	1.32	76	43
Montgomery	14	83	1.48	4	35
Morgan	0	2	1.34	76	42
Morrow	0	2	0.63	76	79
Muskingum	2	14	1.66	26	28
Noble	0	1	0.71	83	76
Ottawa	0	0	0.00	87	87
Paulding	0	1	0.49	83	83
Perry	0	3	0.88	71	72
Pickaway	0	8	1.52	43	32
Pike	0	5	1.81	62	13
Portage	0	9	0.59	39	81
Preble	0	2	0.47	76	84
Putnam	0	3	0.86	71	74
Richland	1	22	1.71	13	19
Ross	1	12	1.64	29	29
Sandusky	0	6	0.97	53	65
Scioto	0	11	1.39	31	40
Seneca	0	6	1.02	53	60

NAME	Number of Payday Lenders in 1996	Number of Payday Lenders in 2006	Payday Lenders per 10,000 people in 2006	Rank by Number of Locations in 2006	Rank by Rate per 10,000 in 2006
Shelby	0	5	1.04	62	58
Stark	2	66	1.75	6	17
Summit	3	65	1.20	7	50
Trumbull	1	38	1.69	11	25
Tuscarawas	0	16	1.76	20	15
Union	0	1	0.24	83	86
Van Wert	0	5	1.69	62	25
Vinton	0	0	0.00	87	87
Warren	0	15	0.95	21	67
Washington	0	21	3.32	15	1
Wayne	0	19	1.70	16	23
Williams	0	8	2.04	43	11
Wood	0	11	0.91	31	70
Wyandot	0	2	0.87	76	73

Note: An additional eight locations held Ohio licenses in 2006 but were physically located outside the state.

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COMMUNITY SHARES

Revised 3/6/2007

Mr. KUCINICH. And thank you, Mr. Rothstein. I appreciate the exceptional and thorough report which Policy Matters has submitted to this committee.

Now we will hear from Ms. Grossman. Thank you very much for being here.

STATEMENT OF FRAN GROSSMAN

Mr. GROSSMAN. Thank you. I am Fran Grossman. I am an executive vice president at ShoreBank. I am a grandmother, and actually I did miss my flight, so my grandchildren——

Mr. KUCINICH. Did you say something about it?

Mr. GROSSMAN. I missed my flight.

Mr. KUCINICH. But when I asked does anyone here have a flight——

Mr. GROSSMAN. No, no. There was no way I was going to make it.

Mr. KUCINICH. I just wanted to make sure I didn't——

Mr. GROSSMAN. When I was going like this, that is what I was doing.

Mr. KUCINICH. I am sensitive to people missing flights, so when I asked witnesses to raise their hand——

Mr. GROSSMAN. You were wonderful. I just wanted credit for staying.

Mr. KUCINICH. Well, thank you.

Mr. GROSSMAN. I wasn't subtle enough.

Mr. KUCINICH. The Chair will duly credit the gentlelady from ShoreBank here. Thank you for being here.

Mr. GROSSMAN. I started out as I taught school as a librarian, as a social worker. I worked at Continental Bank and Bank of America running small business real estate lending, starting the CDC, raising capital for ShoreBank. I wound up at ShoreBank. I also got my start with Gail Sincata. I care a lot about the subject.

I would like to use, though, my 5 minutes to give you a glimpse of the payday lending industry from our vantage in Chicago. I am sorry that Congressman Davis is not here, but I will send it to him, and we speak, anyway.

What I am going to posit is a way that community development banks like ShoreBank can help meet the complicated needs of our customers and members of our neighborhoods who use payday loans.

As I said on the phone when we talked about this with your terrific staff person, there are no easy answers. There are no silver bullets. I think I am not going to go into the horrors of payday lending. I think you have heard enough from others. What has happened in Illinois—and Ms. Fox has this in her prepared testimony—is we have developed regulations that have changed but not eliminated payday lending. These guys are smart, and every time you make a new rule they are going to figure it out, because there is a lot of money involved. As we always say, nature abhors a vacuum, and they do find the loopholes.

A number of things have taken place in Illinois, including an industry-wide cap limiting payday loan principal to 25 percent of somebody's income, only 345 days of continual indebtedness before a mandatory debt recovery period, special protection which I think we are all interested in for military personnel, including a limit on wage garnishments. And we do have a Statewide reporting system and we do have fines. It is not perfect, but it is a start and it is an acknowledgement.

But it is also important to remember that payday lending fits into a broader set of businesses that provide alternative financial services, and usually they all charge high rates for basic services such as check cashing, bill paying, and the like.

ShoreBank is a $2 billion mainstream financial institution that is also a community development bank. We have 39,000 checking accounts. Our largest service area is the Chicago area. We also have branches in Cleveland. We did $7 million in single family mortgages in Cleveland last year. We have lost market share because we have a fixed rate product, which means that none of the fancy stuff. We underwrite them ourselves. What you see is what you get.

But the consumer is bombarded with probably over 300 types of mortgage products today. When you were mayor of Cleveland, everyone you knew got a mortgage at a bank. Now everyone you know doesn't get a mortgage at a bank.

I think what Tommy FitzGibbon was talking about was very interesting. We also have a 600,000 deposit from the Cuyahoga County Link Deposit Program, and we are going to talk about doing more business, but that is not in my speech.

Our communities have a median income of just over $30,000. We offer a wide range of products, from loans to rehab mortgage loans for walk-up rental apartment buildings. These are affordable rental apartment buildings and they are not subsidized. This is not FHA. This is not section 8. Well, it could be. It is not section 8 project based. It is not low income housing tax credits. These are Ma and Pa developers who buy a building. We help them get a rehab mortgage, and they charge micro-market rents.

We make loans to small businesses. We do a lot of lending to churches and nonprofits, as well as we do many kinds of accounts for individual customers.

We are a community development bank and we meet the strict criteria as a community development bank, which means that we have to make 60 percent of our loans in low and moderate-income communities. But, interestingly enough, there are only 52 community development banks nationwide. Some of you may know that the community development financial institution is a part of Treasury, and it certifies banks, credit unions, venture funds, and nonprofit loan funds. They do the 60 percent.

Our banks are located in many of the same areas where payday lenders, check cashers, money transmission shops, and those are the remittance shops, and pawn shops—don't forget about pawn shops. There is a whole array of people out there who are in what we would call the quick cash business.

Payday loan customers care about their customers and they are often customers of our banks and banks like ours. They care because they are a constant source of income.

We provide many services that these same customers want, and remember that people who use paydays have to have a checking account, so we do share many of our customers, but we cannot, though we know, we cannot provide for these small, unsecured credit, these loans of $500 to $1,000 with no credit, no unsecured. We cannot make them at this point. We don't have the ability.

There are some programs, and the reasons are some have to do with issues of pricing and prudent risk management. Others have to do with the banking culture and regulatory system. And still others with all of our full understanding of how to effectively and responsibly meet the needs of many community residents.

The consultants who work with retail banks tell us that, in order for a checking account to be profitable—and that means that it would earn $136 a year for the bank—it has to have approximately $2,000 in it and only one NSF. Now, you can make a lot of money off of NSF, but that is an equally ugly way to make a living, so that is why I use that number.

I think community bankers and community development bankers can help. We are intensely local and truly relationship focused. We are small organizations with limited resources, as well as limited resources for error. We are regulated.

Some CDFI banks have been able to engage in some alternative developments to payday loans; however, we have not as a group or individually cracked the code that enables us to not only do more, but ideally to move residents of our communities and all of our customers away from paydays into savings accounts and things that really are building assets. And we have certainly not figured out how to do it profitably.

What I also want to make sure, that we don't wind up having programs that are not sustainable over the long haul, are simply a reaction to political and public pressure, and/or are charitable act, because those are not going to be sustainable.

Community development banks could be well positioned to meet the particular needs of these customers. Not only are we relationship driven, we are embedded in the community. We know our Congresspeople. We know our church leaders. they know us. This is our turf and our neighborhoods. Decisions are made locally. You have access to the highest people in the institutions. You call up and you want the president or the chairman of the board and you get him because he is there, or her. You want to know where a credit decision is being made? It is being made there. It is not being made in a far-away State. It is not only formatted lending.

But there are things that we would need as community development banks to do more.

Actually, before that let me give you two examples of what the Central Bank of Kansas does, which is not really an antidote to payday lending but is an attempt to try and get customers of theirs into what they would call savings and we would call savings. They offer a certificate of deposit loan that they feel competes with payday lending products. The customer takes out a loan and immediately receives a certificate of deposit which serves as collateral for the loan, and when the borrower pays the loan back they have established credit and now are bankable.

There is a wonderful bank in Milwaukee, Legacy Bank—actually, it was started by women—and they connect checking account customers with bad credit to financial management classes, and they are able to borrow an emergency loan from the organization that sets it and the bank gets paid back. Legacy's whole focus is on making low income customers good, solid, profitable customers.

One of the problems with the CDFI banks is that the CDFI banks have to declare, in order to be certified by the Treasury, that you are mission oriented, which means that most community bankers who really do all this are not going to say that. They see themselves as bankers and profit people. The fact that 60 percent of their loans and everything they actually do fits into what we would call a CDFI doesn't matter.

One of the reasons then we have over 7,000 community banks nationwide, and it is interesting to note that only 8 percent of those certified are banks, 67 percent are nonprofit loan funds, 19 percent are credit unions, 3 percent are venture loan funds, and another 3 percent are depository holding companies.

The CDFI fund has been helpful with the grant programs to banks, as well as helping many banks get established in areas that would not otherwise be banks. ShoreBank had a community development bank in Cleveland which is now a branch of our bank.

But other things that would be helpful are CDFI banks should receive favorable consideration for receiving Government deposits and loan participations. This came out quite clearly when we talked to people in the Katrina area. What they really needed was not deposits but they needed loans. They had a lot of money, but there was no way to help those banks in an organized fashion, whereas you could have identified them as CDFI banks, certified them, and taken a class of those who passed the 60 percent test.

We need to deal with loan loss reserves if we are going to expect and task community development financial institutes, banks, to support these specialized lending programs.

We need encouragement from bank regulators, the others as well as the FDIC, in the form of examiners who understand and support banks' roles in providing alternatives to payday loans.

The easy money is for financial education. I guess I pray that we don't wind up recommending financial education. Of course it is needed, but everybody would like to send you to a class instead of really doing the hard thing.

Regulating away payday lending will not eliminate the unique financial needs of individuals with low assets and poor credit, needs that high-interest, short-term check cashers offer easily, and it is at a cost, and people do know that. They just can't deal with it because they need the money or we do live in a society of wants. Wherever you go, if you can't afford the plasma TV I will help you get one. If you can't afford the house, I will help you get one. If you want a new fur coat, I will help you get one. Whatever it is, we live in that kind of world and we have to acknowledge that.

What must be part of a regulatory package to limit payday lending are incentives to help mainstream financial institutions and credit unions. Community development banks are mainstream, and they do offer products to these customers and they need to be tasked to offer more.

Bottom line: it is not easy. There are no simple answers. It will take the will of Government to encourage, incentivize, because money does talk. If these banks are able to achieve profitability through loans, deposits, and other ways that the government helps, through the regulators, everyone has to be involved. We do not want to look back a few years from now and see another mess like we now have with some of the subprime lenders and the institutions that funded them.

A way was figured out because we all promoted homeownership. Homeownership was going to be the answer to everything. We wanted minorities to own homes. We wanted poor people to have homes. Whether it was the Democrats, the Republicans, the Governors, the States, we all believed in homeownership. Now we have a pretty mess and a lot of people who thought that they were getting the American dream and now realize that it was a sham. We can't do that on quick loans. We have to figure out how to look at the source. We understand the problem.

[The prepared statement of Ms. Grossman follows:]

Testimony of Fran Grossman, Executive Vice-President of ShoreBank Corporation, Before the House Government Oversight Committee, Subcommittee on Domestic Policy March 21, 2007

Chairman Kucinich, ranking member Issa, distinguished members of the Committee, thank you for the opportunity to testify today on behalf of ShoreBank Corporation. I want to use my 5 minutes to give you a glimpse of the payday loan industry from our vantage point in the Chicago area and to talk about how community development banks like ShoreBank could help meet the complicated needs of customers and members of our neighborhoods who use payday loan and other similar financial services.

We are very pleased that the FDIC, under the leadership of Chairman Bair, is attempting to address payday lending and related issues. ShoreBank's founder and chairman, Ronald Grzywinski, is a member of the FDIC's Advisory Committee on Economic Inclusion. I know he is looking forward to the Committee's first meeting in two weeks, which will focus on this issue.

Payday lending fits into a broader set of businesses that provide alternative financial services and that often charge high rates for basic services, including cashing checks, paying utility bills and the like.

Now, there are no easy answers, no silver bullets to deal with payday lending. As you can well imagine, different people use short-term, high-interest, unsecured payday loans for different reasons and this can be a very profitable business. People with jobs rely on and use payday loans for quick cash. Folks may turn to payday loans for their wants, emergency needs and for basic necessities. Many payday loan customers fall behind on their payments. They are unable to pay back the full amount of the loan, as payday loans typically require, and they then find themselves without other options.

Illinois has developed regulations that have changed but not eliminated some of the more egregious aspects of payday lending. Nature hates a vacuum, and when one exists, such as the need and desire for "quick" cash, it will be filled. A number of things have been put into place, including:

- An industry wide loan cap limiting payday loan principal to 25 percent of a borrower's income.
- A mandatory relatively short debt-free period of recovery following 345 days of continuous indebtedness.

- Special protections for military personnel, including a limit on wage garnishment.
- A statewide consumer reporting service to help with enforcement.

It is not perfect, but it does help with some of the more outrageous practices.

ShoreBank is a $2 billion community development bank. Our largest service area is in and around Chicago and we also have a branch in Detroit and a non retail branch in Cleveland. We work primarily in 25-30 neighborhoods in Chicago and close suburbs. Our communities have a median household income of just under $30,000. ShoreBank offers a range of products. Our loans to rehab multifamily buildings and mortgage loans for walk up rental apartment buildings help provide affordable rentals with no subsidy to low- and moderate-income residents. Our loans to small businesses, churches and nonprofits provide jobs, stability and growth in the communities, and we have low-fee accounts for individual customers and nonprofits.

ShoreBank is a community development bank and, as such, meets the strict criteria to be certified under the Community Development Financial Institution (CDFI) Fund in the Department of Treasury. Nationwide, interestingly enough, there are only 52 CDFI Fund-certified banks.

Some of you know about the CDFI Fund. It is housed in the Treasury Department and certifies banks, credit unions and non-profits that do 60 percent of their business in low-income areas. The CDFI Fund has been helpful with its grant program as well as helping many banks get established in areas that would not otherwise have a bank. Often, these are the same areas where payday lenders, check cashers, pawn shops and money transmission shops thrive.

Payday loan customers are sometimes customers of our bank and banks like ours. We provide many services they need and want, but obviously not all, and we well know there is a need for small, short-term, unsecured credit. We know, and we fervently believe that we need to encourage people to have a savings nest egg of at least $500 to $1,000. But until that happens, there remains a void.

There are many reasons for this void. Some have to do with the issues of pricing and prudent risk management. Others have to do with the banking culture and regulatory system and still others with all of our lack of understanding of how to effectively and responsibly meet the needs of many community residents.

So, why do these two types of institutions – community development banks and payday lenders – co-exist in the same community? Community development banks are well-positioned to meet many of the lending needs of lower-income customers, and even customers with thin or no credit history or who have had some bouts of bad credit. But we have not been able to fill all the needs of every potential customer, and we have been particularly challenged by the demand for small-sum, short-term, unsecured credit.

Let's start with why community development banks are well-positioned to meet the particular lending needs of these customers.

1. Banks like ShoreBank often take a person's character into account when making a decision. We are not formula lenders.

   Many good borrowers do not always look so good on paper. They have either long, negative credit histories, or short ones with virtually no traditional information. In either case, poor credit scores – or no score at all – make automated underwriting tough. The FDIC calls these borrowers "informationally opaque." But WE know them and WE can serve many of them.

2. Community development banks are mainly locally owned and managed.

   They are embedded in and involved with their communities. Customers and the community have access to the senior management. Decisions are made locally.

3. As small institutions, they have the ability to move quickly.

4. Community development banks are interested in having customers who are borrowers as well as savers.

As community bankers, we are intensely local and truly relationship focused. We are small organizations with finite resources which, unlike large banks limits the errors we can make. Various CDFI banks have been able to engage in some limited alternative products to payday loans; however, we have not, as a group or individually, cracked the code that enables us to not only do more, but also ideally to move residents of our communities away from payday loans. Also, we have not figured out how to do it profitably, so that the product and our relationship with those customers are sustainable over the long haul and not simply seen as a charitable act or a short-term reaction to political pressure.

There are numerous examples of products and innovative ways that CDFI banks have found to address the needs of consumers AND push and guide them on a path to prosperity. Here are two examples:

- Central Bank of Kansas City offers a CD Loan that helps customers establish good credit and avoid payday lending in the first place. It works like this: the customer takes out a loan and immediately receives a CD for $1,500 which serves as collateral for the loan. When the borrower pays off the loan in 1 – 2 years, the CD and the accrued interest belong to the customer. The loan and its successful payoff are reported to the credit bureaus, enabling the borrower to build a positive credit score, which will, in turn, lead to credit on better terms, whether from Central Bank or another lender. What distinguishes Central Bank's product from similar products elsewhere is that they actively promote it to customers.

- Legacy Bank in Milwaukee connects checking account customers who have had bad credit to financial management classes. Customers may then choose emergency loans and the bank gets paid back. Legacy focuses on making low-income customers good, solid, profitable customers by helping them learn how to use bank financial services, including credit, not by regarding them as serial fee generators.

CDFI banks are small, and while profitable, their margins are often strained by a combination of high fixed costs (including regulatory costs), and smaller loan sizes, limited fee income and a population that needs more personal attention. Small dollar, short-term credit is one of these products that we have found is quite difficult to offer under current conditions. They would, however, be interested in working with the CDFI Fund, the FDIC and others to break through financial, technological and regulatory barriers. For example:

1. CDFIs should receive favorable consideration for government deposits and loan participations.

2. THE CDFI Fund needs to be well funded.

3. The CDFI Fund needs to encourage more community oriented banks to apply for certification.

   There are more than 7,000 community banks that are committed to their communities and a good percentage do much of their business in low-income neighborhoods. Currently 67% of the certified CDFIs are nonprofit loan funds, 19% are low-income credit unions, 8% are banks or thrifts, 3% are venture capital funds and 3% are depository holding companies. Not to encourage and provide incentives to mainstream financial institutions which know and care about the community and whose ability to survive is dependent on that community is nonsensical.

4. CDFI banks need loan loss reserves to support special lending programs.

5. CDFI banks need encouragement from bank regulators – others as well as the FDIC – in the form of examiners who understand and support a bank's role in providing alternatives to payday loans.

6. CDFI banks need funding to provide the level and appropriate type of financial education and coaching that will best enable customers to not only enter but stay in the financial mainstream and build assets.

Regulating away payday lending will not eliminate the unique financial needs of individuals with low assets and poor credit, needs that high interest short-term check-cashing facilities offer easily and at a cost. We need a multifaceted approach to deal with unscrupulous payday lenders and their clones, people who used to be called loan sharks. It will take the will of the government to encourage and regulate banks, credit unions, nonprofits and government agencies to ethically and responsibly respond to the needs of consumers we have been discussing. What must be part of a regulatory package to limit payday lending are incentives to help mainstream financial institutions (community development banks are mainstream) and credit unions offer products to these customers.

The foregoing examples constitute some of our recommendations in connection with any such regulatory package. If, in our attempt to "fix it," we ignore the causes of the problem, we may find ourselves in a position not dissimilar from what we are facing today because of some clever sub prime lenders. In an attempt to increase the number of minority homeowners, we allowed and encouraged products that left many of those we were trying to help worse off.

Bottom line: it will not be easy. There are no easy answers. Let us try and get it right.

Frances R. Grossman is an Executive Vice President at ShoreBank Corporation and works on projects for its largest affiliate, ShoreBank in Chicago, Cleveland and Detroit, and with its other for profit and nonprofit companies nationwide, including the Center for Financial Services Innovation. Grossman manages external relations and investor and stakeholder activities. She is responsible for ShoreBank's civic affairs and contributions in Chicago and nationally and is involved with business development and managing government/ municipal and business relationships.

Before joining ShoreBank, Ms. Grossman worked in community development banking at Bank of America for 10 years. She created, developed and managed the Community Development Banking group and the Bank of America's Chicago Community Development Corporation. She also managed the Bank of America Foundation and government relations in Illinois.

Grossman previously oversaw a neighborhood-based community development corporation, taught in Chicago Public Schools and managed an after-school and summer program in the Ida B. Wells Homes.

Active in the community, Grossman serves on the board of directors for the National Association of Affordable Housing Lenders, the South East Chicago Commission, Chicago LISC, the Chicago Metropolitan Housing Development Corporation, the Coalition of Community Development Financial Institutions, the Community Development Bankers Association and Partnership for Quality Child Care. She recently served on a Blue Ribbon Commission addressing critical issues at Chicago Public Schools.

Ms. Grossman holds a master's degree from the University of Chicago School of Social Service Administration and a bachelor's degree from Vassar College.

Mr. KUCINICH. Thank you very much for your testimony, Ms. Grossman.

I am going to now go into the questions for the second panel. I would like to ask Mr. Davis if he would like to start, or if you want me to start.

Mr. DAVIS OF ILLINOIS. You can go ahead.

Mr. KUCINICH. OK. To Ms. Haynes, thank you again for being here and thank you for the work that Faith Community United Credit Union does for people.

Ms. HAYNES. Thank you, Mr. Chairman.

Mr. KUCINICH. One of the things that is important to realize, I think, about the payday lending industry is that payday loans are made only to people who, one, are employed and, two, have checking accounts. Customers are working people, have a relationship with the bank.

Ms. HAYNES. Right.

Mr. KUCINICH. Nonetheless, they go to payday lenders and not to their banks. Why do you think that is? Why don't they go to the bank?

Ms. HAYNES. The payday lenders make them feel wanted, which banks don't. They are quick. At times when they get off work, they are open and available. They are even open on Sundays. They are on every corner. That is why people go to them rather than to a bank, and sometimes to a credit union that has hours that don't always apply to what they need.

Mr. KUCINICH. Since you offer a competing product to payday lenders, what is most important to the borrower? Is it the cost of the loan, the speed with which they get the loan, the location, accessibility? What do you feel are the factors?

Ms. HAYNES. I think the simplicity to make it quick and easy and convenient for them. And the cost is not the primary thing that they are looking at. They need the money. They need it then, and they want the solution to this problem right then.

Mr. KUCINICH. I am sure you have given this some thought in terms of loans. In your opinion, the payday lenders, they are charging these high fees and these big interest rates. Do you think that is necessary for them to do that, to charge such high interest rates and big fees to make these kind of loans?

Ms. HAYNES. No, I definitely do not. I think that those rates are unnecessary for them to charge; however, they are taking a niche that banks and credit unions should be filling, and they are simply over-charging people for the service that they are giving them. But the people in a depressed market need the funds so bad that they will pay whatever, and then they get trapped into that. And it is very difficult for a credit union like us to get them out of that habit of getting the money immediately and using those post-dated checks.

Mr. KUCINICH. Right. What, if anything, about the Federal or State governments do you think that could be done to change the laws to protect people you describe as being trapped?

Ms. HAYNES. Well, I think laws should be made to regulate them just as credit unions are regulated. We are regulated as to how much interest we can charge and all of that. I think there should be regulation to regulate those payday outfits, as I call them.

Mr. KUCINICH. And the people who use the payday outfits, you talk about being trapped. What do you think is the biggest trap they get into, just in your experience with people who use that model? What is the trap? What is going on in their minds when they are using it?

Ms. HAYNES. The only thing going on in their minds is they need the money, they need it right then, and they are not looking down the road to having credit. They don't ask them things that we would ask in a credit union about building credit, saving for the future, those kinds of things. They see them as being friendly because they don't ask the most meager questions about what are you doing, how are you going to send your children off to college if you don't have a good credit rating or savings account. So in the credit unions we try to build that into pulling them or weaning them, as we call it, from the payday lenders.

Mr. KUCINICH. You know, it would be interesting to do some historical research, because I remember in growing up in the inner city that there were always people out there on the corner you could borrow money from.

Ms. HAYNES. Right.

Mr. KUCINICH. But they would charge you a lot of money to loan you money.

Ms. HAYNES. Yes.

Mr. KUCINICH. And these people were sometimes called loan sharks.

Ms. HAYNES. Yes.

Mr. KUCINICH. And there was a point at which if you charged a certain percentage it was made illegal.

Ms. HAYNES. Yes, that is true.

Mr. KUCINICH. And we are in a situation today where there is a lack of regulation here. You know, when you look at annualized percentage rates, it would be interesting to see if that in any way falls into the same kind of category, because these percentage rates are so high that it does raise questions about matters of fairness and simple justice.

Thank you very much.

Ms. HAYNES. Thank you.

Mr. KUCINICH. I have a minute left just to ask a question of Mr. Rothstein, and then I will come back to you.

You noted in your testimony that one payday lender, Buckeye Check Cashing, receiving taxpayer financed grants and loans from the State of Ohio to finance their operation. As a matter of fact, I made a note on the chart there. Can you tell us more about this? How did that happen?

Mr. ROTHSTEIN. Sure. Thank you for the question, Chairman Kucinich. What happened is they received several loans and grants. The first is they received $100,000 business development grant through the Ohio Department of Development which was approved by the Ohio Controlling Board.

Mr. KUCINICH. What was the interest rate?

Mr. ROTHSTEIN. I don't actually know that offhand.

Mr. KUCINICH. It would be good to find that out, wouldn't it?

Mr. ROTHSTEIN. That is a good question. I don't know it offhand, though.

Mr. KUCINICH. I am sure it wasn't 391 percent.

Mr. ROTHSTEIN. The vote from the Controlling Board was six to one, with only one member dissenting saying that he doesn't think that public dollars should go to financing this type of business.

They also received a 60 percent, 9-year job creation tax credit in 2004 from paying the corporate franchise tax in Ohio.

The city of Dublin, which, for those of you who aren't familiar with Ohio, is a very wealthy, affluent suburb located right near Columbus, offered them a 25 percent, 5-year payroll performance incentive and a $150,000 relocation grant.

I should note that they declined a $7 million Ohio enterprise bond fund loan as specifically citing Federal tax reasons.

Those are list of credits that I have noted for them.

Mr. KUCINICH. OK. I would like to come back to you, but at this point I would like to yield time to my friend and colleague, Mr. Davis.

Mr. DAVIS OF ILLINOIS. Thank you very much, Mr. Chairman.

First of all let me again thank you for the patience and the fact that you are still here. I mean, that is an indication to me that we are what we call in the community real troopers, you know, that you are actually people who care a great deal about what you are doing, what we are talking about, and seriously seeking solutions or direction or something that is going to help alleviate the problem.

But, Ms. Grossman, you indicated that people are really looking for money. I mean, they are not looking for financial education, and yet, as I listen to the discussion, it appears to me that a great deal of what they actually need is education.

Mr. GROSSMAN. Maybe I wasn't clear. It is not that people do not need financial education and that financial literacy is important, but it becomes like homeownership. It becomes the large banks, the large institutions, the large insurance companies. It is an easy fix. Of course, it is a part of it, but if we stop at financial literacy and we put it in the high schools and we put it in after school and we put it here and we don't do anything else, we will not have solved anywhere near.

One of the issues I guess I am looking for is trying to figure out. We know there is a terrible problem. We might be able, through regulatory issues and legislation, to begin to control the rate, but the problem will still exist, and that is why I began to talk about the CDFIs and community development banks. We have to begin to think about ways to acknowledge the need, provide education, but also help people so that they can go and borrow money, that they can develop credit, because if we stop this we will go back to loan sharks, we will go back to contract buyers. I mean, you and I remember the contract buyers leagues. I mean, these people are always going to be with us.

Mr. DAVIS OF ILLINOIS. It is kind of like my father would say: pray for a good harvest, but keep on hoeing. I mean, that is, provide alternatives at the moment, while at the same time try and wean people away.

Mr. GROSSMAN. Yes.

Mr. DAVIS OF ILLINOIS. I mean, I was thinking of I used to work in health care, and how we would see a brand new health center down the street, and there were more people going to the Medicaid mill up on the corner. When we would ask them why, they would come back and say they really know what we want, and they give us the pills that we like or they give us the pills that we ask for. So it seems like a combination of both things.

Let me ask, we talk about usury. We talk about the high fees. Would we be treading on sacred ground if we were to regulate those entities and say you can only charge 10 percent?

Mr. GROSSMAN. That is what leaders are for.

Mr. DAVIS OF ILLINOIS. Or 12 percent.

Mr. GROSSMAN. That is what leaders are for. Of course it is sacred ground to somebody, but that is what leadership is about. That is why some of us, including you, are still here, because it is wrong and we know it is wrong and we have to not only stop it but we have to move on and think of other ways.

Ms. FOX. There are 11 States that still have their usury and small loan laws that apply to small loan companies. You would violate criminal law in New Jersey if you charge more than 30 percent APR, and 25 percent in New York. In Georgia it is a RICO violation to do payday lending at over 60 percent APR. North Carolina tried it and found it was such a debt trap that they reimposed their 36 percent small loan rate cap if payday lenders want to get a regular small loan license.

Congress said the way to protect military borrowers was to cap interest rates at 36 percent, including all of the extra fees, and to prohibit check holding and electronic access to the bank account.

We are starting to move back to thinking about how to protect borrowers in this market, and there are States that still do it through rate caps.

On your question about loan sharks, a paper in Salt Lake City did a big story that talked about payday lenders and title lenders, rate lenders, and what we call loan sharks today were charging. That was less.

Mr. DAVIS OF ILLINOIS. Finally, is there anything that would, from a market vantage point—for example, if we were to talk about a national cap, are there things that are taking place in one market that would suggest that there is something or some reason why the rate couldn't be the same in New York as it is in Illinois as it is in Indiana as it is in Texas as it is in Missouri?

Ms. FOX. Traditionally, the small loan industry has been regulated at the State level, and interest rate caps have been a function of State law. The Federal Government does cap credit unions at 18 percent APR for federally chartered credit unions.

Mr. DAVIS OF ILLINOIS. So it would just be new territory.

Ms. FOX. It would.

Mr. DAVIS OF ILLINOIS. Or new ground that was being looked at.

Ms. FOX. For civilian. Congress last year enacted a national rate cap for loans to the military at 36 percent APR. A lot of folks said wow, that is really high, and we said well, it is a lot less than 390 percent for a payday loan or 300 percent for a car title loan or, you know, a couple hundred percent for refund anticipation loan, or other forms of high-cost credit.

But the other thing we really need you to do besides looking at the cost is to take the features of payday loans off the table that trap people in repeat borrowing, and that is their ability to get you to write them a check when they know you do not have money in the bank, and hopes that on your payday you will. That is an unsafe banking practice, and that is something that Congress could do.

Mr. DAVIS OF ILLINOIS. Thank you very much. And thank you, Mr. Chairman.

Mr. KUCINICH. Thank you, Mr. Davis.

Mr. Cummings.

Mr. CUMMINGS. Just one question.

Mr. KUCINICH. Take your time.

Mr. CUMMINGS. The credit unions have always seemed to provide services and have been able to target populations that the bank seems to skip over, and I think the credit unions give people a sense of ease, as far as getting into them. You know, you have several people on the job and somebody says, Girl, did you join a credit union? How did you get your car? You say I got it through the credit union. So the next thing you know they feel comfortable.

I am just wondering, I see that some of you are from credit unions and you may have testified to this, but how can credit unions help to address these kinds of issues? Is there something that you all have and are there things that you are able to do that the banks are not able to do? Do you follow me?

Mr. GROSSMAN. Can I just say I think it is important to know that you are talking about low income credit unions.

Mr. CUMMINGS. Right.

Mr. GROSSMAN. We are involved on the banking side. You now have very, very large credit unions who act much more like large banks, whereas Faith—and I think she can respond much better—I mean, these are small credit unions, North Side Credit Union, South Side Credit Union, they are very different than the Credit Union of New York, which encompasses the whole State.

I just wanted to make sure that we understood the difference between those credit unions.

Mr. CUMMINGS. I have you. I still want to know.

Ms. HAYNES. Yes, Representative Cummings, one of the reasons that we can't really compete as a credit union—we are a low income community development credit union, CDFI—we are only $10 million in assets. We cannot compete with payday lenders on every corner——

Mr. CUMMINGS. Right.

Ms. HAYNES [continuing]. That are open all day, evenings, and Sundays.

Mr. CUMMINGS. Right.

Ms. HAYNES. So that is why credit unions can't compete as totally as the payday lenders. And, of course, the transactions are costly, you know. They are a costly kind of loan to make.

Mr. CUMMINGS. Sure.

Ms. HAYNES. So, consequently, we are regulated and our interest rate is capped, so theirs needs to be capped.

Mr. CUMMINGS. Yes, ma'am.

Ms. FOX. The bank's equivalent of a payday loan is the cash advance on a credit card or an overdraft line of credit at 18 percent APR. The FDIC has proposed guidelines for banks for responsible small loan products. We have congratulated the FDIC for taking the leadership on that. Hopefully those will be issued and they will be an encouragement to banks to look at the small loan needs of their own customers in a responsible way.

Credit unions are also looking at ways that they can make small loans to their members. I understand that at the recent CUNA conference that session was standing room only to talk about how to compete with payday loans for your own members.

So there is work going on in this area, but that fact isn't reason to not address the consumer protection issues. I agree we need both effective regulation, small loan market, and good alternatives for consumers. And the third thing that we really need is emergency savings accounts for people.

We have done some research. We have looked at research. For families making $25,000 a year, if they have over $500 in emergency savings they are much less likely to take out a payday loan than a consumer making $25,000 with no savings. The difference is you are eight times as likely to have a payday loan in your portfolio if you have no emergency savings than you would be if you have a least $500 in the bank. Savings are really important.

Mr. CUMMINGS. That is interesting you said that, because one of the things that I talk about quite a bit in my District is what I call bridges. So often what happens to people is that $500 you just talked about, if that bridge, that $500 can bridge them from one thing to another—now, it is only $500, but without it they are doomed. I think that is where the payday loan folk come in. They are looking at it from the standpoint, the borrower is looking at it from the standpoint. Let's say, for example, I got all of the money for my daughter's tuition but I need $500, and so they go to the payday loan person, get the money knowing that it is going to cost them a lot, but they look at it from the standpoint that this is the bridge to get me from one point to the other.

I have heard people talk about this kind of stuff. While this $500 is only $500, for that situation it is like a million dollars because they are looking at it that this is what is going to allow my kid to be able to afford the tuition to go on to become the doctor, or whatever.

So I think companies do take advantage of that, and I guess people get hooked on those payday loans, and then it is just rolling down a hill of ice. So I was just amazed as I listened to the various testimony that has been presented here, Mr. Chairman. I look at the neighborhood that I live in. I live in the inner city of Baltimore. I see people who are paying the highest prices for everything. They pay the highest prices at the grocery store, because there are no stores. They do the payday loan thing. They get cabs because they don't have a car.

I mean, you go on and on. If they have a car, they pay the highest insurance. It is amazing that people who are poor ever get out of the hole. And when you go to the grocery store, when I shop in the grocery store in my neighborhood—and I know Mr. Chairman is going to have some hearings on grocery stores—I go to the grocery store in my neighborhood, you know, to buy a can of shaving cream, there may be a 50 cent difference. In my neighborhood it may cost me $3. I go to a neighborhood about may be 5 miles away and it is 50 cents less. They add up and they add up, so people just go down and down and down.

Then folks say why can't they ever get up and get on their feet. And even when it comes time to get their taxes, you have folks saying come to me, I will give you your money right away. Even then they are finding themselves in difficult circumstances.

That is why I asked the question about the credit unions, because I am trying to figure out, you know, this is a multi-faceted problem that perhaps needs multi-faceted solutions.

I want to thank you all for staying around here. I know we have another panel. I just wanted to thank you.

Mr. KUCINICH. And I want to thank Mr. Cummings and Mr. Davis for staying with us, because we all represent constituencies which include solid inner city constituents, and our experience is that people are always broke, and that if they don't have a job and they need money they borrow money, they get into debt. People are maxing out. If they don't have the kind of traditional paths to credit that some people have, they get into these traps and it becomes a nightmare. It is absolutely a nightmare, and people never get out of it. They never get their head above the water. That is why we are here.

I appreciate Mr. Cummings and Mr. Davis staying with us on this.

I think that what we will do, there are numerous questions that we have for the witnesses, and what I would like staff to do is to followup and submit these questions to the witnesses so that perhaps in some followup discussion with our committee you can give us some written responses, because you are such valuable resources on this important economic issue for people in the cities.

What I would like to do right now is to thank the second panel and thank you for the cooperation you have given us and will continue to give us. Good evening.

We will now call those hearty souls who have been here all day waiting for a chance to testify to the committee. Please come forward. Thank you.

We are, indeed, fortunate to have an outstanding group of witnesses on our third panel. Actually it is a couple at this point. Mr. FitzGibbon had testified earlier.

I want to welcome Mr. Calvin Bradford. Mr. Bradford is the president of Calvin Bradford and Associations, a consulting firm that engages in research, policy evaluation, general consulting, and expert witness services in the fields of fair housing and community development. Mr. Bradford is also a board member of the National Training and Information Center, which was founded in 1973 as a research and technical support provider to National People's Action and other community organizations that first initiated the movement against redlining and disinvestment.

Through issue-based community organizing, NTIC helped spearhead the Community Reinvestment Act. Since its passage, the NTIC's efforts on the Community Reinvestment Act have resulted in over $1.1 trillion to low and moderate-income families across the United States. NTIC has been involved in more CRA agreements than any other organization, which is a tremendous testimony to your work.

Next we welcome Professor Michael T. Maloney. Professor Maloney is a professor of economics in the John E. Walker Department of Economics at Clemson. Mr. Maloney received his Ph.D in economics from Louisiana State University and started at Clemson in 1974. He has taught at Emory University, as well. He was a senior financial economist at the U.S. Securities and Exchange Commission in 1990. Mr. Maloney is an associate editor of the Journal of Corporate Finance and is widely published on a variety of topics, including research and development in the drug industry, nuclear power and nonproliferation, and the complexity of financial markets.

Welcome, gentlemen. I would ask you if you would stand.

[Witnesses sworn.]

Mr. KUCINICH. The record will show that the witnesses responded in the affirmative.

Mr. Bradford, you may proceed.

STATEMENTS OF CALVIN BRADFORD, NATIONAL TRAINING AND INFORMATION CENTER, CHICAGO, IL; AND MICHAEL T. MALONEY, DEPARTMENT OF ECONOMICS, CLEMSON, SOUTH CAROLINA

STATEMENT OF CALVIN BRADFORD

Mr. BRADFORD. Thank you, Chairman Kucinich and members of this committee. My name is Calvin Bradford, and I am a board member representing the National Training and Information Center. I want to convey to this committee NTIC's assessment of CRA enforcement after our 35 years of providing training and assistance to community-based organizations who are responsible for both the Home Mortgage Disclosure Act and the Community Reinvestment Act.

We have not forgotten your role, Mr. Chairman. I have a copy of your agreement from May 1979. And we also point out that we know, as Congressman Davis pointed out, the CRA in many respects started in his neighborhood with Gail Sincata and the organizing there. In light of your hearings, it is important, I think, to say that its purpose was to pump prime lending money back into neighborhoods that at that time in Cleveland and Baltimore and Chicago and Detroit and other cities were devastated by the predatory abuses of FHA lending. So in some ways we are in a similar situation today.

Our overall assessment of the Community Reinvestment Act is that many of the community groups and some lenders deserve outstanding ratings, while the Government regulatory agencies typically deserve substantial noncompliance ratings.

The details of our recommendations are contained in our written statement. In summary, we find that the CRA needs a formal written fair lending test with a public disclosure, which it doesn't have, a requirement that all communities and all service areas be given a full evaluation. There should be no CRA-free zones, as the regulators now permit. There should be a requirement that all the lending affiliates and subsidiaries of a lender should be included in the lending test so that lenders can't, as they can today, pick and choose which affiliates to use and cherry pick their performance.

But the CRA regulations, exam process, and examiner training need to be revised to eliminate grade inflation and ensure accurate ratings of real performance.

We also recommend some changes in the Home Mortgage Disclosure Act and in the release of CRA and HMDA data to make it more usable by the public.

I would like to summarize just a few examples that are more fully defined in our written statement. We provided three examples of cases where the Federal CRA regulators consistently gave satisfactory and even outstanding ratings to three major regional lenders and found no violations of the fair lending laws, while at the same time the U.S. Department of Justice under this administration filed race discrimination cases against these very lenders and claimed blatant racial redlining and violations with the Fair Housing Act, the Equal Credit Opportunity Act, and the CRA by systematically excluding the minority neighborhoods in the metropolitan areas that these lenders served.

Mid-America in Chicago, Old Kent in Detroit, and Centier in Gary, IN, are all major metropolitan-wide lenders. All define their metropolitan service areas in ways to exclude the minority areas, in some cases excluding the entire central city.

Over many years and several CRA evaluations, the OTS, the Fed, and the FDIC ignored this blatant form of discrimination and rewarded these lenders with satisfactory and outstanding evaluations, allowing them to engage in substantial expansions into other White neighborhoods by granting additional branches and expansions and approvals of mergers.

Then consider finally the case of Flagstar Bank. It was twice found liable for race discrimination in Federal courts, first in an individual case in Detroit and then in Indianapolis for a nationwide written policy that set fees explicitly based on race. This case was so blatant that the court ruled against Flagstar in summary judgment. Yet, the OTS actually raised its rating from satisfactory to outstanding after this decision. Moreover, this written racial pricing policy was developed and implemented while the OTS was examining Flagstar for compliance. Flagstar literally violated its way to an outstanding rating.

The Sunflower Community Organization in Wichita, KS, had a significant concern about lending practices of a Bank of America. The Wichita MSA has a large African American population, and the largest Hispanic, Native American, and Asian population in the entire State of Kansas, yet the Comptroller of the Currency did not consider Wichita large enough for a full CRA evaluation, so its rating of the Bank of America was based on performance in other communities. It took years of research and organization and negotiations with the help of NTIC to get the Comptroller to add a more in-depth evaluation of this one lender in just this one metropolitan area.

Finally, the recent actions by Countrywide lending illustrate our concern that lenders will hide behind the protection of banking regulators. In the past, Countrywide has been one of those lenders that has shown huge disparities in FHA lending that are racially based. We have submitted with our testimony examples of that for Baltimore, Washington, Chicago, and Orange County, CA.

Last fall the Attorney General of New York charged Countrywide with racial bias in subprime lending. When Elliot Spitzer announced the settlement with Countrywide last November, he lamented that the Federal regulatory agencies were protecting depository institutions by refusing to allow State agencies to investigate them for fair lending violations. At that time, Countrywide was the Nation's largest independent lender, not regulated. But just this month on March 12th the parent company of Countrywide became a savings and loan holding company and changed its full regulation to the Office of Thrift Supervision, clearly the regulator with the worst fair lending record.

These are the kinds of examples we have come against year after year in the past 28 years of CRA enforcement.

I would be glad to respond to any questions you may have.

[The prepared statement of Mr. Bradford follows:]

"Violating Your Way to an Outstanding Rating"

Testimony of Calvin Bradford for the National Training and Information Center (NTIC) before the Subcommittee on Domestic Policy of the House Committee on Oversight and Government Reform
March 21, 2007

Thank you Chairman Kucinich and members of this Committee for this chance to review the performance of the federal agencies charged with the enforcement of the lending laws and the Community Reinvestment Act. My name is Calvin Bradford. I am a board member of the National Training and Information Center (NTIC).

Today, I want to convey to this Committee NTIC's assessment after thirty-five years of work providing technical assistance, training, and research to the community-based organizations all across this country who first conceived of and proposed the twin towers of community banking and fair lending reform in the United States – the Home Mortgage Disclosure Act (HMDA) and the Community Reinvestment Act (CRA).

At the outset, NTIC wants to thank you, Mr. Chairman, for your long-standing concern and commitment to this area. I have brought with me the first written Community Reinvestment Act agreement that was signed on May 10, 1979. The agreement is between the City of Cleveland and First federal Savings and Loan Association of Cleveland. Signing for the City was Mayor Dennis J. Kucinch.

Looking back over the history of the CRA, there are three themes that stand out. First, in the vernacular of the CRA rating system, the record of community-based organizations in the communities which have suffered from lending discrimination and disinvestment must receive an "Outstanding" rating. Second, there are some lenders, particularly those working in partnership with their local communities, have done a "Satisfactory" job and a lesser number that have done an "Outstanding" job. Third, the federal agencies charged with the enforcement of the CRA have not risen above a "Needs to Improve" rating, and have too often fallen into "Substantial Noncompliance".

In reviewing the failure of the regulatory agencies, there are six main points that NTIC wants to make clear and for which we will provide some examples.

- First, issues of racial and ethnic discrimination have been slowly and deliberately removed from the CRA process over the years. As a result, there are no CRA consequences for lenders that engage in discriminatory behavior. Indeed, I will give you one example where a lender seems to have violated its way to an "Outstanding" CRA rating.

  Our recommendation is that the CRA should be changed to require an analysis of race-based lending as a component in the "lending test" for CRA compliance.

- Second, almost no lender ever fails the CRA – and certainly no large lender fails the CRA. The current rating scale is designed for a financial depository to pass, regardless of its performance. Our examples of how discrimination is permitted, and even rewarded, will also show how unreliable and misleading the ratings are.

  Our recommendation is that the CRA regulations, examination process, and examiner training need to be revised so that there is an accurate rating system to combat documented CRA grade inflation.

- Third, the CRA ratings for large institutions with many operations in many different markets within a region or across the county are based on a full review in only selected markets. Therefore, as long as lenders get passing ratings in those selected markets, they can ignore the needs of their other communities with impunity. This undermines the very essence of the Community Reinvestment Act that a lender should define its communities fairly and serve the needs of all communities within all of its areas. The CRA was supposed to cover everyone. There should be no CRA free communities.

  Our recommendation is that the CRA performance of a lender should be evaluated in all communities and that a poor record of service in any community should result in a failing rating for that community and should result in a mandatory lowering of the overall CRA evaluation.

- Fourth, contributing the problems of grade inflation and misleading CRA evaluations is the provision that allows the lenders the option of picking and choosing which of its affiliates and subsidiaries to include in the CRA examination. This has become even more important and most mortgage lending has been shifted from depository itself to various affiliate and subsidiary mortgage companies and commercial credit companies. This leads to a financial institution's potential to manipulate its CRA rating. Currently, for example, a financial institution can own a predatory lender but include only those loans of other affiliates that would enhance its CRA rating. CRA performance evaluations do not reflect the total picture of a financial institution's lending practices without accurate descriptions of all lending activity. This is a practice that we believe is arbitrary and capricious on its face and requires no justification to defend our recommendation for change.

  Our recommendation is that all affiliates and subsidiaries of the depository, including all subprime affiliates and subsidiaries, be included in the lender's CRA examination.

- Fifth, NTIC is mindful of the heavy toll that abuses in subprime lending have taken on many low- and moderate-income and minority communities. Other panel members will focus in these issues. One would only add that many of the dire impacts of subprime lending, like the past abuses in FHA lending, result from a lack of creative conventional credit from regulated depository institution and their affiliates. In other words, subprime abuses that occur across entire communities are to some significant degree related to CRA failures that go unrecognized by the regulatory agencies. NTIC believes that our recommendations would go a long way toward protecting communities from further subprime abuses.

Our recommendation is that the HMDA disclosures be expanded to include additional separate data on points and fees and data on credit scores and loan-to-value ratios and that the CRA examinations specifically take account of patterns that concentrate high cost loans in low- and moderate-income and minority markets within any affiliate or subsidiary of the regulated institution or its parent company.

- Finally, the Home Mortgage Disclosure Act has provided the main source of assessing mortgage lending performance over the years. We believe that the present disclosure requirements still lack reasonable disclosure of the points and fees that define exploitation and discrimination. Also, the disclosure fails to indicate the two main drivers that set the pricing for high cost loans, credit scores and loan-to-value ratios.

Our recommendation is that the FFIEC and/or the Consumer Advisory Council to the Federal Reserve Board hold a series of meetings with representatives of the major community-based organizations and assistance providers in order to restructure the disclosure formats for the HMDA data, the CRA data, and the CRA ratings and Public Evaluation reports.

The Communities Have Done Their Job

The Community Reinvestment Act was designed to create the basis for a development banking industry for underserved communities in the United States. While there have been billions of dollars reinvestment in once redlining and ignored communities, the promise of a real development banking industry remains unfulfilled.

From the community perspective, community-based organizations have done their work. With few resources and sheer determination, these organizations have led the way in identifying underserved markets, proposing real business solutions, and developing the public-private partnerships to provide the structural and institutional support to channel needed reinvestment into rural, small town, urban, and minority communities. The community-based organizations often created structures or institutional vehicles to channel investments into economic development and housing rehabilitation and development activities when they did not already exist.

Since the CRA was implemented, community-based organizations have been responsible for the creation of hundreds of Community Reinvestment Act agreements and programs. I have been involved personally in projects that have reviewed hundreds of Community Reinvestment Act agreements, programs, and challenges. It is impressive to see the commitment and creativity of so many community-based organizations sometimes working with a few equally creative and committed individual bankers. These include state-wide or local activities in most of the districts or states represented by this Committee, such as in the Boston, Chicago, Indianapolis, Baltimore, Cleveland, New Britain, and Waterloo areas or regional or statewide agreements as in California, Florida.

Over the years, many local organizations have met with individual regulators to make their concerns known and to seek constructive solutions to the problems of poor CRA enforcement. NTIC has provided assistance to many of these local organizations and to the National People's Action and other coalitions and national level organizations seeking CRA reform. This has involved many meetings with individual regulators. NTIC organized a major meting in 2002 with representatives of all of the CRA regulatory agencies where the major recommendations for modernizing and reforming the CRA were presented, and it has assisted in several follow-up meetings with individual regulators since that time.

The Failure of the Regulatory Agencies

In spite of the efforts of community-based organizations and some creative lenders, those in charge of enforcing the Community Reinvestment Act have failed to achieve the goal of creating a development banking industry and have not provided adequate protection from continued redlining and disinvestment in many communities. We believe that what is most lacking is a commitment and serious enforcement effort by the federal banking regulatory agencies who have watered down the enforcement tools - the CRA examinations, public ratings and evaluations, and the review of challenges to branching and acquisition activities.

The Failure to Account for Racial and Ethnic Discrimination

The Home Mortgage Disclosure Act and the Community Reinvestment Act were created as the result of a national movement against redlining, led by the National Peoples Action. It was, it its heart, a movement to end discrimination against communities based on their race and ethnicity.

When we find that after more than two decades of experience with the CRA the financial regulatory agencies are still sanctioning blatant redlining, we can only conclude that there is fundamental failure of federal enforcement and that Congress needs to intervene.

While racial redlining and discrimination was a major factor in the drive to create the CRA, the final wording of the Act requires lenders to serve all parts of their community, including low- and moderate-income areas. This wording does not, as the regulators have sometimes argued, eliminate a focus of racial and ethnic discrimination in the CRA – for prohibitions against lending discrimination are already built into the Fair Housing Act and the Equal Credit Opportunity Act. The inclusion of the specific language about low- and moderate-income neighborhoods was meant to add this protected class so that urban, rural, and small town areas that were not predominantly minority would also be protected against disinvestment.

Initially, one of the twelve assessment factors was "evidence of discrimination or other illegal credit practices". Over the years, the fair lending aspects of the CRA examinations have been diminished. Today, the regulatory agencies in their public reviews do not include race or ethnicity in any of their tables for the lending test. All of their analyses are based entirely on various income ranges of borrowers or areas. What remains is only a factor that requires comment on whether the regulatory agency has found that the lender has violated fair lending laws – and, as we shall see in our examples – no action seems to cross this threshold.

NTIC believes that one of the best ways to demonstrate how discrimination has been permitted, and even rewarded, is to review cases where the regulators gave a lending institution passing CRA ratings during the same period when the U.S. Department of Justice filed charges of discrimination and reached settlements with these same lenders. We find this approach particularly revealing since the Department of Justice has been criticized by civil rights groups in recent years for cutting back on its fair lending enforcement activities. Therefore, the cases that have been brought can be seen as representing particularly blatant claims of discrimination.

Basic Redlining Cases

As background for these reviews, NTIC notes that the most fundamental principle of the CRA is that a lender should serve its locally defined community. Since the initial passage of the Act and its first implementing regulations, the primary standard has been that a lender define a local community that is both reasonable for its size and that does not avoid low-and moderate and minority communities. Many of the initial CRA challenges and responses by the regulatory agencies focused on this single issue.

The Community Reinvestment Act regulations require that the delineated community: "(1) must consist of whole geographies"; (2) may not reflect illegal discrimination; (and) (3) may not arbitrarily exclude low- or moderate-income geographies". [See Section 228.41(e) of the regulations as amended 1997.] These standards are also built into the CRA examination procedures. [See, for example, the FFIEC Community Reinvestment Act Examination Procedures for Large Retail Institutions, April 1997, at pages 3-4.]

Past discrimination has created both severe patterns of geographic racial segregation and a significant correlation between income and race (or ethnicity). As a result, if a lender actually did include all the low- and moderate-income communities in its local service area, it could not avoid including most of the minority communities as well. Therefore, if a regulator allowed a lender to define a service area that avoided significant minority communities, the regulator would almost always be guilty of allowing the lender to violate the most fundamental provision of the Community

Reinvestment Act by avoiding low- and moderate-income areas and by engaging in illegal discrimination as well.

In this context, we provide the following examples of racial redlining allowed by the CRA regulators but found by the Department of Justice (DOJ) to be in violation of the Fair Housing and Equal Credit Opportunity Acts, as well as in violation of the CRA:

The OTS and Mid America Federal

The Chicago metropolitan area is the largest African-American home lending market in the United States, and one of the largest Hispanic markets outside of the Southwest as well. Mid America is the largest independent thrift institution in the entire Chicago market. It is one of the largest mortgage lenders in the Chicago markets. Mid America is regulated by the Office of Thrift Supervision (OTS). Since 1994, the OTS has given Mid America four Outstanding ratings and one Satisfactory rating.

In 2002, DOJ filed suit against Mid America for violating the Fair Housing Act and the Equal Credit Opportunity Act.[1] In specifically citing Section 228 of the CRA regulations (Reg BB), the suit stated that, "In establishing its assessment area, also known as its community service area, boundaries under the Community Reinvestment Act of 1977, 12 U.S.C. §§2901-2906 ("CRA"), Mid America has, since at least 1996, excluded nearly all predominantly African American and African American/Hispanic neighborhoods in the Chicago MSA, even those located in close proximity to its branch offices." [See the attached map which reproduces the exhibit from the DOJ complaint.]

Even though it was a major lender in the white communities along Lake Michigan in the City of Chicago and in the northern suburbs, it defined its assessment area largely as a suburban area west of Chicago. Essentially, Mid America eliminated the minority communities within the City of Chicago and the southern suburbs.

According to the 2000 census, 91% of the low- and moderate-income census tracts in the City of Chicago, for example, are also minority census tracts. Looked at from another perspective, 86% of all the minority census tracts in Chicago are also low- or moderate-income census tracts. Thus, for many years, the Office of Thrift Supervision has allowed this major Chicago metropolitan area lender to exclude both low- and moderate-income and minority areas from its defined service area.

The DOJ suit cites the pattern of expansion of Mid America through the opening of branches in the Chicago metropolitan area. The complaint states that, "Mid America has engaged in a race-based pattern of locating or acquiring new offices. It has located or acquired new branch and other offices to serve the residential lending and credit needs of predominantly white areas but not those of predominantly African American or African American/Hispanic neighborhoods. Mid America has never opened any new full-service

[1] Copies of the complaints and consent decrees for this and the other DOJ cases cited in this statement can be found on the DOJ website at http://www.usdoj.gov/crt/housing/caselist.htm#lending.

branch office in a majority African American or African American/ Hispanic neighborhood. As of March 1, 2002, of Mid America's 33 branch offices, only one, Broadview, is located in a census tract in which a majority of the residents are African American. However, the Broadview branch is the only non-traditional office operated by Mid America. In contrast to all its other branch offices, the Bank's Broadview office consists solely of an ATM machine and a lobby area located inside a K Mart. Moreover, the level of services offered at the Broadview branch is substantially less than that offered at Mid America's other branches. Every other branch office offers mortgage lending or investment services, or both; neither is offered at the Broadview branch."

Opening branches is a privilege that should be granted only to institutions that have satisfied their CRA obligations. By continually allowing Mid America to expand, the OTS was rewarding a major lender in the nations largest African-American mortgage market for engaging in racial redlining – the very practice that led to the creation on the CRA in the first place.

While DOJ settled the case by requiring the lender to open minority branches, to pay $10 million for special minority loans to compensate for past discrimination, and to develop outreach programs and to participate in existing special loan programs, the OTS still gave the lender a rating of Satisfactory after noting the lawsuit (the only rating below Outstanding that the OTS gave this lender since 1992). The OTS noted that in light of the lawsuit it could "not find the lender had not violated the fair lending laws". As the lender complied with the settlement order, the OTS gave the lender credit for expanded lending and raised the rating to Outstanding. Thus, the actions that Mid America took as the result of a consent order by a Federal court were used to raise its rating to Outstanding.

The Federal Reserve Board and Old Kent Bank

Between 1997 and 2001, the Federal Reserve Board had given three Satisfactory CRA ratings to Old Kent Bank, a major lender in the Detroit metropolitan area.[2] During this period, Old Kent defined its assessment area in terms of several counties and parts of counties that encircled the City of Detroit, but excluded the City of Detroit itself. A review of the Public CRA Evaluation reports indicates that the Federal Reserve Board was clearly aware of this exclusion and that it accepted this exclusion of Detroit and evaluated Old Kent based on the service it provided to the predominantly white suburban areas only.

In 2006, DOJ filed suit against Old Kent for violating the Fair Housing Act and the Equal Credit Opportunity Act. In specifically citing Section 228 of the CRA regulations (Reg BB), the suit stated that, "Instead of defining its assessment area in accordance with Regulation BB, Old Kent Bank circumscribed its lending area in the Detroit MSA to exclude most of the majority African American neighborhoods by excluding the City of Detroit." [See the attached map which reproduces the exhibit from the DOJ complaint.] The complaint also indicates that "As of March 2000, Old Kent

[2] The 2001 rating was given after the FRB had approved the merger of Old Kent into First Third Bank.

Bank still did not have a single branch in the City of Detroit, where the population is more than 81% African American."

According to the 2000 census, 93% of the low- and moderate-income tracts in Detroit, are also minority census tracts. Looked at from another perspective, 86% of all the minority census tracts in Detroit are also low- or moderate-income census tracts. Thus, for many years, the Federal Reserve Board had allowed this major Detroit metropolitan area lender to exclude both low- and moderate-income and minority areas from its defined service area.

The DOJ suit cites the pattern of expansion of Old Kent through the opening of branches in the Detroit metropolitan area. The complaint states that, "As of January 1996, Old Kent Bank operated at least 18 branches in the Detroit MSA. Not a single one of these branches was located in the City of Detroit. As of March 2000, Old Kent Bank had expanded its business presence in the Detroit MSA to include a branch network of at least 53 branches, located in every county of the Detroit MSA. Virtually all of Old Kent Bank's branches were located in predominantly white suburbs." Opening branches is a privilege that should be granted only to institutions that have satisfied their CRA obligations. By continually allowing Old Kent to expand (and by later allowing the merger of Old Kent and Fifth Third), the Federal Reserve Board was rewarding a major lender for engaging in racial redlining.

The DOJ complaint also cited Old Kent for failing to provide equal lending services for both home mortgage and small business loans to the minority areas that were illegally excluded from its CRA lending community. As a result, DOJ engaged in a consent order requiring corrective actions that had not been ordered by the Federal Reserve Board.

The FDIC and Centier Bank:

Centier Bank is regulated by the FDIC. It serves a regional market in Northwest Indiana. The FDIC examined Centier four times between 1993 and 2003. Each time the bank was given a Satisfactory rating. This rating allowed the bank to continue to engage in branching and expansion activities which should have been denied had the institution bee given a failing CRA rating. Indeed, it has become clear that even when community challenges are made, a passing CRA rating provides the lender with a safe harbor. Therefore, challenges become a fruitless gesture for lenders with passing CRA ratings – and almost all lenders have passing CRA ratings.

While Centier's delineated service area literally surrounded the City of Gary (a predominantly African-American city), through at least most of 1999, almost all of the City of Gary, and all of Gary's predominantly minority census tracts, were excluded from the delineated community. In this year (according to the DOJ complaint), "the FDIC informed the Bank that its assessment area violated the CRA and its regulations." Even at this point, the FDIC continued to give the bank a Satisfactory rating.

In 2006, DOJ filed suit against Centier for violating the Fair Housing Act and the Equal Credit Opportunity Act. In specifically citing Section 228 of the CRA regulations (Reg BB), the suits stated that, "Instead of defining its assessment area in accordance with Reg BB, Centier long circumscribed its lending area in the Gary PMSA to exclude most majority-minority neighborhoods, including having two geographically separate assessment areas for many years. Until late 1999, Centier's CRA assessment area included only three majority-minority census tracts from Gary, East Chicago, and Hammond, despite the fact that a large number of minority tracts were adjacent to the non-minority tracts included in the assessment area." [See the attached map which reproduces the exhibit from the DOJ complaint.]

According to the 2000 census, 93% of the low- and moderate-income tracts in Gary, Indiana, are also minority census tracts. Looked at from another perspective, 87% of all the minority census tracts in Gary are also low- or moderate-income census tracts. Thus, for many years, the FDIC had allowed this major Northwest Indiana lender to exclude both low- and moderate-income and minority areas from its defined service area. In allowing the institution to continue to open branches in the areas outside of Gary, the FDIC was actually rewarding Centier for its discrimination.

The DOJ complaint also cited Centier for failing to provide equal lending services for both home mortgage and small business loans to the minority areas that were illegally excluded from its CRA lending community. As a result, DOJ engaged in a consent order requiring corrective actions that had not been ordered by the FDIC.

<u>Flagstar – Violating Your Way to an Outstanding Rating</u>

If the regulatory agencies can't identify discrimination as blatant as that described in these examples of DOJ cases, then there is a fundamental problem that surely requires Congressional action to be corrected. Still, one might try to set aside these cases by claiming that these all involved settlements where the lenders claimed that they did no wrong. That is, these cases did not involve court decisions that fair lending violations occurred. Let us turn, then, to a case where there were such legal findings.

The case of Flagstar Bank, FSB, represents that rare exception where we actually have proof of fair lending violations that we can compare to the public comments of the institution's regulator and to the CRA ratings given to the bank before and after the violations occurred. This case illustrates how even multiple legal findings of discrimination can lead a lender to an Outstanding CRA rating.

- Between February of 1994 and November of 2005, during which time the OTS gave Flagstar Bank "Satisfactory" and "Outstanding" CRA ratings, this lender was sued several times in federal court for issues related to discrimination in lending. Flagstar, in contrast, was found liable for discrimination at trial or by the court in at least two of these cases.

- In 1999, a jury in Detroit found Flagstar liable for discrimination against minority borrowers, and plaintiffs were awarded damages. Later the Sixth Circuit Court of Appeals upheld one of these findings. In 2003, in a national class action suit, a federal court in Indianapolis found a written pricing policy developed by Flagstar management in 2001 so overtly discriminatory that the court ruled against Flagstar on summary judgment. The policy explicitly stated that pricing would be different for minority and non-minority borrowers. It appears that the discriminatory pricing policy was developed and implemented by Flagstar *while* the OTS was conducting its consumer compliance examination.

- The OTS conducted five CRA examinations and never found Flagstar in violation of discrimination laws. During this time period, Flagstar was given a "Satisfactory" CRA rating four times and was elevated to an "Outstanding" rating after the summary judgment finding in 2003.

Flagstar was one of the nation's twenty largest mortgage lenders during the period covered by this litigation. It sold loans to both Fannie Mae and Freddie Mac and was one of the largest underwriters of FHA loans through certification granted by HUD.

Moreover, Flagstar was allowed to expand significantly during this time period by opening numerous branches, expanding into a new state, and expanding to additional metropolitan areas in these states. The approval of its applications to expand was based, in part, on its CRA ratings. As a result, during the period from 1994 through 2005, Flagstar grew from just over $500 million in assets to nearly $13 billion in assets.

The actions taken by Flagstar as a result of the settlement of suits in Detroit were actually used to raise its later CRA rating. After the Federal Court in Indiana forced the elimination of its written racial pricing policy, the OTS gave Flagstar an Outstanding rating, finding no violation of fair lending laws in spite of two legal decisions. As bizarre as it seems, Flagstar seems to have literally violated its way to an Outstanding rating.

Providing Lenders with CRA Free Communities

Another issue relates to which cities and areas are included in the examination process. Many communities outside of the largest metropolitan areas have been concerned that the high CRA ratings given to almost all the major lenders are based only on their alleged performance in the largest markets. This allows them to avoid smaller cities and rural areas and still gain the full protections of high ratings.

For instance, it took years of work from a small local organization, Sunflower Community Action in Wichita, Kansas, to get an enhanced examination of Bank of America's CRA performance in their community. The organization had significant concerns with the bank's denial rates to African Americans, branch locations and suggestions of ways for the bank to meet the credit needs of Latinos. It was even a battle for the group to get Bank of America to provide them with the appropriate decision maker.

The Wichita metropolitan area is the largest metropolitan area in the State of Kansas. It has the largest Hispanic population, the second largest African-American population, the largest Native American population, and the largest Asian population of any metropolitan area in Kansas. Over 28% of the total population of the Wichita metropolitan area is minority. Yet because Bank of America serves so many larger metropolitan areas, the Comptroller of the Currency did not weigh the bank's performance in Wichita equally.

It took years of research organizing and negotiation to get the comptroller to agree to add a more in depth evaluation of Wichita into the exam of just one single lender (Bank of America). The Comptroller should have taken this initiative itself and it should have required the review of the lending and investment patterns of all of its large lenders across all significant markets. Each community should not have to fight with each regulator over each lender across the entire country just because the regulatory agencies are not interested in the financial needs of citizens outside of the largest markets. The CRA was supposed to protect all citizens in all communities – not just those in the largest financial markets.

Grade Inflation and Its Impacts

We believe that the examples of redlining we have provided as well as the example of the exclusion of all but the largest metropolitan areas for full assessments of performance under the CRA supports our point that the present limited and poor level of CRA enforcement leads to grade inflation in several different ways. Of course, including all areas for full CRA assessments would not, in itself, correct the grade inflation that comes from simply ignoring redlining or poor performance that is not cited under the present forms of CRA evaluations.

The Impact of Bad CRA Enforcement

Bad examinations not only hurt the communities where the lender operates, but they can be used to block challenges. Having a passing CRA rating, Mid America, Old Kent, Centier, and Flagstar were all able to engage in branching and acquisitions in spite of their discriminatory behavior.

What signal does this regulatory behavior give to lenders? NTIC is concerned that lenders see the advantages of using the federal bank regulators to create a shield from investigation of their possible discriminatory lending. Moreover, existing regulated institution may see an advantage in switching their charters from one regulator to another in order to find safe harbor in the regulator with the worst record of fair lending and CRA enforcement.

Using Bad Federal Regulation as a Shield

There is a trend for independent lenders to acquire banks or savings institutions to expand their roles in financial markets. This has been a growing pattern for subprime lenders. NTIC is concerned that independent mortgage companies could try to fold their lending under the protection of the charter of their depository lenders in order to protect themselves from aggressive fair lending and consumer protection enforcement.

The example of Countrywide serves to illustrate this concern. In the first action taken based on racial disparities in subprime lending from the revised HMDA data, the Attorney General of the State of New York, now Governor Spitzer, found a pattern of racial lending and pricing disparities by Countrywide Home Loans in their 2004 HMDA data. By subpoena, further analysis of underwriting factors led the Attorney General to conclude that racial disparities existed even after controlling for underwriting factors. Countrywide reached a settlement agreement in November of 2006.[3]

When these same expanded HMDA data for 2004 were first released with the pricing data that allowed for improved identification of subprime lending patterns, the Fed identified a series of lenders whose racial disparities were significantly adverse. Each regulatory agency was provided with the list of its lenders that showed these disparities. The agencies were to investigate these disparities in more depth.

With little confidence in the federal regulatory agencies, many consumer groups looked to the sates' attorneys general or to their state civil rights enforcement agencies to investigate discrimination and violations of consumer protection laws. In the press announcement for the Countrywide settlement, however, then Attorney General Elliot Spitzer indicated that the federal regulatory agencies (specifically the OCC) were shielding regulated lenders from fair lending investigations by claiming federal exemption for enforcement. Indeed, the OCC has gone to court to prohibit state agencies from enforcing fair lending laws.

Countywide presents a particularly interesting case in regard to the possible attempts of lenders to seek federal protection from fair lending enforcement. The parent corporation of Countrywide Home Loans is Countywide Financial Corporation. Since 1990, Countrywide Financial has owned a national bank – Countrywide Bank. In the same month that Countrywide Home Loans settled with the Attorney General of New York, it applied to the Office of Thrift Supervision to change its charter from a national bank to a federal savings bank. As of March 12 of this year, Countrywide Bank is now operating as a federal savings bank under the supervision of the OTS. Moreover, the parent company, Countrywide Financial Corporation, is now designated as a savings and loan holding company and is also regulated by the OTS. This places all of the lending activities of one of the nations very largest lenders under the supervision of the regulatory agency that provided an Outstanding CRA rating to a lender twice found liable for fair

[3] See the Attorney General of the State of New York, Civil Rights Bureau in the matter of Countrywide Home Loans, Inc., Assurance of Discontinuance Pursuant to Executive Law 63(15), November 22, 2006.

lending violations during the times it was being reviewed for consumer compliance by the OTS.

Countrywide's lending patterns have long been a concern for fair housing and community-based organizations. Prior to the present extreme concern over subprime lending and pricing disparities that has arising in the late 1990s, the steering of minorities and minority neighborhoods to FHA lending was the major concern as the concentration of FHA foreclosures harmed the housing markets and local economies of those areas. Indeed, one of the main reasons for the creation of he CRA was to help ensure a fair floe of conventional prime loans into minority and racially diverse communities.

Historically, Countrywide's lending has often raised concerns. In a detailed study of lending from 1995 to 1997 that I conducted with the Equal Rights Center in the Baltimore market area, we found that of the 2,779 home purchase loans made by Countywide in this market with a large number of African-America communities, there were only 70 conventional loans in minority census tracts (just 2.5% of the total).[4] [See the maps attached to this statement.]

Using data from a study of the Chicago and Washington, D.C. markets that I did for HUD for the years 1994 to 1996, Countrywide's lending shows clear pattern of shifting a larger percentage of its minority loans to FHA as it expanded its market in those metropolitan areas. In the Chicago market, the FHA share of all home purchase loans to African-Americans rose from 23% in 1994 to 49% in 1996, while the overall FHA share for the entire market remained constant. In the Washington market area, while the overall market share of FHA home purchase loans to African-Americans rose about 9%, Countrywide's share of FHA loans to African-Americans rose by 46%.

During this same time period, the National Fair Housing Alliance was conducting a nationwide testing program for lending discrimination under a grant from HUD. Countywide was one of the lenders for which NFHA found racial disparities in its tests related to FHA steering.

From data that I analyzed for Orange County, California from 1999 to 2001, Countrywide also showed large disparities in FHA lending by race in this market. The FHA share of loans made to white borrowers ranged from 5% to about 9%. Meanwhile, the FHA share of home purchase loans made to African-Americans ranged from 29% to 35%.

Given the consistency of these patterns, disparities in pricing for high cost loans now offered by Countrywide as one of the largest subprime lenders would certainly be a concern, particularly given the increasing foreclosure rate of high cost loans and their concentrations in communities of color. We would not expect the Federal Government to provide protection for lenders against the honest investigation of lending disparities by

[4] See, *Crisis in Déjà vu: A Profile of the Racial Patterns in Home Purchase Lending in the Baltimore Market – A Report from The Public Justice Center*, May 2000.

agencies in state and local governments. We would be especially concerned if this protection is provided under the guise of Community Reinvestment Act enforcement.

Public Disclosure with a Hitch

The HMDA are a critical companion to the CRA in the area of home lending. While we commend the Federal Reserve for its expansion of the HMDA data into the area of pricing, we must indicate that there are still serious issues with the use of the HMDA. Many of these have already been raised in the hearings of the Subcommittee on Financial Institutions and Consumer Credit of the House Financial Services Committee last June – and the issues raised in those hearings should continue to be pursued.

I would, however, add one example of the kind of problem that needs to be addressed in the formats for making the public data available to – the public. It has always been the community-based groups that have fought for the CRA and that have initiated the most creative partnerships and programs. Most of the major programs today are based on these initiatives by local community groups, local development organizations, and their banking partners. For example, Fannie Mae created a flexible loan product with the National Training Information Center which required housing counseling and used non-traditional credit standards with very affordable mortgage insurance rates. This product had incredibly low defaults due to the borrower having contact with a local community organization. NTIC was able to use HMDA data to make the case that a product like this could bring credit to low and moderate income communities. Most recently, several lenders have worked with community organizations to create creative approaches to keep people in their homes. This happened partly due to the fact that foreclosure rates were increasing and many unsuitable loans (ARMS and interest only) were being made. NTIC is able to do research like this with few resources. Most are not equipped do engage in detailed statistical analysis of the HMDA data.

The FFIEC does provide easy access to CDs with the complete file of the raw individual loan application register data for each year. The raw HMDA data are important, but they generally require access to some sophisticated – and often expensive - software in order to aggregate the individual loan application records into meaningful categories for analysis and review.

Since the HMDA was implemented, sets of basic HMDA tables providing tabulations of data that can be used for many critical lending evaluations have been created by the FFIEC and printed and placed in local public depositories. The main advantage of these tables was that the raw individual loan data was aggregated into various categories and into census tract totals – both for all the lending in a metropolitan area and for each individual lender. Yet, these depositories did not always maintain these data well. These depositories were often far from a local community. Moreover, one could only copy down data or make copies of tables, but could not place these raw tabulations into simple spreadsheets where people could calculate simple patterns, such as the percentages of loans made to various areas or to racial, ethnic or income groups.

For the 2003 and 2004 HMDA data, the FFIEC created a special CD with what are essentially these public tables in an electronic format. The CD had an easy-to-use extraction program. Not only could you print out the tables, but, more importantly, you could load any table for any metropolitan area and any lender into a simple spreadsheet and easily make calculations and additional tabulations of your own. This provided a wonderful resource that could have helped to overcome the major obstacle to the use of the HMDA data by local community organizations – the need to tabulate the individual loan records into groups by borrower or geographic area characteristics. These pre-defined tables represented a valuable resource that technical assistance groups could have developed rather easily into training programs that would have allowed many local groups to use the HMDA data more quickly and effectively – and at the cost of only $10 for the disk for the entire nation.

On the other hand, few people realized that this resource existed. It was not widely announced or highlighted. The CD has now been discontinued and replaced by a process where the tables can only be accessed online. This requires a rather high speed internet connection. One can print out a specific table (a PDF version), though this cannot be inserted into a spreadsheet. While the CD allowed a person to extract and load any individual table into a simple spreadsheet format, the online system only allows one to download the entire set of tables all streamed together in a single text file. For any but the smallest MSA, these tables typically have thousands of rows of data. For most of the tables, there is no row with a title or any other indication of where the table begins.

To extract one major table for the medium sized Wichita MSA (Aggregate Table 5-3), for example, one must search through 1,639 of the 3,488 rows of data to find where the table began. Even then, one needs to extract and review the picture (PDF) versions of the tables in order to identify the fields and exact data that indicate the beginning and end of the table one wants to use. Finally, unless one is skilled at locating and disabling all the various programs on their computer with pop-up blocking mechanisms, the data cannot be downloaded at all. Only after this sometimes painstakingly slow process can one effectively locate an individual table and use its data.

The existing CDs were eliminated and this convoluted online system was developed with no input from the community-based users of the HMDA data. Similar changes were made for the private mortgage insurance version of the HMDA data and for the CRA data. How ironic it is that the Fed would create such a potentially valuable set of tables and then make it as difficult as possible for people to use them.

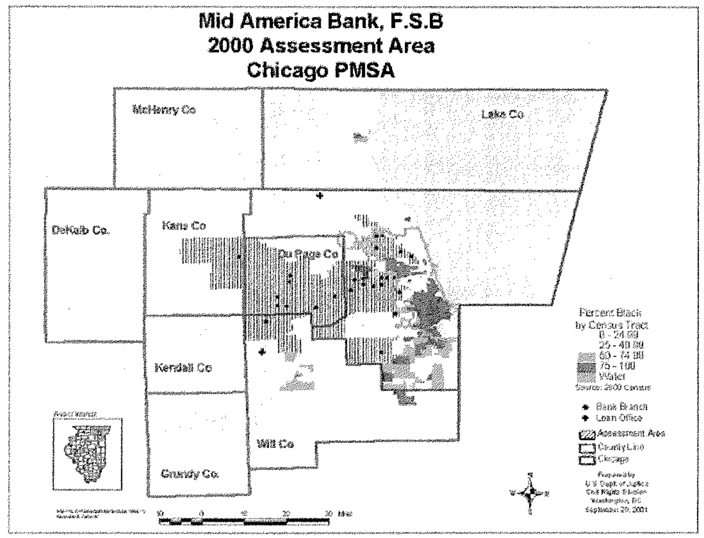
I was told by a person at the Fed who was managing this system that this was done to save people the cost of $10 for the CD. This indicates how out of touch the Fed is with the public users – or potential public users – of the HMDA data. The time that one needs to spend struggling with the online format certainly far exceeds the small fee for the CD with its convenient extraction program. It is time that the FFIEC, possibly through the actions of the Fed's Consumer Advisory Council, sets up a dialogue involving a wide range of community groups, technical assistance providers, and those who actually are involved in the collection and disclosure of the HMDA at the FFIEC so that the data can be collected and released in formats that actually support its use by the public – and not just by the regulatory agencies, lenders, and those organizations with access to skilled researchers with sophisticated computer systems and software.

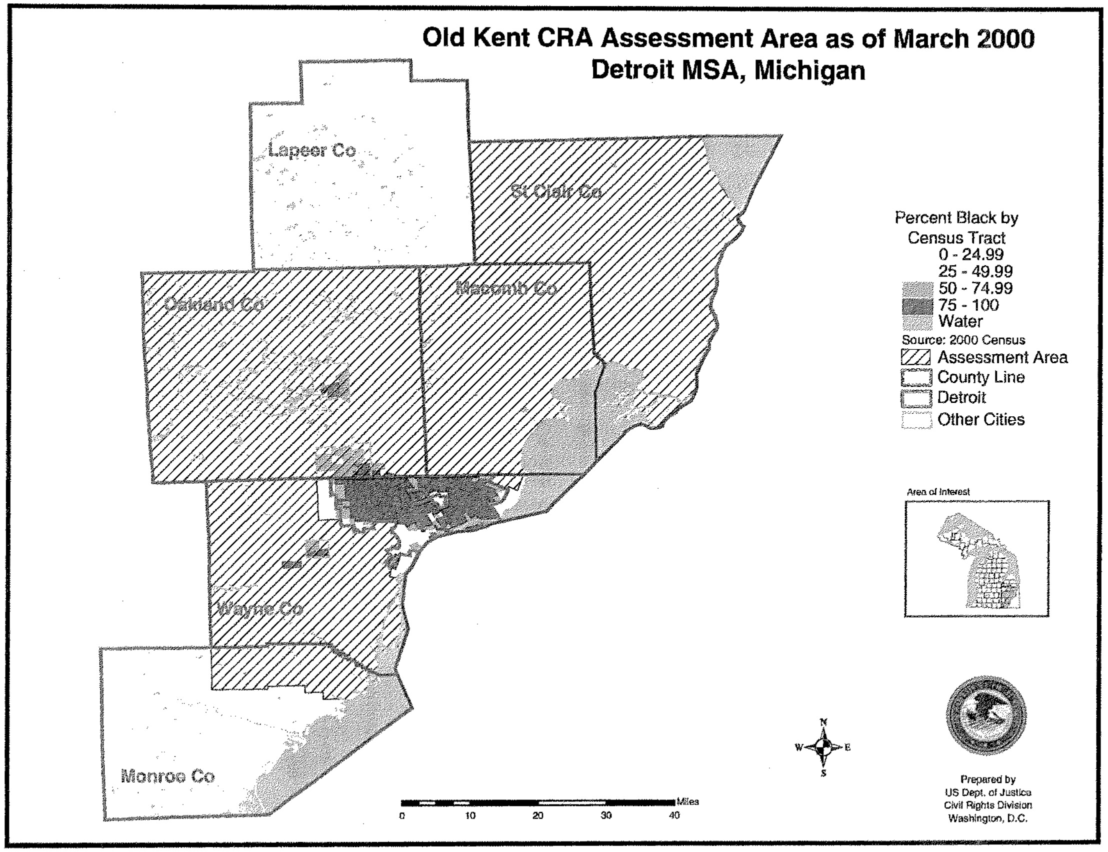
Turning to the process for the release of the CRA ratings and the CRA Public Examination reports, the individual online systems for locating and downloading these reports is also difficult to use and confusing. In many cases, one cannot locate a CRA evaluation by entering the full name of the lending institution, but most actually enter only a partial name in order to get the system to retrieve the records. In the case of the Comptroller of the Currency, the new system no longer searches for all reports but requires that you first identify the exact year and month when the report you are seeking was released from within a matrix of 131 yearly and monthly links. How many of us looking for a history of CRA reports on an individual lender or even the report on the most recent examination know exactly which month of which year it was released? Essentially, the Comptroller's site is set up so that you can't search for a report unless you already know where it is. A person looking for all the historical evaluations on a lender would have to search individually through all 131 of these links. This is more than clumsy, it is outright obstructive.

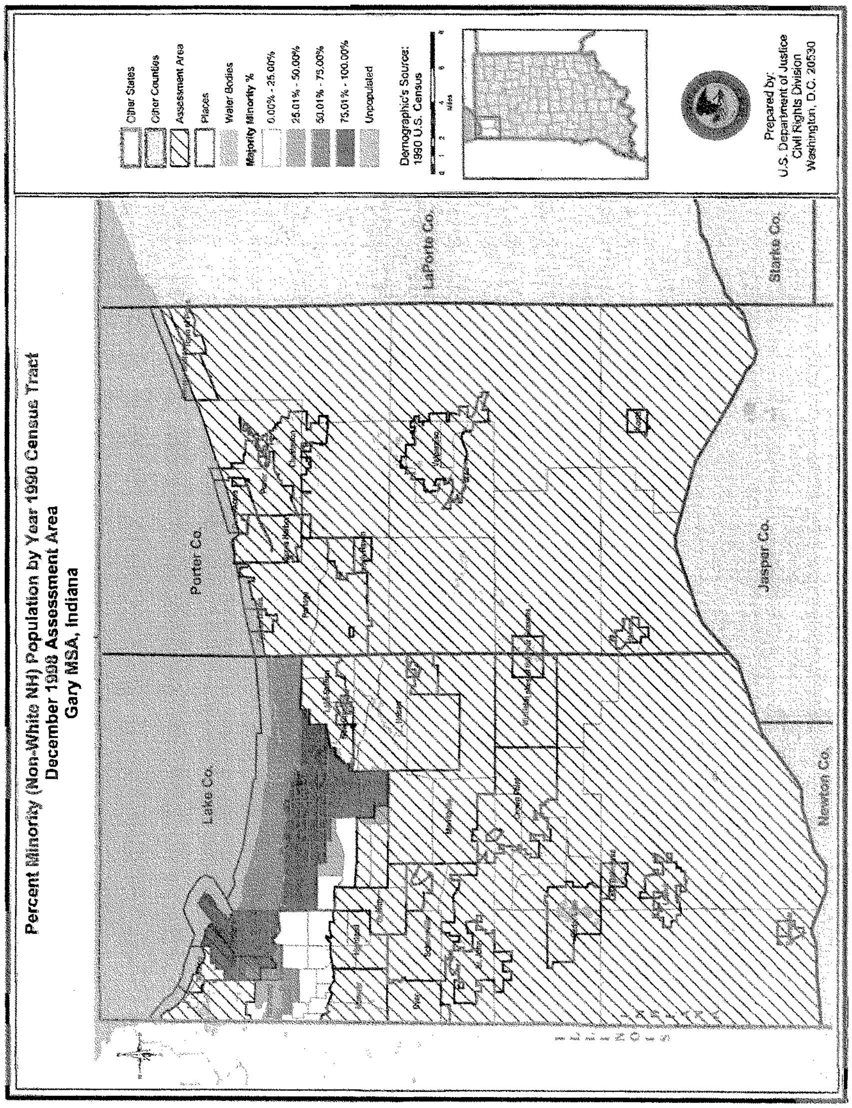
Save Us from the Regulatory Malpractice

In summary, it appears to us that the law designed by citizens and enacted by Congress to create access to government regulated lending institutions for all people and all communities has been transformed into a vast bureaucratic system to protect the lending institutions from investigation criticism and accountability. The goal of creating a community development banking industry has been kept on life support by the constant nursing efforts of community-based organizations and their development partners. Meanwhile, the federal regulators who are granted all of the diagnostic and treatment powers continually cut off the blood supply to the CRA's vital organs.

I would be glad to respond to any questions or concerns that you may have and NTIC would be glad to provide the Committee with additional information on points and issues that could not be addressed adequately in our limited time here today.


Mid America Bank, F.S.B
2000 Assessment Area
Chicago PMSA
McHenry Co
Lake Co
DeKalb Co.
Kane Co
Du Page Co
Kendall Co
Will Co
Grundy Co.
Percent Black
by Census Tract
0 - 24.99
25 - 49.99
50 - 74.99
75 - 100
Water
Source: 2000 Census
Bank Branch
Loan Office
Assessment Area
County Line
Chicago

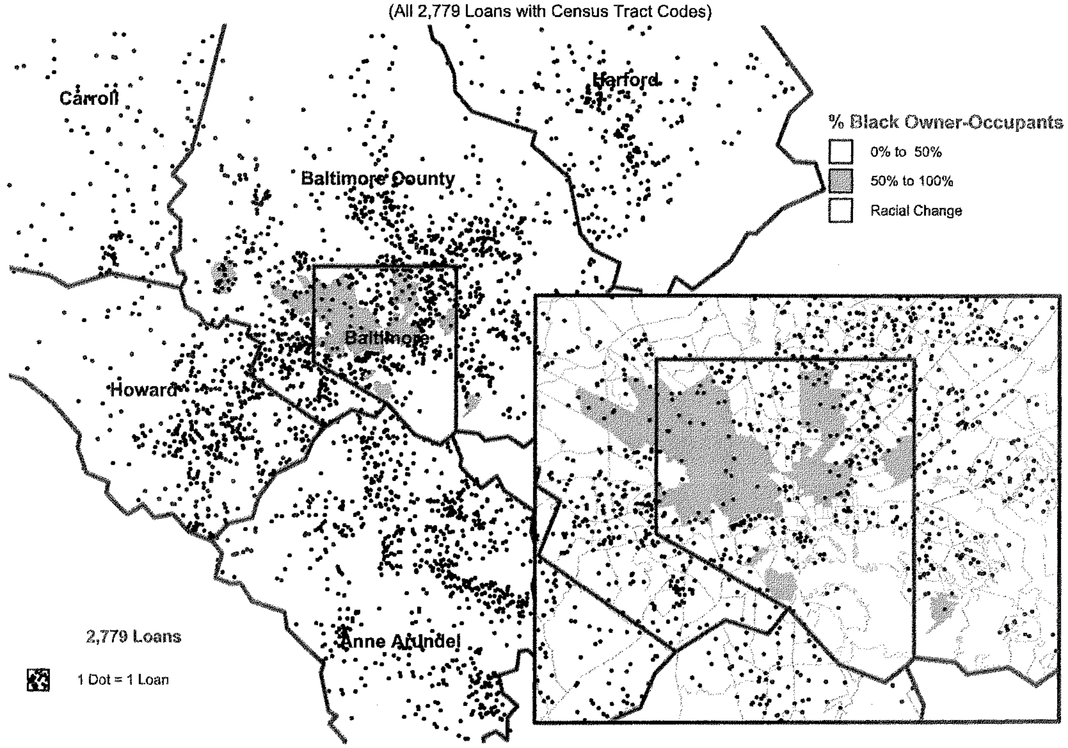

Old Kent CRA Assessment Area as of March 2000
Detroit MSA, Michigan
Lapeer Co
St Clair Co
Oakland Co
Macomb Co
Wayne Co
Monroe Co
Percent Black by
Census Tract
0 - 24.99
25 - 49.99
50 - 74.99
75 - 100
Water
Source: 2000 Census
Assessment Area
County Line
Detroit
Other Cities
Area of Interest
N
W
E
S
0
10
20
30
40
Miles
Prepared by
US Dept. of Justice
Civil Rights Division
Washington, D.C.

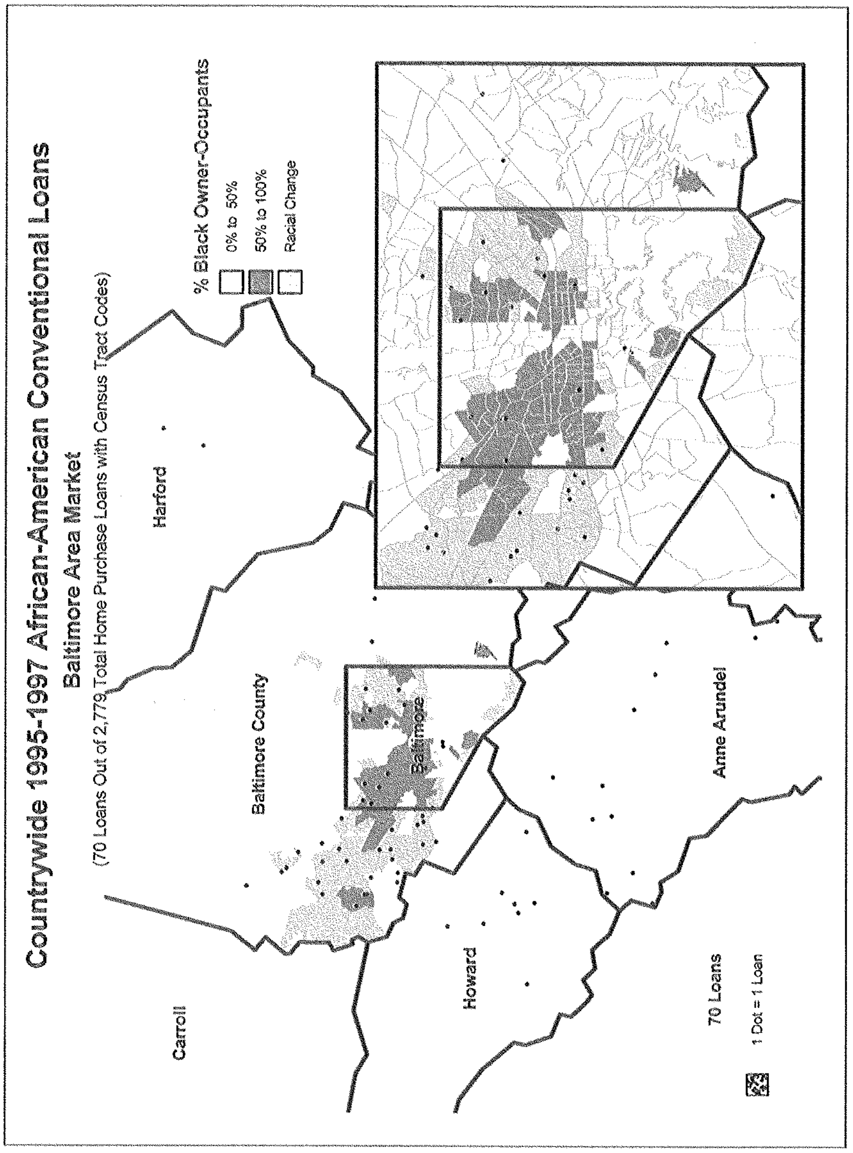

Percent Minority (Non-White NH) Population by Year 1990 Census Tract
December 1998 Assessment Area
Gary MSA, Indiana
Lake Co.
Porter Co.
LaPorte Co.
Starke Co.
Jasper Co.
Newton Co.
Other States
Other Counties
Assessment Area
Places
Water Bodies
Majority Minority %
0.00% - 25.00%
25.01% - 50.00%
50.01% - 75.00%
75.01% - 100.00%
Unpopulated
Demographic's Source:
1990 U.S. Census
Prepared by:
U.S. Department of Justice
Civil Rights Division
Washington, D.C. 20530

Countrywide 1995-1997 All Home Purchase Loans

Baltimore Area Market

(All 2,779 Loans with Census Tract Codes)





Countrywide 1995-1997 African-American Conventional Loans
Baltimore Area Market
(70 Loans Out of 2,779 Total Home Purchase Loans with Census Tract Codes)
% Black Owner-Occupants
0% to 50%
50% to 100%
Racial Change
Harford
Baltimore County
Baltimore
Carroll
Howard
Anne Arundel
70 Loans
1 Dot = 1 Loan

Mr. KUCINICH. I thank the gentleman.

Professor Maloney, you may proceed. Thank you.

STATEMENT OF MICHAEL MALONEY

Mr. MALONEY. Thank you, Chairman Kucinich, for asking me to be here today, and honorable members of the committee. It is an honor to be here. I am going to talk about payday lending, and I am going to talk about it from a slightly different tack than the other people on the former panel.

My interest in this topic is 5 or 6 years old and purely academic. From that perspective, I have done some research that I will report today.

As you pointed out, I am a professor of economics at Clemson. I have been on the staff of the Securities and Exchange Commission. But my main love is teaching, and especially graduate students.

At Clemson we are interested in the short-term credit market, and, in particular, whether consumers are better off having access to such credit. As part of our research, we have examined payday lending and its impact on consumers, and our research has found that payday lending has increased access to short-term credit without harming consumers.

A couple of things that need to be pointed out, I believe, in the context of the short-term credit industry, the industry, itself, generates more than $95 billion in fees annually. These are not interest charges; these are fees.

Some of those fees may shock you. The fees charged for insufficient funds amount to $30 billion. More than $50 billion is generated by credit card companies for late fees or over-the-limit fees. So these are fees that are being charged by other credit providers. The payday lending industry generates $6 billion in fees.

I think that credit card thing is the one that is kind of shocking, because you think about somebody that has a credit card and they are just paying some fairly high interest rate, but where they really get ding'ed is where they don't make that payment or they go over the limit.

One of my graduate students had this exact thing happen to her. I was just shocked by the number.

Some critics of payday lending have proposed limiting interest rates or eliminating these loans altogether. In fact, the interest rate cap of 36 percent will end the industry, because they can't make any money at 36 percent. They can't cover their cost. I don't think that is the right tack to take.

All forms of legal credit are vast improvements over loan sharks and wholly unregulated forms of credit that dominated the credit market prior to the 20th century, and I think that we would return to that again if people are denied access to legal forms of short-term credit.

The access to credit is best conducted in the open and competitive market. Although likely to be always relatively high cost, short-term credit has high cost because of its fixed cost and in the cost of doing business. Its fees are still competitively determined, and there is a lot of competition in the industry. Hence, we have to believe that is the cost of doing business.

Research by Dr. Donald Morgan at the Federal Reserve Bank of New York has confirmed previously published research that consumers of payday loans shop for best prices and have benefited from increased competition.

Another thing to recognize about payday loans is, as Ms. Grossman pointed out, consumers want these loans and they recognize the value of the loan because of its ease of access. They also enjoy its convenience in terms of location and its privacy.

As I mentioned before, for many it is a choice of taking out a payday loan or confronting more expensive alternatives. A 2005 study by Professor Tom Lehman confirms that payday loan fees offer a cost advantage to consumers over non-sufficient fees at banks, and are understood by consumers to be that.

But what I really want to talk to you about today is the new research we have done at Clemson.

My position on this payday loan industry has always been that it could be good or it could be bad. It seemed to me that the questions that should be answered are whether communities are worse because of payday loans or better off. Are there more homeless people because of payday loans, or are there less homeless people because of payday loans. That is a scientific question, and a scientific question that I think we have some answers to, though not complete.

We looked at bankruptcies nationwide, State-by-State. We compared bankruptcies State-by-State over the years 1990 to 2004 to the number of payday stores in each State over that period. What we found was that, instead of payday loans causing bankruptcies, payday loans reduced bankruptcies in a statistical test of causality. We also found, as you might expect, bankruptcies caused payday loans. When bankruptcies go up, payday loan stores go up, responding to the demands for short-term credit by those consumers.

Now, as I say, a lot more research needs to be done on this topic. We are pursuing it, and I hope a lot of academics in the marketplace are pursuing it and the answers will come forth.

I think our results on bankruptcy is especially important in the light of the other issues that were being considered today, particularly important in the light of the focus on mortgages and foreclosures. Having access to emergency cash that is not tied to a credit rating, home equity, or assets is particularly important for consumers who are seeking to maintain their homes.

In conclusion, Mr. Chairman, payday lending is one of many options available to consumers of short-term credit. it appears to offer advantages of convenience, privacy, and cost that make it welfare-enhancing to consumers. No data exists to show that payday lending is inherently a poor choice for consumers as a whole, relative to the other options that they have.

Demand for short-term credit will always exist as long as cash reserves for consumers are less than the emergency cost they are likely to face, and efforts to constrain the market forces are more likely to harm rather than benefit consumers with short-term credit needs.

Thank you.

[The prepared statement of Mr. Maloney follows:]

Testimony of

Dr. Michael T. Maloney
Professor of Economics
John E. Walker Department of Economics
Clemson University

before

The Domestic Policy Subcommittee

of the

U.S. House of Representatives Committee on Oversight and Government Reform

hearing on

"Foreclosure, Predatory Mortgage and Payday Lending in America's Cities"

March 21, 2007

Thank you Chairman Kucinich, ranking member Issa and distinguished members of the subcommittee for asking me to testify today. It is an honor to be here today to testify on Foreclosure, Predatory Mortgage and Payday Lending in America's Cities. The main focus of my testimony is payday lending.

I am a Professor of Economics at Clemson University. I formerly served on the staff of the Securities and Exchange Commission.

At Clemson we are interested in short-term consumer credit and, in particular, in whether consumers are better off having access to such credit. As part of our research, we have examined payday lending and its impact on consumers. Our research has found that payday lending has increased access to short-term credit without harming consumer welfare.

The number of payday lenders has surged in recent years with the high level of consumer demand for short-term, small-denomination credit and the increasing failure of banks to meet this demand. Providers of payday loans today include large regional or national multi-service providers of payday loans and large regional or national so-called "monoline" payday loan entities. With limited exceptions, insured depository institutions have left this market. Nevertheless, the number of payday loan offices nationwide has increased from approximately 300 in 1992 to more than 20,000 today as consumers seek access to credit.

Payday lending is one of many options for short-term credit, yet it remains relatively small in terms of overall economic impact. Short-term consumer credit as an industry generates more than $95 billion in non-periodic-interest fees per year nationwide. Of those fees, only $6 billion are generated by the payday loan industry. More than $30 billion dollars are generated in bank and credit union non-sufficient funds (NSF) fees, and more than $50 billion are generated from credit card late and over-the-limit fees. By the way, these fees exclude the costs of other forms of short-term consumer credit, such as pawn, tax-refund-anticipation, credit card and all retail installment lending.

Some critics of payday lending have proposed limiting interest rates or eliminating these loans altogether. Economic theory tells us that neither price controls nor prohibition will help consumers who need access to capital. Borrowers have legitimate needs for credit, and payday loans exist today as one of many legal options.

All forms of legal credit are vast improvements over the loan sharks and wholly unregulated forms of credit that dominated the credit market prior to the 20th Century and that would once again dominate credit options for Americans in the absence of these lawful services.

Access to credit is best conducted in the open and competitive marketplace. Although likely always to be relatively costly due to the risk profile of the borrowers it serves and the fixed costs of delivery and collection, the payday loan industry is increasingly competitive, and fees and profit margins for providers of payday loans have been reduced in recent years. Recent research by Dr. Donald Morgan of the Federal Reserve Bank of New York has confirmed previously published research that consumers of payday loans shop for best prices, have benefited from increased competition, and have their overall welfare improved by increased access to credit.

Thus, contrary to the popular view of consumers turning to payday lenders in desperation, research shows that consumers who can access alternative sources of credit have opted for the relative convenience and speed of a payday loan. A Georgetown University survey in 2001 found more than half (59%) identified the most important reason for choosing a payday loan over another source was "quick, easy process, fast approval, less paperwork." About 10% chose a payday loan because of a convenient location. Significantly, about 10% identified privacy as a critical and the most important reason.

For many, it is a choice of taking out a payday loan or confronting more expensive alternatives. For example, a consumer can merely write a bad check and incur bank and check recipients' returned-check fees. A June 2005 study by Professor Thomas Lehman confirms that payday loan fees offer a cost advantage to consumers over NSF fees and are understood as such by consumers. Similarly, research conducted by Professors William Brown and Charles Cushman in 2006 showed that military personnel, a tiny subset of all payday loan users, often use payday loans to avoid the consequences to their credit rating and military careers of bounced checks.

The research currently being conducted at Clemson has found that payday loans have a unique effect on borrowers who have the fewest options for short-term credit, those in or near bankruptcy. While studying the relationship between bankruptcy and payday loans, we have discovered two interesting facts: The first is that, after controlling for other economic conditions, increased consumer bankruptcy rates lead to an increase in payday loan stores rather than the opposite. The second is that payday loan stores in a state decrease the expected rate of bankruptcies. While more research is needed, this strongly suggests that consumers who have already declared bankruptcy turn to payday loans to meet their emergency needs, and that some consumers on the edge of bankruptcy avoid filing because of the availability of payday loans for meeting financial emergencies for which no alternative sources of credit exist.

This concept is particularly important in light of today's focus on mortgages and foreclosures. Having access to emergency cash that is not tied to a credit rating, home equity or assets is particularly important to consumers who are seeking to maintain their homes. Eliminating short-term credit and forcing cash-strapped homeowners to choose between their mortgage payments and medical bills or car repairs can only increase late payments and foreclosures among lower-income consumers.

In conclusion, Mr. Chairman, payday lending is one of many options available to consumers of short-term credit, and it appears to offer advantages of convenience, privacy and cost that make it welfare-enhancing for consumers. Furthermore, no data exist to show that payday lending is inherently a poor choice for consumers or for the economy as a whole. Demand for short-term credit will always exist as long as cash reserves for consumers are less than the emergency costs they are likely to face, and efforts to constrain market forces are more likely to harm rather than to benefit consumers who need short-term credit.

Additional Written Testimony

The Puzzle

If you Google payday lending, you will find only one favorable entry on the first two pages. A casual poll of friends and acquaintances will probably find many who do not know anything about the industry, but once informed almost all will react negatively. Most news stories call it loan sharking and the word "predatory" will certainly be in the first two or three sentences. Payday lending is the whipping boy of high-minded thought.

The problem is that it is hard to understand how this financial service fits these clothes. To me, "predatory" means that somehow a lender shills a consumer. A predatory loan is one in which the lender makes the borrower think she is getting a good deal when she is really getting a terrible one, one in which treasured assets are lost as if by theft. I think that there are probably lenders who are predatory, but to my mind none of them work in payday stores.

Let's look at the salient facts: Payday lenders have little collection recourse. If a payday borrower reneges on the loan, there is nothing much the lender can do except refuse to make further loans.[1] But here is the remarkable thing: payday borrowers default less than almost any other class of borrowers (2%).[2] How can this be? The only thing that it can mean is that payday borrowers really value access to this credit market. They pay the money back not because they have assets at risk but because they do no want to be foreclosed from future borrowing.

Again, it seems absurd to pay $45 for a $300 loan for two weeks. It is especially affronting to people with seven digit portfolios who search to save $3 on a $15,000 brokerage transaction. Nonetheless, the fact is that there is strong evidence that the people who take out payday loans want to keep this option open.

In addition to the low default rates, profit rates on payday lending are also rock bottom. They are much the same as the grocery industry. A quick look at the books of one prominent payday lender over the last several years shows a profit of around $7 on an average loan of $300. This is a profit rate of around 2.5 percent.

Admittedly, the profit rate could be calculated in many ways, but this is the right way to think about it from the perspective of the consumer. The $300 loan is like a basket of groceries. The $7 profit is the return above cost for the provider. It is a modest payoff and it only makes sense to be in the business if you can make a lot of these transactions. In other words, if you are a payday lender, you make money by giving the consumer something that she wants in a way that she appreciates so that she and others will come back.

Let's put these two facts together. Payday lending is a service that the borrowers value as evidenced by their willingness to maintain the good faith of the lender, and it is a service that only makes money if the lender maintains the loyalty of the customer. So how can this be bad?

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[1] In some states, it appears that payday lenders can bring legal action against defaulters. In on-going research we are attempting to assess the effect of these laws on the payday loan industry.

[2] This comes from an analysis of the annual reports of Advance America. Advance America is a publicly traded company that must issue an audited annual report each year plus a host of additional filings to the federal government. These are all available on-line.

An Anecdote

For many years I have lectured about payday loans in my classes. I find it intriguing to see what students will say about this market. Many are disdainful, but most of my students are libertarian-minded, so they take the attitude that people should be allowed to do what they want.

However, I once had a student who admitted that he had been a payday customer. As he explained it, he was a work-study student. It was Wednesday and payday was Friday. He was down to eating Raman noodles, which is to say he was essentially out of money. His car broke down and it was going to cost $300 to get it fixed. He had a date for Friday night so he went to the payday store to get the money to get his car fixed.

I did not probe deeply on his misfortune. Obviously, he was living on a shoe string so he was not going to be able to pay back the loan completely from his two week pay check. I did find out that it took him several cycles to get over it. But he was not fooled about the cost of loan. He just wanted his car for his date.

I never knew exactly why a payday loan was his chosen alternative. I presume that he did not have a credit card and was unwilling or unable to borrow from friends or family. Clearly something pushed him into a spell of payday borrowing precipitated by his car troubles. After he was finally able to pay off the car repair cost, he exited the payday market.

What we would like to know is, how typical is this student's experience.

Alternative Hypotheses

Opponents of payday lending make several arguments against this business. One is that consumers are fooled about the true cost of the loan. Another argument is that payday lenders trap consumers into a cycle of debt. And finally, consumer advocates suggest that payday borrowers are being fooled into thinking that they need the product when they could get by without it.[3] I would like to address these arguments one by one and then present some scientific facts that inform us on the issue.

The first argument is not seriously considered even by payday opponents. Of all of the financial products on the market, payday loans are the simplest to understand. The customer writes a check for $345 and gets $300 in cash. The cost of the loan is patently obvious.[4]

The debt-trap argument is the fall-back position for payday loan opponents. They claim that consumers do not recognize that it will take several rounds of payday borrowing to pay off the loan. The average payday borrower probably takes out around 15 loans a year.[5] We have a picture of a payday borrower who is consistently, month after month, borrowing a relatively small amount of money for a relatively short period of time, just to get by. It seems unlikely that consumers are ignorant of their plight. Also, to call this a debt trap is a pejorative and disingenuous accusation against the lender. The payday lender does not make money by trapping people in a loan they cannot pay back. The payday lender wants the consumer to repay the loan.

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[3] Payday loan opponents make many more arguments, but this list forms an umbrella under which they all seem to fit.

[4] As an amusing side note, back in the 1970s consumer advocates claimed that consumers could not understand interest charges on consumer loans and forced regulations on lenders to inform customers about the total amount of money they would pay in interest charges. Payday loans do exactly this as part of the standard business model.

[5] Statistics are ambiguous on this. The implied number based on analysis of the 2004 annual report from Advance America is nine. Nonetheless, it is likely that the average is more than 10, including all definitions of rollovers, extensions, and new loans.

So we move to the next argument against payday loans: payday loans offer people something that they do not need. Even if payday borrowers fully understand their position, they are behaving stupidly. They are hurting themselves and possibly others. And they should be stopped from doing it. Consumer advocates are fundamentally arguing that the cost of payday loans is unconscionably high and borrowers should be prohibited from paying so much even if they are willing to do so.

This is the core of the argument against payday lending. Moreover, it is a legitimate argument. Society chooses to regulate many activities where we think that people are unable to personally restrain themselves. For instance, we regulate the consumption of drugs and alcohol. So it may be that the same thing is true of payday borrowing, but there is no theoretical reason to believe that this is true, and no systematic empirical evidence has been presented that it is so.

Even if payday borrowers have already fallen into financial distress (which seems to be supported by the facts) does payday borrowing cause them to fall further into the abyss of social distress and mire them forever in the muck of financial indigence, or does payday lending offer financially distressed consumers an option of borrowing small amounts of money, obligations within their capacity to repay, that allow them to clear the hurdles that they face week after week until they break into the clear? Is it not possible that a payday loan allows a father to buy a present for his child on her birthday adding to the well-being of the family? In this setting, is a $50 fee too much? No doubt, proper planning would have saved the $50, but we have all forgotten birthdays.

I propose the following questions: Do payday loans mitigate or exacerbate social ills? For instance, where payday borrowing is available, are crime rates higher, is divorce and child neglect more common, are people more homeless and hungry, is school performance lower? What is the marginal effect of regulation? Where payday borrowing is more restricted, are there more or less social problems of the sort listed above?

I think that the real question concerning the payday loan industry cannot be answered with anecdotes. The real question is whether or not society in some aggregate sense based on hard and fast measures of welfare is made better off or worse off by payday lending.

One Answer

We do not yet have answers to all of these questions. However, we do have one answer that we will present to this honorable group today. We have looked at personal bankruptcies and compared the incidence of bankruptcy to the availability of payday lending. This analysis is scientific and systematic. It follows the conventions and methods of standard economic research. The analysis is discussed in detail in the next section. However, let me give a broad-brush summary here.

Bankruptcy is one measure of social ill. We also want to look at others, but I think that we can all agree that personal bankruptcy is bad. A straightforward test of the hypothesis that I have proposed above is: Does payday lending cause bankruptcy? If payday lending causes bankruptcy, then the next step would be to investigate the extent of this problem and if it is pervasive, to propose regulations that mitigate it. On the other hand, if payday lending does not cause bankruptcy, then at least we have some evidence that payday lending is not ruining society and maybe we should leave payday borrowers alone, foolish though they may be in our eyes.

To summarize our results, payday borrowing is predictably the result of bankruptcy not the cause of it. Moreover, if anything payday borrowing reduces bankruptcy rather than increasing it. The scientific evidence is that as the number of payday loan outlets in a state increases, the incidence of bankruptcy declines. Payday borrowing predictably *reduces* bankruptcy. This is quite a striking finding. Not only is payday lending not bad for society, it is arguably beneficial.

Statistical Analysis of the Effects of Payday Lending

We approach the problem empirically in the following way. We want to examine the causal relation between social problems and payday loans. There are many measures of social problems that we would like to examine. One that we have gathered data on is personal bankruptcies. Bankruptcy is an appropriate metric in this case because payday loans are a financial instrument and if consumers are using this instrument in an excessive way, it could result in bankruptcy. We have gathered data on the number of personal bankruptcies in each state for each year since 1990.

For payday loans, we have data on the number of stores operating in each state. More precisely, we have obtained from the Community Financial Services Association (CFSA) data on their member stores. For all of the stores operating in March 2006, we know the state in which the store operates and the date that the store opened. So we have a measure of the growth of the industry across time and space.

The empirical question is whether payday stores cause personal bankruptcies or, alternatively, whether personal bankruptcies attract payday stores. To answer this question we use a Granger definition of causality based on the time sequence of events.[6] The idea is simple enough. If the number of payday stores in South Carolina increases between 2000 and 2001 and the number of bankruptcies increases from 2001 to 2002, we say that payday lending caused bankruptcy. Alternatively, if the number of bankruptcies in Georgia increased from 2001 to 2002 and the number of payday stores increased from 2002 to 2003, we say that bankruptcies caused payday stores to begin doing business.

Of course, Granger causality is based on more than anecdotal evidence. We must do statistical tests of these leads and lags in the opening of stores and filings of bankruptcies. Moreover, it is possible that the causality operates in both directions. Nonetheless the methodology is straightforward and widely accepted.

Table 1 shows the summary statistics for our dataset. [The tables are found at the end of this document in the Table section.] Included in addition to bankruptcies and payday loan stores is income, the unemployment rate, population, and the percent of the population without health insurance. These latter variables we will use to condition the number of bankruptcies by economic conditions. The unit of observation in Table 1 is a state-year. So, for instance, the average number of payday stores operating in a state between 1990 and 2005 was 49. The largest number was 914 which is California in 2005.

Personal bankruptcies varied from 522 (Vermont 1990) to 204,667 (California 1998), with a mean of 23,596 and a standard deviation that is slightly larger. Average disposable income over the period was $22,424 per year per person. The unemployment rate varied from a low of 2.3 percent to 11.3 percent (West Virginia 1993). In other studies of bankruptcy it has been shown that the percent of the population that does not have health insurance is a strong predictor. This is almost certainly due to the fact that large medical bills cause financial crisis for people without insurance. The average across the states is 14 percent. The highest is Texas in 2002, but interestingly there are several other states above 25 percent in some years.

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[6] Granger causality is named for the famous time-series econometrician and Nobel Laureate Clive Granger.

To perform the Granger test, we calculate the change in these variables from one year to the next. So, for instance, Texas had 77,056 bankruptcies in 2002. In 2001, it had 58,056. So the change in the number of bankruptcies from 2001 to 2002 was 19,000. We also lag the values of all of the variables so that we can statistically relate the change in one variable in one year to the change in another variable in the year before.

Formally, we can write the simple Granger test as follows:

$$\Delta B_{i,t} = \alpha_0 + \alpha_1 \Delta P_{i,t-1}$$
$$\Delta P_{i,t} = \beta_0 + \beta_1 \Delta B_{i,t-1}$$

where $B_{i,t}$ is the number of bankruptcies in state i in year t, $\Delta B_{i,t} = B_{i,t} - B_{i,t-1}$, $P_{i,t}$ is the number of payday loan stores in state i in year t, and α and β are parameters to be estimated by linear regression. If payday loans cause bankruptcy, then α_1 will be positive indicating that increases in payday stores in the past is statistically related to bankruptcies today.

Let's move to the estimates. Table 2 shows the simple Granger test. Column (a) is the test of whether bankruptcies cause payday stores. The coefficient is positive and statistically significant at the 1 percent level. This says that bankruptcies do cause payday stores to open up. The coefficient magnitude says that an additional 1000 bankruptcies causes 1 additional payday store to open.

Next look at column (b). This is the test of whether payday stores cause bankruptcy. The coefficient is negative and statistically significant at the 1 percent level. If payday loans caused bankruptcy, the coefficient would be positive. However, it is negative. The interpretation of a negative coefficient is that payday loans reduce bankruptcies. This is a striking result and it clearly deserves further investigation, but on the face of it we cannot condemn payday lending out of hand.

Further investigation of the findings leads us to a more expansive model. Table 3 shows some extensions. Here we include several explanatory variables for bankruptcy—the unemployment rate, the percentage of the population that lacks health insurance, and disposable personal income. We include the current year value of these variables as well as one-year lags, all in year-to-year differences. We also include the change number of payday stores in the current year and the change in the number of stores one year before. Essentially this is the same regression that we reported in Table 2 with the addition of economic factors that we expect to be associated with bankruptcy.

The findings are basically consistent with our expectations. The strongest predictor of bankruptcy is the percent of the population without health insurance. As this percentage goes up, bankruptcies increase; every percentage point increase is associated with 1400 addition bankruptcies. The lag is also positive but not statistically significant. Unemployment and income in the current period also have the expected effect, though the coefficients are not large or strongly significant.

The variable of most interest is the effect of payday stores on bankruptcies. The contemporaneous value is positively related, but the Granger criterion does not speak to this. The contemporaneous value is the result of the simultaneous relation between the two factors. The variable of interest is the lagged value of the change in the number of payday stores and the current value of the change in the number of bankruptcies. Consistent with the coefficient estimate in Table 2, the estimate in Table 3 is negative and statistically significant at the 1 percent level. Again, we find that not only does the opening of payday stores not increase bankruptcies, if anything it reduces them.

The magnitude of this coefficient is not large, but it is consistently statistically significant in each specification. The magnitude says that every new payday store reduces bankruptcies by 40 to 50.

We estimate the model in OLS and also in three-stage least squares (3SLS). The 3SLS estimates take account of the fact that bankruptcies and payday lending are potentially simultaneously determined by the other economic factors included in the model. In the payday-store equation we include the unemployment rate and income because we imagine that these may be determinants of payday stores. We exclude the percent of the population without health insurance for lack of a theoretical reason to include it. (When it is included in the OLS specification it is not significant.) The unemployment rate effect on the number of payday stores is not statistically significant. Income has a positive effect in the current period and the lagged value is statistically zero. Again we see that the lagged value of bankruptcies is positive. That is, when bankruptcies increase in one year, the number of payday stores increases in the next.

Other Facts from our Research

People at all levels of the economic scale have a need for access to credit. This includes both long term *and* short term loans. Typical forms of short term credit include but are not limited to, payday loans, bounced check fees, late fees, re-connect fees, pawn loans, title loans, and credit card loans.

Consumers choose payday loans for a variety of reasons, among them are a desire to avoid tapping into savings, convenience and price. (Fact Book p.14) I assert that the reason that people choose payday loans over credit cards is that they know if they have a(nother) credit card they will get into a "debt trap." The problem with credit cards is that they are open-ended. People with credit problems tend to run credit cards up to the limit without good cause.

Payday borrowers are typically young: over 60 percent of Advance America's customers are between 18 and 44 compared to 40 in the population at large. They are consumers who have bank accounts, commonly own their homes, and have income levels only slightly below the median.

The use of payday borrowing by the military is a hot-button issue. Let me highlight some recent findings in a study by Dr. William Brown and Dr. Chuck Cushman on military lending. (Dr. Brown holds a PhD from Clemson and is now at UNC-Greensboro; Dr. Cushman is a graduate of West Point and a professor at the George Washington University.)

Only a small fraction — 13% — of military enlisted personnel stationed near a payday loan store have had a payday loan in the last year. Given the relatively low overall default rate for such loans in general, the claims of some opponents of payday lending that payday loans are a threat to military readiness appear unsupported.

Military enlisted personnel who have had payday loans repay them more quickly and are more likely to remain out of debt than their civilian counterparts: 49% of military enlisted payday-loan borrowers reported they have used a payday loan no more than twice in the last year (compared to 16% of the general population of payday borrowers); 79% said they had no more than four loans in the last year (compared to 65% of the general population).

The location of payday loan stores has been a point of criticism by payday loan opponents. Opponents claim that payday loan stores are located near military bases and in African-American neighborhoods with the implication that payday lenders are somehow "targeting" these groups. This argument is based on the presumption of the false premise. It assumes what it is trying to prove. It assumes that payday loans are bad. The evidence that we presented in the last section shows that payday stores move in to meet the demand for their services. That is, we show that as bankruptcies increase, payday stores increase. The same fact arguably applies across the board. Where there is a demand, we expect the market to respond. So the fact that payday stores locate near military bases or in African-American neighborhoods does not in and of itself incriminate the industry. The question remains, does payday lending make people better or worse off. If it makes them better off, then the fact that the stores locate nearby is good, not bad.

Tables

Table 1. Summary Statistics

	mean	*std. dev.*	*min.*	*max.*
Bankrupcy Fillings—Non Business	23595.82	27679.73	522	204667
Disposable Personal Income	22423.83	5321.04	11910	48432
Unemployment Rate	5.22	1.42	2.3	11.3
% of Population without Health Insurance	13.99	3.95	6.1	25.8
Population	5329.13	5961.69	463	35940
Payday Loan Stores	49.36	105.10	0	914

Notes: 816 observations by state by year, 1990 to 2005. Income in current dollars. Payday loan stores by year of opening; from CFSA for stores that were still in business in March 2006.

Table 2. Simple Test of Granger Causality between Bankruptcy and Payday Lending

	Dependent Variables:	
	(a)	(b)
Independent Variables:	Change in the # of Payday Stores	Change in the # of Bankruptcies
Lag of the Change in the # of Bankruptcies (÷ 1000) $[B_{i,t-1}]$	0.95	
	(2.52)	
Lag in the Change in the # of Payday Stores $[P_{i,t-1}]$		-42.27
		(-3.99)
Intercept	8.39	3698.28
	(5.94)	(7.92)
R-squared	0.05	0.02

Notes: 714 observations across states for years 1990 through 2005. All variables are the differences between current year and past year for each state. Bankruptcy regression weighted by population. Robust *t*-statistics in parentheses.

Table 3. Granger Test of Causality between Payday Lending and Bankruptcy including Other Explanatory Variables

	Dependent Variable:			
	Change in # Payday Stores		Change in # Bankruptcies	
Independent Variables:	*3SLS*	*OLS*	*3SLS*	*OLS*
Intercept	5.17	2.10	1672.02	2131.49
	(1.24)	(1.14)	(1.43)	(1.56)
Unemployment Rate	-2.58	-1.83	1398.63	1384.75
	(-0.97)	(-1.36)	(1.87)	(1.97)
lag	-0.03	-0.55	-1675.63	-2083.86
	(-0.01)	(-0.37)	(-2.34)	(-3.24)
% Population with No Health Insurance			1428.81	1436.36
			(4.90)	(4.94)
lag			319.28	258.86
			(1.10)	(0.90)
Income (÷ 100)	0.97	0.38	-8.68	-1.73
	(3.38)	(2.51)	(-0.11)	(-1.70)
lag	0.38	0.22	198.08	3.12
	(1.28)	(1.23)	(2.38)	(3.00)
Bankruptcies (÷ 100)	-0.03	0.03		
	(-2.11)	(0.79)		
lag	**0.10**	**0.10**		
	(6.51)	**(2.65)**		
Payday Stores			20.88	29.57
			(1.56)	(2.22)
lag			**-57.18**	**-55.66**
			(-4.08)	**(-4.03)**
R-squared		0.07		0.09

Notes: 714 observations across states for years 1990 through 2005. All variables are the differences between current year and past year for each state. Bold values represent values representing the test of casuality. The 3SLS regressions and the OLS bankruptcy regression are weighted by population. Robust *t*-statistics in parentheses beneath coefficients.

Mr. KUCINICH. Thank you very much, Professor Maloney.

I would like to just ask you a question about that study that you talked about that is being done that shows that the more bankruptcies there are the more payday loans there are.

Mr. MALONEY. Yes. If you just kind of think about it in terms of time, going through time, as bankruptcies go up in, say, year one, the number of payday stores will increase in year two.

Mr. KUCINICH. Yes.

Mr. MALONEY. Now, if the number of payday stores increases in year two, the number of bankruptcies in year three will go down. That is the kind of sequencing of causality that we are finding.

Mr. KUCINICH. You are not really trying to establish, though, that payday loans are the answer to holding the limit on bankruptcies, are you?

Mr. MALONEY. What we are finding is that payday loans reduce the number of bankruptcies, that the ability—to use Mr. Cummings' idea, the ability to bridge certain bad events with a payday loan may make people better off in terms of avoiding bankruptcy.

Now, the effect is very small. I mean, it is not a huge thing. You wouldn't expect it to be.

Mr. KUCINICH. What you are saying is that some people will take out a payday loan, and that may help them avoid bankruptcy, but you are not trying to establish an axiom here?

Mr. MALONEY. I don't think that payday loans are going to stop bankruptcy. No.

Mr. KUCINICH. Right. I just wanted to make sure that, you know, in some cases—Mr. Bradford, would you like to respond to that?

Mr. BRADFORD. I guess what I would like to say is if you look at the population, say, that are affected by payday loans, which tend to be more rental people, people who haven't had a lot of established credit, as opposed to the predatory lenders we talked about who are dealing with people who own homes or are in a position to own a home or have credit, you are dealing with different populations.

To some extent the renter population has less incentive to ever file bankruptcy anyway because they haven't got debts to protect themselves from, other than maybe the payday loans.

Also, I guess I would just say, since my own Ph.D dissertation was in statistical analysis, that I think you have to be careful in making assumptions about aggregate sets of relationships without actually doing time sequence studies that track individual people over time to see what the sequence of their behavior is. We oftentimes get correlations between events at an aggregate level that don't actually represent the actual behavior underneath those, so I think you would need more study.

Mr. KUCINICH. In fairness, I think Professor Maloney a moment ago asserted that, you know, maybe in some cases. He wasn't trying to establish any real, but your point is well taken.

Let me ask you a question, Mr. Bradford. Your testimony discusses the apparent paradox that most banks are passing their CRA compliance tests while African Americans and Latinos specifically are receiving higher-priced subprime loans. We used to call that redlining.

Mr. BRADFORD. Yes.

Mr. KUCINICH. In your opinion, is race still a factor in banking?

Mr. BRADFORD. I think it is a serious factor in banking. Yes. I think you can see it from these examples. What I am more concerned about is that the existence of race in banking seems to be something that the Federal regulators just ignore. They don't take it into account. It used to be an actual factor in a CRA evaluation that you had to, as a rating factor, explain how you defined your area and your area couldn't have been defined by any discriminatory processes. There is still part of that in the regulation, but there is no assessment factor any more for that.

Also, for your first part of your question about making subprime loans, when you look at the way they analyze loans for CRA, they lump all the loans together. What you really end up with is a situation where subprime lenders who target minority neighborhoods are going to get outstanding ratings on the lending performance because they have lots of loans in those neighborhoods because the agencies aren't taking account of the effect of different types of loans or whether various types of loans are appropriate.

The same thing happened early on with FHA loans, where they inundated the east side of Cleveland or the west side of Chicago with FHA loans. Those banks who did those loans would get very high ratings because they had high penetration in those markets, without taking into account whether that led to high foreclosure rates or whether those loans were unsound.

Mr. KUCINICH. Well, you make a good point, and that is in a followup we really do need to take that into account. We need to take into account, OK, you are giving these loans, but what is happening, because it could be the height of cynicism for an institution to say all of a sudden, OK, you want loans, we will give you loans, but then either the terms are close to usurious or they know full well that they are going to be putting somebody in a position where they can't pay it back anyway.

Mr. BRADFORD. Well, the other thing that they can do under the present rules is, if you have several loan companies—and that has become very common with the large banking institutions—you have several subsidiaries and they specialize in different types of loans. But it is more likely that the bank, itself, through direct lending will make CRA loans. So if you just look at the bank's loans, they will have a fairly good number of loans in minority and low and moderate-income neighborhoods. And then if they say they don't want their subsidiaries counted, then you get this great CRA performance, where they might have one of the largest subprime lenders as a subsidiary, and if you counted them the loan pattern would look quite different.

Mr. KUCINICH. I think it would be helpful to do a case-by-case analysis in selected urban areas to be able to demonstrate how that actually works.

Mr. BRADFORD. Yes.

Mr. KUCINICH. We will discuss that with staff as a followup.

I am going to go to my colleague, Mr. Davis, right now for the next 5 minutes. We will come back to Mr. Bradford in a second and closing round.

Thank you.

Mr. DAVIS OF ILLINOIS. Thank you very much, Mr. Chairman.

Mr. Maloney, would you suggest that one could view payday loan establishments the same way that you would view a convenience store? I am saying that people are simply willing to pay for the convenience of getting whatever it is that they are looking for whenever it is that they need it or want it, and therefore they just simply pay for it?

Mr. MALONEY. I definitely think that is the truth. I mean, I think that all of the studies suggest that the consumers are really, really interested in that convenience, and, as the lady with the Faith Credit Union pointed out, I mean, consumers of payday loans like the smiling faces they get when they walk in the store. These stores charge a lot of money, but they also charge a lot of money for milk at the Quick Way relative to the grocery store, so you are getting a similar phenomenon.

Mr. DAVIS OF ILLINOIS. And so would you be suggesting also that the market sort of dictates the action?

Mr. MALONEY. Yes.

Mr. DAVIS OF ILLINOIS. As well as the behavior of the institution?

Mr. MALONEY. Well, I think I am not exactly sure what you mean, but——

Mr. DAVIS OF ILLINOIS. Well, what I mean is that whatever the market will bear, I mean, that is what people charge.

Mr. MALONEY. Well, there is a lot of competition in the industry, and I believe competition lowers prices to the bare minimum cost, and my reading of the data is that the profit rates are just not that high in the industry. If you look at the profit for an average transaction, it is about 2.5 percent. That is about the same as the grocery store industry. If you think about an average transaction of, say, $300—I think the average for Advance America is about $340—you look at that average, that $340 would be like a basket of groceries. The vendor is making about $7 on it, so you have 2.5 percent. It is about the same as a grocery store.

Mr. DAVIS OF ILLINOIS. I would ask either one of you or both of you and Mr. Bradford, of course, payday loans is a fairly new phenomenon. I am saying I don't remember any of them when I was a kid. There may have been some, but I didn't come in contact with them or I didn't hear about them.

Is there any evidence that the advent of these on the scene has reduced loan sharking, or have you come into contact with any evidence that would suggest that there aren't as many loan sharks around, and part of the result may very well be because of the payday loans?

Mr. BRADFORD. I just don't know. Sorry. It seems very likely, but I don't have any data on that.

Mr. DAVIS OF ILLINOIS. I am trying to firm up in my mind the moral value of these, as well as the economic utility, and you indicated that they might go out of business if there was a cap at a certain level, and I am trying to see whether or not I think if they went out of business that wouldn't be a good thing.

Mr. BRADFORD. Both of us are.

Mr. DAVIS OF ILLINOIS. Yes.

Mr. BRADFORD. I am very interested in that question.

Mr. DAVIS OF ILLINOIS. Yes.

Mr. BRADFORD. By the way, I have some vague recollection of a study about Europe, looking at the difference between England and France, and it was in reference to loan sharking. The evidence there, and my recollection is very vague on this, but my recollection is there was some evidence that loan sharking went down. Loan sharking was negatively related to payday lending. I will get you a reference on that if you would like it.

Mr. DAVIS OF ILLINOIS. Well, thank you both very much. It has been a very interesting discussion.

Thank you, Mr. Chairman.

Mr. KUCINICH. Thank you.

Mr. Cummings.

Mr. CUMMINGS. First of all, thank you both for your testimony.

Dr. Maloney, I was very intrigued by almost everything you said. I just wanted to ask you, I was just reading your written statement, and I guess you read that. Is that what you read from?

Mr. MALONEY. More or less, yes. The first part of my written statement, yes.

Mr. CUMMINGS. It says "our research has found that payday lending has increased access to short-term credit without harming consumer welfare." What does that mean?

Mr. MALONEY. Well, that was just a summary statement of this bankruptcy finding that we have.

Mr. CUMMINGS. Yes.

Mr. MALONEY. But, in general, what I think we should be looking at is consumer welfare measured a whole bunch of different ways, like crime, domestic abuse, child abuse, homelessness. But the one thing we have data on right now is bankruptcy, and so what we have found is that payday lending does not increase bankruptcy and, in fact, arguably it decreases it.

Mr. CUMMINGS. I am a lawyer, but I never did any of this kind of stuff you talked about, you doctors, the kind of research you do. I am just trying to hook up this causal thing, because it seems like there is a gap here. On the one hand, I am just trying to figure out how do you go into an area and figure that payday loans have reduced bankruptcies? I don't understand how you do that. How is that done? You just don't look at the blanket numbers, do you? I mean, it seems like you have to go a little deeper than that.

Do you follow what I am saying?

Mr. MALONEY. I do. I do, very much so. The whole issue of correlation versus causation is one that plagues all scientific analyses. But the technique that we used is called the Granger causality test. It is based on the timing of events. So we look at States across time and we look at how much did the bankruptcy rate change between time period one and time period two.

Better put, more to the point, we look at how the number of payday stores changed from period one to period two, and then we look at how the bankruptcies changed from period two to period three, under the argument that if the payday stores increased in the prior period, that couldn't be caused by bankruptcies going up in a later period, and hence the causation has to run that way.

Mr. CUMMINGS. Professor Bradford said something that I found very interesting when he talked about so often these payday loan folks are based in areas that have a large percentage of renters. Did you factor that into your research?

Mr. MALONEY. No.

Mr. CUMMINGS. Because you saw that as irrelevant?

Mr. MALONEY. No. I mean, we haven't collected all the data in the world. What we did have was we had a lot of control variables for bankruptcy, and in the literature the one that tends to be the most important is the number of people that don't have health insurance. You know, when you get sick, if you don't have health insurance it is going to put a drain on your financial resources, and that is a big predictor. Unemployment rate, income, we looked at those kinds of things. Income would surely pick up rental versus homeownership as a proxy.

We looked at a lot of that stuff, but, again, this Granger causality thing really takes account of everything that could be going on to change payday stores back here is in the past, and bankruptcies in the future can't be causing the payday stores in the past.

Mr. CUMMINGS. Hang with me, because I have to get these questions in and I am running out of time.

Mr. KUCINICH. You can have whatever time you need.

Mr. CUMMINGS. Thank you.

I guess what I am trying to get at is we have 44 million people in America, 40 to 44 million without health insurance, and a whole lot of them are in my neighborhood.

Mr. MALONEY. Yes. Serious concern for you.

Mr. CUMMINGS. That is serious now. You made some statements here that really do concern me, because I feel like I am putting together a puzzle and there are some pieces missing. When was this research done?

Mr. MALONEY. It is preliminary. We are still working on it.

Mr. CUMMINGS. So this research isn't complete?

Mr. MALONEY. No, no. No. Not even close. We will probably have a research document, a research paper done, submitted to a journal by the middle of the summer. It is very preliminary research.

Mr. CUMMINGS. I see. So really the information that you are giving us is preliminary. And is it possible or probable that your findings might change when you come to the end of your research?

Mr. MALONEY. It is entirely possible.

Mr. CUMMINGS. All right.

Mr. MALONEY. But I wouldn't come here and tell you stuff that I didn't think was going to be true in the long run. I mean, I am just a scientist.

Mr. CUMMINGS. I understand that. I understand. I am just trying to figure out. I believe in research, so I am just trying to figure out whether this is rolling research or whether this is done research or what it is.

Mr. MALONEY. Yes.

Mr. CUMMINGS. The thing that I guess I found very interesting is that you have said that in paragraph four of your statement, "nevertheless, the number of payday loan offices nationwide has increased from approximately—" and this is deep—"from approximately 300 in 1992 to more than 20,000 today." Is that accurate?

Mr. MALONEY. I think so, yes.

Mr. CUMMINGS. What do you mean you think so?

Mr. MALONEY. Well, I mean, the numbers are——

Mr. CUMMINGS. Where did you get those numbers from? This is your statement. I am just reading what you gave us.

Mr. MALONEY. I know. I know. It is over 20,000, but the numbers on that come from various sources. I don't exactly know what the number is.

Mr. CUMMINGS. Do you know what the sources are they cited here?

Mr. MALONEY. Some of the sources are industry sources. The trade organization, Community Financial Services Association, has members that are payday, and they report their members, and then they estimate how many other stores are not members, and they probably do Yellow Pages counts, but our research on the Yellow Pages counts is that they are not always accurate.

Mr. CUMMINGS. I see. What did you get your doctorate in? I am just curious.

Mr. MALONEY. Economics.

Mr. CUMMINGS. Economics. I just have a few more questions. I am going now to the second page of your statement, and you said about 10 percent—no, let me go back to something else that I found very interesting. You said in paragraph three on the second page, "Access to credit is best conducted in the open and competitive marketplace." This is what I want to know about. "Although likely always to be relatively costly due to the risk profile of the borrowers it serves and the fixed cost of delivery and collection, the payday loan industry is increasingly competitive, and fees and profit margins for providers of payday loans have been reduced in recent years." I want you to just tell me what you mean by the risk of the borrowers. What does that refer to, and how does that relate to your research?

Mr. MALONEY. Well, the riskiness of the borrowers is that they obviously are not good credit risks or they would have access to lower-cost credit alternatives. But the fact of the matter is they are not all that risky in terms of their default. They are risky to the lender because the lender does not have very much recourse. The lender can't do much except not give them another loan, and so that is really what the riskiness is.

Mr. CUMMINGS. Is this an assumption on your part, or is this that they are bad credit risks because they use the payday loan system? Is that an assumption, or is that based on some research? Have you looked at any credit ratings on these people? Because, you know, there are a whole lot of people who are the working poor, and they work hard. Even you, in your statement you talk about how 10 percent chose payday loans because they were located at a convenient place.

A lot of these people have not even had access to banks. Banks are not in their neighborhoods. A lot of them, maybe their education, maybe they have limited education and they are trying to figure out the best way, trying to deal with things the easiest way. It doesn't mean that they are necessarily a bad credit risk. As a matter of fact, many of them are probably paying their rent every week. Did you take any of that into consideration?

Mr. MALONEY. Let me just go back a step and say what is really the riskiness of the borrower from the lender's perspective is that the lender does not have much recourse to collecting the debt. There is no real assets at risk. It is not like a car title loan where the lender can go repossess the car. So that is a riskiness to the lender.

Mr. CUMMINGS. OK. Let me just ask you this one last question, because I want to give the weight of your testimony the weight that it deserves, and you told me that this is basically what I would call a rolling piece of research, document, because you said that it is not complete. Am I right?

Mr. MALONEY. You are right.

Mr. CUMMINGS. And I am just wondering, do you do work for the payday loan people? Do you do any research for them?

Mr. MALONEY. This study, the payday loan industry has made grants to Clemson University to fund graduate student research.

Mr. CUMMINGS. All right. Thank you.

Mr. KUCINICH. I thank Mr. Cummings.

I just have a couple of final questions, and I would invite Mr. Davis and Mr. Cummings, if you can just hang in there for a few minutes then if you would like to ask any final questions.

I want to go back to Mr. Bradford. Your testimony discusses the coincidence of a few cases where Federal bank regulators passed banks for outstanding or satisfactory compliance with the Federal law preventing redlining and discrimination, while at the same time the Department of Justice is prosecuting these same banks for discrimination. How do you explain this coincidence? How can a bank fulfill the purpose of the CRA, on the one hand, and at the same time be guilty of discrimination?

Mr. BRADFORD. Well, Mr. Chairman, that is a question I would sure like to see the regulators have to come up and answer some time in specific to these cases.

There is an interesting quirk of language that the OTS and the FDIC used for these same lenders after they were found to violate these laws. In the CRA reports they usually say "we found no violations of fair lending," and now they say "we were not able to find no violations of fair lending," whatever that means. I mean, even when someone has been essentially found liable twice in a Federal court, they can't bring themselves to say there has been a fair lending violation.

I think that is why we recommend that there has to be a publicly disclosed fair lending exam as part of this process, because the law was created to stop discrimination in lending, and if the regulatory agencies can't find it when the Justice Department finds it over and over again and private individuals find it over and over again, then there is no point in issuing these exams and giving them the right to branch.

Mr. KUCINICH. You raise a very interesting point, and that is that if there has been a finding by the Justice Department, why wouldn't we amend the law if we need to on CRA to say that has to be taken into account as to whether or not they are in compliance? Would that——

Mr. BRADFORD. Well, I think as a practical matter, the problem is, you know, that your regulatory agencies in a certain sense are competing with each other, because institutions change their charter from one place to another for particular reasons to protect themselves, and so in a way the financial regulators have been in the business of protecting their industry. I think they are also concerned about what liability it creates if they say that they found a violation of fair lending, because then they are basically exposing that lender to lawsuits that other people might file.

I think those are issues that they have to face. After all, they refer cases to the Justice Department when they think there are violations, and there is no reason why they can't produce that in their public reports.

But the examples we gave you couldn't be more blatant. I mean, you know, Centier eliminated the entire city of Gary, IN. Old Kent eliminated the entire city of Detroit, which is the largest African American city in the United States. In the Chicago market Mid-America eliminated all the Black neighborhoods. It is the largest African American home buying market in the United States.

I mean, if you are the largest lender, which they were at 1 year, in the largest African American market, and you eliminate them, you certainly expect a regulatory agency to figure that out. I just think they are so fundamentally incapable of doing exams they have to start again. They have to rewrite their regulations. They have to start the exam trainer all over again. They are really going to have to go back to square one, or all the effort that you and other people put into this right from the beginning seemed lost.

Mr. KUCINICH. Mr. Davis, Mr. Cummings, do you have anything else?

[No response.]

Mr. KUCINICH. I want to say to Mr. Bradford, it was interesting that you produced that document from May 1979, because it was an institution on, I believe, Kingsman Avenue, which is in the African American community in Cleveland——

Mr. BRADFORD. Right.

Mr. KUCINICH [continuing]. Where we were experiencing that people were not getting the benefits that they were putting money into the bank, but the bank wasn't loaning money back to the community in a way that was equitable, and that was what the CRA was designed to do to begin with, to make sure there is some relationship between people helping to assure the financial integrity of an institution, putting their deposits in, and then when they need help to grow a community, you know, for their homes or whatever reason, they would be able to have access. CRA was passed to make that mandatory. That was 1979. Here we are.

I would be happy, by the way, to make sure that is included in the record.

[The information referred to follows:]

URBAN REVITALIZATION AGREEMENT

BETWEEN THE FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF CLEVELAND

AND THE ADMINISTRATION OF THE CITY OF CLEVELAND

WHEREAS, The First Federal Savings and Loan Association of Cleveland presently has pending before the Federal Home Loan Bank Board an application for permission to establish a branch office in Stow, Ohio; and

WHEREAS, the Economic Development Division of the City of Cleveland has filed a protest against the above mentioned application; and

WHEREAS, the parties to this Agreement desire to improve the housing in the City of Cleveland; and

WHEREAS, the Economic Development Division of the City of Cleveland agrees to withdraw its protest to the above application for branch office;

NOW, THEREFORE, The First Federal Savings and Loan Association of Cleveland and the Economic Development Division of the City of Cleveland agree to the attached proposal, dated May 8, 1979. It is further agreed that no provision in this Agreement shall be effective if it is in violation of any laws, rules or regulations of the United States Congress or of the Federal Home Loan Bank.

Dennis J. Kucinich	Charles Joseph Koch
Dennis J. Kucinich	Charles Joseph Koch
Mayor	President and Chairman of the Board
City of Cleveland	The First Federal Savings and Loan Association of Cleveland
May 10, 1979	May 10, 1979
Date	Date

May 8, 1979

A PROPOSAL BY THE FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION
OF CLEVELAND TO THE ADMINISTRATION OF THE CITY OF CLEVELAND

It is the belief of The First Federal Savings and Loan Association of Cleveland that a major opportunity now exists in the City of Cleveland to implement a cooperative program to help provide solutions to the problems of urban revitalization.

Urban revitalization is a major goal challenging the United States. The problem is complex and most of the past governmental programs, although well intended, have not proven successful. Recently, however, programs involving the cooperative efforts of local citizens, local government, community groups and local private industries are most encouraging. The Neighborhood Housing Services is one excellent example. Of utmost significance, is the Community Reinvestment Act recently passed by the Congress of the United States which is intended to encourage federally insured commercial banks, mutual savings banks and savings and loan associations to help meet the credit needs of their entire communities, including low and moderate income neighborhoods, while preserving the flexibility needed by financial institutions to operate safely and soundly.

The City of Cleveland, as provided by the Community Reinvestment Act, has used its opportunity for challenge of a First Federal branch office application as a vehicle to institute a dialogue with the Association. The result of this joint communication is the creation of an atmosphere of mutual concern and cooperation between the City Administration and First Federal.

In Cleveland, urban revitalization is critically important. We are convinced that local citizens, the City Administration, and First Federal along with other savings and loans in Cleveland, have a vital interest and concern for the quality of housing and living standards.

In view of the Community Reinvestment Act, most savings and loans have, or may have in the near future, urban development specialists.

First Federal proposes to the City Administration to offer the services of its urban development specialist to help facilitate a continuing dialogue with the City and other community interest groups, and to assist in the City's urban revitalization activity by helping to determine and meet the credit needs of the community in accordance with the Community Reinvestment Act and in accordance with the Rules and Regulations of the Federal Home Loan Bank.

First Federal will also communicate with other Cleveland savings and loan associations to have them join this effort--hopefully leading to a cooperative program including the City, local citizens and local financial institutions.

Specifically, as a result of this dialogue between First Federal and the City of Cleveland, First Federal proposes the following:

1. We agree to work in close coordination with the City of Cleveland to help contribute to the revitalization of the City.

2. We volunteer to spearhead an effort to form a consortium of urban development specialists from various savings and loans, government officials, community leaders, and hopefully, a representative from the Federal Home Loan Bank. The objectives of this forum would be to communicate jointly through meetings, addressing the subject of urban revitalization. Possibly, this program could be implemented in conjunction with the Northeastern Ohio Savings and Loan League.

3. In order to establish a more effective outreach effort to needy consumers in urban communities and to ascertain the credit needs of local citizens, First Federal's urban development specialist team will continue communications with various community groups. First Federal intends to routinely address the community and to sponsor local meetings for the purpose of consumer financial education and financial counseling.

4. First Federal in its long range planning will establish goals to continue to increase annually the amount of new residential contruction financing, home mortgage loans and home improvement loans made in the City of Cleveland. It is anticipated that credit needs and funds availability will permit First Federal to invest a total of over 15 million dollars within the next two years within the City of Cleveland. These investments will be made consistent with First Federal's published guidelines and in accordance with the Rules and Regulations of the Federal Home Loan Bank in a safe and sound manner.

To reiterate, the urban revitalization problem is complex. Obviously, no one group or individual can solve the problem. The cooperative effort of all having a basic interest and need for urban revitalization can succeed.

Mr. KUCINICH. This is the Domestic Policy Subcommittee, which has held a hearing on foreclosure, predatory mortgage, and payday lending in America's cities. We have had 15 witnesses today on three panels, and we are pleased to have with us, after almost 6 hours of work here, Mr. Davis and Mr. Cummings.

We will continue our inquiry into this economic challenge that is causing so many people in the inner cities to look for alternative ways of surviving financially and finding themselves sometimes in a greater bind than they were before they started.

This committee will stand adjourned. I thank the witnesses and everyone for participating and hanging in there with us, including our staff. Thank you.

[Whereupon, at 8:55 p.m., the subcommittee was adjourned.]

[The prepared statement of Hon. Bruce Braley follows:]

Congressman Bruce Braley
Domestic Policy Subcommittee
Oversight and Government Reform Committee
"Foreclosure, Predatory Mortgage and Pay Day Lending in America's Cities"

March 21, 2007

2154 Rayburn HOB – 2:00 P.M.

I would like to thank the Domestic Policy Subcommittee Chairman Kucinich and Ranking Member Issa for holding this important hearing today on foreclosure, predatory mortgage, and payday lending in the United States.

I am concerned by reports that predatory lending – abusive practices by some mortgage and pay day loan companies that cause borrowers to pay too much and become trapped in high-cost loans – is on the rise nationwide. In the worst cases these practices, which often include high-pressure sales tactics, misleading offers, and inaccurate, incomplete, or confusing information, result in consumers not being able to make their loan payments and losing their homes. In my state of Iowa alone, foreclosures were up 64 percent in 2006 compared to 2005.

I am also concerned that the sub-prime mortgage industry and the pay day lending industry target our nation's most vulnerable consumers, including borrowers with low incomes, impaired credit, or other situations that prevent them from obtaining loans in the prime market. Women, minorities, and the elderly are also particularly vulnerable to these predatory lending practices.

The purpose of financial institutions should be to help borrowers become financially stable, not drive them into debt or cost them their homes. I am glad we are having this hearing today to examine, and hopefully begin to remedy, some of the problems associated with foreclosure, predatory mortgage, and payday lending. I am also pleased that we have witnesses here who will testify about positive programs that prevent foreclosure and about institutions that offer positive alternatives to risky pay day loans. I look forward to the testimony of the witnesses today and I hope that this hearing will be a first step in holding predatory lenders accountable for their practices and in exploring alternatives that will allow vulnerable consumers to borrow money without the risk of falling into debt or losing their homes.