

**Prime, subprime and predatory lending**

**A. *Stolen Wealth***, a study by the California Reinvestment Committee (CRC), took analysis of Home Mortgage Disclosure Act (HMDA) data to the next level. CRC interviewed, in a consistent and standardized manner, over 100 borrowers throughout the State and reviewed their loan documents, to provide a more complete picture of what was happening in the subprime market. The findings of the CRC study, *Stolen Wealth* were that: a) prime lenders were not serving low-income communities and communities of color; b) subprime lenders were targeting the elderly and minority borrowers in communities; c) most sub-prime borrowers were stuck with loans that had unjustifiable erroneous provisions, so there actually was not risk-based pricing; and d) borrowers were victimized by bait-and-switch tactics. (Testimony of Kevin Stein, H&CD Hearing, 9/12/02, p. 28, lines 3-12.)

**B.** While prime lending is subject to regulation and competition, subprime lending typically involves less governmental regulation, and provides for hidden costs, fees, and terms that make comparison shopping difficult. (*Curbing Predatory Home Mortgage Lending*, pp. 2, 18.)

**C.** While subprime lending has allowed many borrowers to gain access to credit formerly denied them, it has also allowed to opportunity for abusive practices, commonly known as predatory lending. (*Curbing Predatory Home Mortgage Lending*, p. 13.)

**D.** Predatory lending is characterized by a number of specific practices including making a loan for more than the borrower can repay, repeatedly refinancing a loan without benefit to the borrower, charging excessive prepayment penalties, and financing single-premium credit insurance. (*Curbing Predatory Home Mortgage Lending*, pp. 76, 73, 89 and 92.)

**E.** The AARP Model Act proposes limiting six lending practices on all loans, whether or not they are considered ‘high cost’ loans, with a limited exception for the collection of fees for late payments. The following practices are declared to be ‘inherently abusive and rarely included in conventional loans. These are unnecessary to facilitate credit availability, and prohibiting them appropriately protects home ownership and home equity without limiting borrowers’ access to credit.’

1. Credit Insurance and Debt Cancellation Agreements
2. Loan Flipping
3. Recommendation of Default
4. Late Fees
5. Call Provision Prohibition
6. Fee for Loan Balance

(*Home Loan Protection Act: A Model State Statute*, p.15-17.)

**F.** Brokers originate over half of all mortgage loans, both prime and subprime. Kickbacks are inherently abusive since they give the broker an incentive to make the interest rate to the borrower as high as possible without regard to the borrower’s

creditworthiness. (*Quantifying the Economic Cost of Predatory Lending*, Coalition for Responsible Lending 2001, p. 10)

**G.** Predatory lending is deterred in the prime market through competition, but too frequent abuses occur in the subprime lending market. (*Curbing Predatory Home Mortgage Lending*, p.2)

**H.** U.S. borrowers lose \$9.1 billion annually to predatory lending practices. These costs come from a number of sources:

- Equity stripping from financed credit insurance (\$2.1 billion, affecting 500,000 families), exorbitant up-front fees (\$1.8 billion, affecting 750,000 families), and subprime prepayment penalties (\$2.3 billion, affecting 850,000 families);
- Rate-risk disparities from excess interest charged (\$2.9 billion, affecting 600,000 families); and,
- Excessive foreclosures from a lack of concern for the ability of the borrowers to repay the loan (unknown amount.)

(*Quantifying the Economic Cost of Predatory Lending*.)

**I.** While higher than average rates of foreclosure should be expected in subprime lending where borrowers frequently pose higher credit risks, the studies to date have suggested that subprime foreclosures are disproportionate even taking this assumption into account. (*Quantifying the Economic Cost of Predatory Lending*, 2001, p. 11.)

**J.** Subprime loans are legitimate and meet a need in the community – those with less than perfect credit or who had had past credit problems are less likely to qualify for conventional home loans. Subprime loans have higher interest rates and fees because these are higher-risk customers for the lending industry. However a subset of the subprime market is where predatory lending occurs. Predatory lending involves deception or fraud, aggressive sales tactics, or unfair advantage of a borrower's lack of understanding about loan terms. (Testimony by Rosemarie Ibañez, H&CD Hearing, 4/17/02, p. 9, lines 14-23.)

**K.** Barbara Zeidman, of Fannie Mae's HouseLosAngeles Partnership, stated that predatory lending occurs in the broker network and those brokers deliver their loans to mainstream lenders. (H&CD Hearing, 4/17/02, p. 35, lines 4-6.)

**L.** Joy Simmons, Directing Attorney, Legal Aid Foundation of Los Angeles, LAFLA, testified to the characteristics of predatory loans commonly seen by LAFLA: repeated refinancing of a loan, unnecessary upfront fees, prepayment penalties, excessive points, default interest rates, loan for more than the borrower actually needs, financing of single premium credit insurance, high interest rates when they would really qualify for a lower interest rate, steering to high cost loans, and loans where the borrower does not have the ability to repay the loan. (H&CD Hearing, 9/12/02, p. 17, lines 2-10.)

**M.** John Sorensen, who spoke for his wife, Linda, a Mandarin-speaker, said that his wife took out a predatory loan two years ago, and she's currently filing a complaint against the

Department of Corporations with the following complaints: deceptive sales practices, purposely debasing her credit profile for gain, violation of disclosure laws, failure to disclose a mandatory arbitration clause, failure to make copies of her loan documents, and fraud. (H&CD Hearing, 9/12/02, pp. 24-25.)

**N.** HUD's list of top subprime lenders include names such as Beneficial, Household Finance, Ameriquest, New Century and many others. Lender names can change overnight, but the practices remain consistent. There is a distinction between subprime and predatory – there is a market for subprime, for those that cannot qualify for prime loans. But it is in a subset of the subprime market that predatory lending is found. A subprime loan becomes predatory when its high interest rate is combined with excessive costs, hidden fees, and/or deceptive practices. (Testimony by Rosemarie Ibañez, H&CD Hearing, 9/12/02, p. 42, lines 7-25.)

**O.** Carol Schatz of the Central City Association (CCA), representing CCA members Bank of America, Washington Mutual and Wells Fargo, stated that abusive lending practices, which come from some mortgage lenders, and are not practices that well-established banks and lenders engage in. (H&CD Hearing, 9/12/02, p. 4, lines 14-20.)

**P.** Follow-up information from LAHD was submitted to the H&CD Committee. Testimony by Rosemarie Ibañez included a chart listing the top subprime lenders in Los Angeles. While Carol Schatz of CCA had just stated that major banks are not involved, the chart shows the top subprime lenders, and in parenthesis their parent companies, which are major banks: National City Mortgage owns First Franklin Financial (subprime), Washington Mutual's subprime subsidiary is Long Beach Mortgage, Citigroup owns the subprime Associates Financial, and Countrywide Home Loans' subprime subsidiary is Full Spectrum Lending. (Testimony by Rosemarie Ibañez, H&CD Hearing, 9/12/02, p. 46, lines 2-15.)

**Q.** Unlike HOEPA, which was designed to protect existing homeowners, the [AARP] Model Act covers both refinance and home purchase loans. (*Home Loan Protection Act: A Model State Statute*, p.7.)

**R.** All the homeowners who testified that they were victimized by predatory loans, were existing homeowners who had refinanced their loans (H&CD Hearings, 2/21/02, 4/17/02, 9/12/02.)