Testimony before the Board of Governors of the Federal Reserve regarding

Home Equity Lending and HOEPA

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Governor Gramlich, Ms. Smith, Ms. Hurt, Mr. Michaels, and Mr. Walker, on behalf of our low-income clients, the National Consumer Law Center[1] thanks the Board for inviting us to testify today and discuss the increase in predatory lending directed at low income and elderly borrowers and appropriate remedial actions to address this problem.

We are pleased that the Board recognizes the gravity of the predatory lending problem. This is a problem that existed for many years prior to the passage of the Home Ownership and Equity Protection Act, which has since grown exponentially. We saw these problems in the 1980s, Congress recognized these problems in the early 1990s. It is obvious from the substantial testimony presented at the HUD/Treasury hearings that occurred in May of this year, these problem loans continue to grow unabated.

While public information about subprime loans is scant, there is ample evidence that there are real problems in the mortgage market:

- Between 1980 and 1998 the rate of home foreclosures in the United States increased by 384%. That means that even though interest mortgage rates were almost twice as high in 1980, as they were in 1998, almost four times the number of homes were foreclosed upon in 1998 as in 1980. [2] More significantly, the foreclosure rate is substantially higher for subprime loans than for prime loans.[3]
- This increase in foreclosure rates *cannot* be traced to the increase in homeownership rates, which was only about 3% during the same period.

The problem is that too many home loans are being made for purposes that have nothing to do with the home. Too often these loans are being made with terms that are inherently unconscionable -- that increase the costs of homeownership and the risk of loss of homeownership to the borrower.

I. INTRODUCTION

In 1994, Congress passed the Home Ownership and Equity Protection Act (HOEPA) to prevent some predatory lending practices after reviewing compelling testimony and evidence presented during a number of hearings that occurred in 1993 and 1994. This law created a special class of regulated closed-end loans made at high rates or with excessive costs and fees. Rather than cap interest rates, points, or other costs for those loans, the protections essentially prohibit or limit certain abusive loan terms and require additional disclosures. HOEPA's provisions are triggered if a loan has an APR of 10 points over the Treasury bill for the same term as the loan, or points equal to more 8% of the amount borrowed.[4]

It was hoped that HOEPA would reverse the trend of the past decade, which had made predatory home equity lending a growth industry and contributed to the loss of equity and homes for so many Americans. However, experience over the last four years has shown that while HOEPA has made a start at addressing the problems, there are still yawning chasms of unprotected borrowers subject to the abuses of high cost home equity lenders.

The three most significant problems with HOEPA:

1. HOEPA does not in any way limit what the lender can charge as up-front costs to the borrower. It is the excessive, combined fees -- in closing costs, credit insurance premiums, and points -- which deplete the equity in abusive loans. These excessive, combined fees are charged over and over, each time the loan is refinanced. And with each refinancing, the homeowner’s equity is depleted by these charges because they are all financed in the loan. The effect of this situation is to encourage lenders to refinance high cost loans because they reap so much immediate reward at each closing. If the law limited the amount of points and closing costs that a lender could finance in high cost loans, this incentive to steal equity would be stopped cold.
2. The interest rate and points and fees triggers for HOEPA are too high, causing many abusive lenders who want to avoid HOEPA strictures to make high cost loans just under the trigger. The effect is that there are no protections whatsoever against these very high cost loans.
3. HOEPA does not apply to open-end loans. When HOEPA was passed in 1994, there were few predatory open-end mortgage loans being made. In the past six years, that picture has changed. It has become apparent that open-end credit provides another vehicle for mortgage abuses. There is no longer any reason to exclude open-end mortgage loans from HOEPA’s coverage. More importantly, unless open-end loans are brought within the scope of HOEPA, the failure to regulate them will simply push the bad actors into that market.

But, otherwise, HOEPA is grounded upon an excellent premise: the economic rationale that the higher the charges for the loan, the more regulation is necessary and appropriate. By passing HOEPA, Congress has already recognized two essential truths: that there are some loans for which the marketplace does not effectively apply restrictions; and government must step in to provide balance to the bargaining position between borrowers who either lack the sophistication to avoid bad loans or do not believe they have a choice if they want the credit. NCLC supports several improvements to HOEPA to target certain abusive creditor behavior. These are highlighted below.

II. IMPROVEMENTS TO HOEPA

A. The APR Trigger Should be Lowered

Substantial information is now available on pricing and losses in the subprime mortgage market. These data suggest that interest rates at either 8 or 10 points above comparable treasuries are unnecessary to make credit available to homeowners representing a reasonable range of foreclosure risk. There should be serious concern regarding borrowers who do get loans at such high rates. There is every reason to apply HOEPA’s special protections to what is now the very high end of the price range for subprime mortgages.>

> The range of interest rates charged to subprime borrowers is very broad, especially compared to the range in the conventional mortgage market. Professor Cathy Lesser Mansfield studied the loan data for over 1 million loans that were securitized between 1995 and 1999, and found that:
>
> The rate range for the subprime loans we looked at increased between 1995 and 1999, with a range in 1995 between 5.00 and 17.99%, and a range in 1999 between 3.00 and 19.99%. For Green Tree Financial, one of the lenders we looked at, the range of rates in 1999 alone was between 4.00% and 19.99%. By contrast, the range of rates in the conventional market was never more than 2 percentage points.[5]

With 30-year treasury bond rates fluctuating between 5 and 7% during the same time period, subprime mortgage lenders charged as much as 13 percentage points above comparable treasury rates. On the other hand, the median subprime mortgage rates were typically 4 to 5 percentage points above comparable treasury securities, so that the bulk of subprime lending was being done well below the Treasury + 10% HOEPA trigger.[6] Reducing the trigger to Treasury + 6% or 8% will not substantially reduce the availability of subprime mortgage credit.

Moreover, those loans that are written at such high interest rates are highly likely to have predatory features, and/or to involve borrowers at very high risk of default and foreclosure, for whom HOEPA protections are especially important. Professor Mansfield's data suggest that even a reduced cutoff of Treasury + 6 points would affect fewer than 25% of loans made in the 1995 to 1999 period.[7]

The presumed justification for charging a higher rate to one subprime borrower than another is the credit risk, i.e. the risk of loss in the event of default and foreclosure. This risk is numerically small, even in cases of subprime mortgages of relatively lower credit quality. Typical subprime lenders experience annual loss rates below 1% of the their loan portfolios.[8] Subprime mortgage lenders concentrating on the most risky borrowers still report modest losses. For example, Aames Financial Corp. reported in February 1999 that its actual annual losses as of 12/31/98 were 1.08% of the serviced portfolio, and it estimated cumulative (i.e. not annual, but over the life of the loan pool) losses of 2.7% of the balance of loans securitized.[9] A more conservative lender, New Century Financial, reported in March 2000 that its current loan production was a mix of about 25% "C" category loans, 20% "B" category, and 55% "A-" or "A" categories.[10] New Century did not provide annual loss information, but the foreclosure rate was about 2.5% and recoveries on foreclosures ranged from 63% to 100% (on reinstated loans) suggesting a loss rate below 1%.

Standard and Poors estimates that a pool of "C" quality loans will have a foreclosure incidence rate of 3.6 times the rate for a conventional mortgage pool, and about 2.5 times the rate for an A- subprime pool.[11] Of course, actual subprime mortgage pools are composed of a mix of loans of different credit quality. One can infer from both the S&P ratios, and the actual loss experiences of lenders, that foreclosure losses on "A"- loans would range between .5% and 1%, and losses on "C" loans would range between 1.25% and 2.5%. In other words, losses on C loans are 2.5 times as high as the losses on A- loans, with the weighted average loss for all categories around 1% a year. Thus, a spread between the subprime lender's best interest rate for "A"- borrowers, and its highest interest rate for "C" borrowers, would only need to be around 2 percentage points to cover higher annual losses from foreclosures.[12]

The variance in interest rates charged to subprime borrowers (more than 10 percentage points) is thus much larger than the variance in loan losses across the spectrum of subprime mortgages. If higher rates for some borrowers were meant *only* to compensate for the increased losses expected, the rates should be no more than 2 or 3 percentage points higher for C loans than for A- loans. The wide range in interest rates seen among subprime mortgage borrowers therefore suggests extensive price discrimination (i.e. charging different rates for similarly situated borrowers).[13] It also suggests that there is no need, from an efficient market standpoint, to facilitate or even tolerate mortgage lending at rates as high as 8 percentage points above comparable treasury rates.

If, in fact, the subprime mortgages made at rates over a "treasury + 8%" formula are priced well above the corresponding risk of loss, borrowers paying such rates are probably not shopping for credit, do not have adequate information about credit costs, and are most vulnerable to predatory practices. Borrowers paying such high rates are also most likely to have marginal ability to repay at best, and to have obtained their loan primarily on the basis of their property value. HOEPA's prohibition on asset-based lending is appropriately targeted to this group.

The Board has the statutory authority to lower the APR trigger by 2 points.[14] There is ample evidence that lowering the trigger to 6% above the Treasury rate is appropriate. Given this analysis, the Board should also seek Congressional permission to lower the APR trigger to 6% on first lien mortgages and 8% on second mortgages. This position is consistent with a provision in the Sarbannes-LaFalce bill (HR 4250). The higher trigger for second mortgages provides some incentive to lenders to make more second mortgages. Most lenders these days prefer to be in first lien position for a variety of reasons. One of the most important reasons is the federal preemption of state law interest rate and point caps.[15] By encouraging lenders to make second mortgages, two consequences could flow that are beneficial to consumers. First, the incentive of predatory lenders to refinance beneficial lower rate first mortgage loans will be reduced. Second, these lenders will be subject to second mortgage loan laws in states that have retained them. These laws often contain an interest rate cap and fee limitations.

B. The Points and Fees Trigger Should Include ALL Points and Fees

The loopholes to the points and fees trigger encourage abusive lenders to avoid HOEPA coverage by padding excluded charges, selling credit insurance, and failing to add in the yield spread premiums paid to brokers. The three-part standard defining which fees and points are included in this calculation is cumbersome and difficult to understand.[16]

For example, this trigger does not include “reasonable” charges if they are not retained by the creditor and are not paid to a third party affiliated with the creditor. Fees for appraisals performed by unaffiliated third parties are not counted if only the direct cost is passed on to the borrower. On the other hand, such a fee is counted if the cost is padded. Determining what is a “reasonable” for purposes of triggering coverage, however, is a difficult burden for consumers to meet.

Consumer advocates are reporting that predatory lenders are now attempting to make loans with just a little less than 8% in points and fees, rather than complying with HOEPA. In many instances, they charge large fees that are not presently included in the HOEPA coverage trigger.

Ms. N. from Denver, Colorado paid $8,539 in settlement costs for a $93,000 mortgage (about $86,000 amount financed.) Some of the settlement costs were excluded from the TILA finance charge, and some were not counted as “Points and fees” for HOEPA purposes, so that the lender took the position no HOEPA disclosures were required. The loan included a proliferation of “junk fees”, such as closing fees, document preparation fees, courier fees, “processing fee”, and the like. The loan included a prepayment penalty that would otherwise be prohibited by HOEPA. WMC refinanced a conventional first mortgage and paid an IRS debt, all so that Ms. N could receive about $10,000 in actual loan proceeds. She also faces serious difficulty in repaying this mortgage on her limited income. Her loan documents are attached as Exhibit 2.

In addition, credit insurance can be a big ticket item in each individual loan. Nationally, consumers spend as much as $6 billion per year on credit insurance, often with little understanding of what they have bought.[17] This volume of business conceals overcharges of $2 billion.[18] Because it is so profitable for both the creditors and insurance industry, the pressures to sell these products are enormous because of the huge commissions realized by lenders.[19]

To illustrate the high cost of single premium insurance, consider the example of Mrs. P of Durham, North Carolina. In December 1998, she entered into a typical cash-out refinancing subprime mortgage for $76,000. She paid over $11,600 in credit insurance premiums, for insurance that would last for 5 to 7 of the 15 years of loan repayment. This credit insurance constituted 16% of the amount financed of the loan. In addition, $600 of total origination fees were attributable to the prepaid credit insurance premium. Mrs. P also will pay over $18,000 in interest over the life of her loan on the insurance premiums. These loan documents are attached as Exhibit 3.

Credit life, credit disability and credit loss-of-income insurance have very low loss ratios.[20] Subprime mortgage borrowers rarely make a separate, considered decision to purchase this product. Credit insurance sometimes provides lenders with a substantial portion of their profits.[21] Advocates report that the premiums are included in loan documents with little or no prior discussion with the consumer, who is faced with the daunting prospect of canceling a loan at a closing as the only way to avoid this expensive add-on purchase.

Advocates have also suggested that the dual market for credit insurance products has a marked disparate impact on minority homeowners. As the HUD studies amply demonstrate, subprime mortgage lending is disproportionately concentrated in minority neighborhoods of major cities.[22] The same minority homeowners are paying the high cost of single advance premium credit insurance, while predominantly white homeowners with conventional mortgages are offered the less expensive monthly premium credit insurance products, which are also offered separately from the mortgage transaction. It is hard to see what business justification there can be for not offering monthly premium credit insurance, as a separate purchase, in the subprime mortgage market. The prohibition of the sale of single premium credit insurance will not harm consumers in any imaginable way.

The *true* cost of credit to the borrower equals the sum of *all* of the points, fees, including credit insurance costs. In their Joint Report to Congress in July 1998, both HUD and the Board proposed that the definition of the finance charge be expanded to include *all* costs the consumer is required to pay in order to close the loan, with very limited exceptions. At the very least, this approach should be adopted for the points and fees trigger. Given the egregious nature of the predatory practices which Congress sought to reduce by the passage of HOEPA, the points and fees trigger should be all inclusive. The current swiss cheese approach assists high rate lenders in avoiding coverage by encouraging them to unbundle the costs involved in extending credit or to pad the fees that are presently excluded from the definition to more than make up for slightly lower points and fees that are counted toward coverage. There are no circumstances under which 8 points in fees and costs, no matter what their basis, are appropriately added to a home equity loan which already carries compensation to the lender in the form of above market interest rates.

Finally, the current approach makes compliance by creditors more difficult. Ken Logan of First Bankshares testified at the 1997 Atlanta HOEPA hearing that this was the "primary" question for his mortgage banking firm. HUD and Treasury made this same recommendation in their Joint Report issued on June 20, 2000. We agree that this definition should be streamlined.

The Board has the authority to include all points and fees in the trigger, with the exception of the time price differential under 15 U.S.C. § 1602(aa)(4).

C. If the Board Does Not Adopt an All-Inclusive Rule, Several Charges Should be Added to the Points & Fee Trigger

1. Refinanced Points

High points and the flipping of loans is a recipe for huge profits for the lender and increased disaster for the homeowner.

Points become exponentially difficult for homeowners to repay over the course of several refinancings. Since points are not rebated, they should be included in the points and fees trigger in the new loan upon refinancing.

Combine high points with refinancing where points are charged again and the result is that the homeowner's equity is quickly bled from the property. Generally, there are no limits on points under state law if the loan is a first mortgage due to federal preemption.[23] In addition, many states do not cap the amount of points that can be charged on second mortgages. Thus, homeowners are left completely unprotected.

Consider the effect of points upon refinancing. Assume the following loan terms:

Loan amount:	$6,169
Points:	
Interest:	15% repayable over 5 years.
Cash to borrower:	$5,000
Finance charge:	$3,805.60.[24]
APR:	25%.

Lenders typically treat points as earned at consummation and, therefore, do not rebate points upon early termination of the loan in the event of refinancing, prepayment, or acceleration.

To see how this affects the borrower, assume that this same loan is refinanced after 24 months.

Compare:

Loan amount:	$5,000
Interest rate:	
Interest earned at 24 months:>	**$2,213.22**

With:

Loan amount:	$6,169
Interest rate:	15% over 5 years
Points:	$1,169
Interest earned at 24 months:	$1,586.86
Total compensation to lender at 24 months:	**$2,755.86**
Effective APR	**29 1/2%**

This example shows that the lender earns $540 more for the "15%" loan when points are charged than for the 25% loan.

Profit to lenders increase upon refinancing because the unpaid principal of the new loan includes the unrebated points. Interest is then charged on the points that were not rebated. In addition, a whole new round of settlement charges are included in the new loan. The equity is thereby sucked out of the property.

For these reasons, points charged in the loan that is being refinanced should be included in the points and fees trigger to the extent of any amount that would have been refunded had the points been subject to a rebate under the actuarial method. This formula only captures the "unearned" points and provides a disincentive to lenders to refinance their own loans on a regular basis if they wish to avoid HOEPA coverage.

2. *Credit Insurance*

As noted at length above, single premium credit insurance products are expensive for the consumer and a profit center for the creditor. Such premiums should be included in the trigger.

3. *Yield Spread Premiums*

Yield spread premiums should be counted in the points and fees trigger because "all compensation paid to mortgage brokers" must be included under the Act.[25] In Regulation Z, the Board added a condition for inclusion not specified in the statute, *i.e.*, that the points and fees must be payable at or before loan closing.[26] Lenders making HOEPA loans, if the yield spread premium is counted, argue that the premium is not paid by the borrower (a position which is indefensible as the borrower clearly pays the premium through the higher interest rate[27]) and that the payment is not made at or before closing. Creditors most often pay the brokers their premiums at or before closing, as disclosed on the HUD-1 Settlement Statement. The consumer, therefore, pays this fee at that time through the funds advanced by the lender which the consumer then repays to the lender over the course of the loan via the higher interest rate. Since there is a lack of clarity, at least in the creditors' minds on this issue, the Board should address this in the context of this review of HOEPA.

Yield spread premiums can be quite large. For example in the case of Ms. D from Brooklyn, the lender contended that the broker fee and lender's fees amounted to 7.956% of the loan amount. These fees, as calculated by the lender, amounted to $7,296, compared to an amount financed of $91,704. The broker also received a yield spread premium of $990, which was not figured into the lender's HOEPA fees calculation. The loan included numerous features that would violate HOEPA, including a 24% default interest rate, a prepayment penalty, and a borrower whose income was less than the loan payment. See loan documents attached as Exhibit 4.

4. *Per Diem Interest*

Per diem interest charges are included in the points and fees trigger only by virtue of Commentary issued by the Board.[28] While per diem interest is interest and is arguably excludable by virtue of § 1602(aa)(4)(A), it is disclosed in the finance charge by virtue of its status as a prepaid finance charge and not because it is part of the interest earned over the life of the loan.

Per diem interest, where collected at settlement or financed through the proceeds of the loan, is not that part of the interest or time-price differential that is earned over the life of the loan. It is only this latter type of interest that Congress meant to exclude from the points and fees trigger given how it worded § 1602(aa)(4)(A).[29]Indeed, lenders have exploited this exclusion. The loan documents from Ms. ___, a borrower in Chicago, show that the loan would have been covered under HOEPA but for this exclusion. Loan documents are attached as Exhibit 5.

D. The Board Should Find Certain Overreaching Creditor Behavior to be Unfair and Deceptive

1. *Prohibit the financing of points, fees, and credit insurance premiums*

NCLC supports the provision in proposed HR 4250 which prohibits lenders from financing more than 3% of the points and fees charged at closing. This protection is not rate regulation as it does not put a cap on the points or fees that can be charged for high rate loans. Presumably, for most borrowers, prohibiting the financing of these charges will be the same as prohibiting the charges altogether, but this will not necessarily mean that these loans cannot be made. It will only mean that these fees will be rolled into the interest rate charged the borrower -- the lender will pay the fees and recoup them through the interest payments on the loan. The rate of interest charged borrowers will increase, but the borrower's equity ownership in the home will be preserved. These loans will be structured exactly the same as the "no cost" mortgage loans provided to prime borrowers all the time.

There are indisputable advantages flowing from the prohibition against the financing of any points, fees, or credit insurance premiums:

No equity will be stripped from the home. The amount of money that the borrower directly receives, or is paid on the borrower's behalf will be the full loan amount, and nothing more. Every payment the borrower makes will reduce the loan amount. If there are repeated refinancings, the loan amount will *not* rise when there is no cash out. The equity in the home will no longer be the source of financing the loan -- the loan can only be financed through the borrower's income.

The lender will have the incentive to make these loans affordable. Currently, a typical predatory mortgage transaction creates thousands of dollars of immediate profit to the lender upon sale of the loan to an investor. When the borrower refinances the loan, the lender sees a substantial profit, providing an incentive to the lender to encourage refinancings, regardless of whether the borrower can actually afford to repay the refinanced loan. Yet, if the lender only reaps a benefit from the loan through the *payments* the lender has a clear incentive to make sure that the borrower can afford the payments.

The market will work to keep the interest rate on these loans competitive. So long as the borrower has not invested a significant amount of money in each loan -- as is done when thousands of dollars in points and fees are financed -- there is little to stop the borrower from shopping for a lower rate loan when his credit improves, or interest rates fall - just as is done in the prime market. As a result, when the loan is first made the wise subprime lender will make the rate only high enough to cover the costs, the real risk, and a reasonable profit. If more is charged, the borrower will be able to refinance at a lower rate with a competitor.

Consider the following high cost loan:

Borrower receives: $70,000

Borrower pays:		
6 Points	**$4,200**	**($4,200 all profit to lender)**
Closing Costs [30]	**$2,500**	**($1,500 profit to lender)**
Credit Insurance	**$2,200**	**($1,000 commission to lender)**
Total Loan Amount>	**$78,900**	**$6,700 - immediate profit to lender upon sale of loan**
Interest Rate of 12%		
30 year term		
Monthly payment	**$811.58**	
Consumer owes after 36 payments	**$77,927.52**	
Consumer owes after 60 payments	**$77,056**	

So long as there is sufficient equity in the home (and there generally is plenty), the lender *benefits* if the borrower defaults. A default provides the lender with reason to make a new loan, and charge more points and fees. This creates another immediate opportunity to turn a quick profit. Yet, the refinanced loan would be for an amount at least $6,000 more to cover the new closing costs, with the same interest rate of 12%, and the consumer will have that much less equity in the house.

However, if the lender could charge as high an interest rate as desired, but could not finance more than 3% in up-front costs and fees, the same loan might look like this:

Borrower receives $70,000

Borrower pays:

Closing costs $2,100 ($1,100 immediate profit to lender)

Total Loan Amount $72,100

Interest Rate of 13.25%

30 year term

Monthly payment - $ 811.68

Consumer owes after 36 payments -- $71,415

Consumer owes after 60 payments -- $70,784.

Lender makes up entire difference amount not permitted to be refinanced [$8,900 - $2,100 = $6,700] in 6 years in additional interest charges paid by the consumer.

This lender has much less incentive to flip this loan than the lender in the first example. Indeed, the lender's main concern will be to make sure that borrower can, in fact, repay the loan. The profit from the loan will only flow from the payments, not from upfront charges.

2. *The Board Should Establish Guidelines for Measuring Repayment Ability and Recommend to Congress that It Eliminate the Pattern and Practice Requirement*

There is substantial evidence that large numbers of homeowners are losing homes to foreclosure as a result of subprime refinancing loans[31], and that loans are going into foreclosure very soon after origination.[32] This evidence suggests there is a serious problem regarding the evaluation of ability to pay among subprime mortgage lenders. The absence of successful enforcement actions also indicates that the requirement to prove a pattern or practice has rendered HOEPA's equity stripping prohibition ineffective.

Only two cases have been fully litigated regarding the HOEPA prohibition of a pattern of making loans without regard to repayment ability: *Newton v. United Companies Financial Corp*[33]., and *State of New York v. Delta Funding Corp*. [34] In the Newton case, the District Court found that there were serious concerns about the repayment ability of the four homeowners named in the case, but found the evidence insufficient to support a pattern and practice finding. In the Delta Funding case, the lender and the New York Attorney General and Banking Department entered into a settlement agreement, agreeing to certain underwriting rules for determining ability to repay, such as requiring a minimum residual income before approving a loan, and properly verifying borrower income.[35] However, the Delta Funding settlement has been criticized as leaving the lender with considerable discretion to continue making marginal loans to strapped homeowners. The pattern requirement has made enforcement by either private plaintiffs or public agencies prohibitively difficult and expensive.

On the other hand, there is widespread evidence of subprime mortgage loans being made that are virtually certain to go into default. For example, Ms. D in Brooklyn entered into a loan with Delta Funding with a monthly payment that exceeded her monthly income by $300, as a result of falsified income documents submitted by a broker. Loan documents are attached as Exhibit 4. Ms. Forrest of Berkeley California had social security income of $836 per month, and obtained a FAMCO mortgage requiring a monthly payment of $931 including tax and insurance. Her income was "grossed up" to $1,045, and her son's "room and board" payments of $600 per month were added, to yield a paper debt ratio of 56%, on the strength of which she got her HOEPA loan, featuring a 16.9% origination fee. See loan documents attached as Exhibit 9.

Many lenders now offer "no-documentation" or "stated income" programs, which do not require any income verification[36]. These programs are an open invitation to broker fraud, and, by definition, constitute making loans without regard to the borrower's repayment ability. Advocates report that no-doc subprime loans are often made with points and rates just below the HOEPA triggers.

It is not uncommon for subprime mortgage lenders to allow debt-to-income ratios of 55%, or even 60%.[37] These ratios contrast to the 41% back-end ratio typically used in conventional, VA or FHA mortgage underwriting. Perversely, borrowers with the poorest credit history are often allowed by subprime mortgage lenders to have the highest payments as a percentage of income.

A common practice in the subprime mortgage industry allows fixed Social Security income of elderly homeowners to be increased by a factor of 1.25 or more, a tactic called "grossing up." The justification offered is that otherwise borrowers with taxable income are treated less favorably because debt-to-income ratios are applied to their pretax income, so they are allowed to borrow a larger percentage of their net income. The grossing up tactic, when combined with a 60% allowable ratio, means that an elderly homeowner receiving $1,000 monthly Social Security can have a monthly mortgage payment of $750 (60% of $1,250), and be left with $250 on which to live. At least one court found this practice to be unconscionable.[38]

Both the Federal Housing Administration and the Veterans Administration have developed income underwriting guidelines for high-risk mortgage borrowers. The VA includes an assessment of "residual income" for low-income borrowers. Residual income becomes important because even reasonable debt to income ratios leave low-income borrowers with unreasonably small amounts of dollars in absolute terms to pay for utilities, food, transportation, and other basic needs. The VA has established amounts for different regions and family sizes, that represent the minimum required residual income after subtracting mortgage, utility and work-related expenses.[39]

For example, a single parent with two children, earning a gross monthly income of $1,500, would qualify for a $600 monthly mortgage payment based on the 41% debt to income ceiling (assuming no other fixed monthly debt payments.) However, this borrower might not meet the residual income standard of the VA To calculate residual income, all mandatory payroll deductions are subtracted. For example, this might mean the same hypothetical applicant has a net income of $1,200 per month. Shelter expense includes not only the mortgage, but also utilities. If this applicant needs $200 per month to pay utilities, and assumes a $600 monthly mortgage payment, the applicant will have $800 in monthly shelter expense. Subtracting $800 from the $1,200 monthly net income, the applicant has only $400 in residual income, to pay for food, transportation, child-care, clothing, medical care, and all other living expenses. The VA guideline is $788 in residual income for a family of 3. This applicant, who meets the income ratio requirements, does not have adequate residual income, and therefore cannot afford such a large mortgage payment.

Taking residual income into account is obviously most important for borrowers with low incomes, for whom the ratios do not adequately measure repayment ability. Because subprime lenders have disproportionately high percentages of low-income borrowers,[40] residual income analysis is an essential component of determining repayment ability for subprime mortgages.

FHA and VA have also revised the required debt-to-income ratio from time to time, in light of their extensive experience with delinquency and foreclosure rates among the high-risk borrowers they serve.[41] While subprime mortgage lenders have perhaps made a case for lending to persons with credit histories that would not qualify for FHA and VA loans, it is less clear why the FHA and VA repayment ability standards should be exceeded.

At a minimum, NCLC urges the Board to consider establishing a safe harbor under the HOEPA repayment ability provision. Any lender who applied FHA and VA repayment ability rules would be considered to have adequately determined repayment ability. Although lenders could still use higher ratios and/or lower (or no) residual income standards, a safe harbor rule for repayment ability would tend to discourage such reckless lending to low-income, high-risk borrowers, or at least require lenders to carefully research and document the validity of more lenient income guidelines.

NCLC also supports the provision in HR 4250 regarding cosigner abuse. Lenders should not determine repayment ability on the strength of income of cosigners or additional borrowers who do not reside in the home and therefore cannot realistically be relied on to assist in making mortgage payments.

3. The Board Should Prohibit the Refinancing of Lower Rate Mortgages

The time has come for the Board to use the specific authority granted by Congress to define refinancing transactions that are abusive or not in the best interest of borrowers.[42] Evidence is accumulating that homeowners are unable to protect themselves in the unregulated subprime mortgage market from expensive, detrimental and pointless transactions, engineered by lenders and brokers concerned only about their fees and “gain-on-sale” income.

In one case a Brooklyn homeowner had a $40,000 low interest, forgivable home repair loan from the City of New York, which was refinanced into a $99,000 refinancing transaction at 13% APR, and in which the broker received nearly $6,000 in fees. The homeowner’s monthly payment exceeded her income, and the application included false income verification concocted by the broker. See loan documents attached as Exhibit 4.

Gale Floyd, a homeowner who testified at the HUD predatory lending task force hearing in New York in May, 2000, had a conventional first mortgage at about 9% interest, and a conventional 2nd mortgage at 11%, and was induced to refinance both of them at over 12% by a contractor who referred her to a subprime mortgage broker.[43] She was steered to the subprime market for refinancing, apparently either because the contractor thought he could get the cash for his contract faster and more reliably, or because a legitimate appraisal would not support any more conventional mortgage debt on the home.

Another homeowner was induced to refinance a state mortgage assistance program loan, at 9% interest, with a subprime mortgage at 18% interest, and never even got the cash she needed for home repairs.[44]

Consumer attorneys and advocates have also reported subprime mortgage lenders refinancing Habitat for Humanity mortgages (which bear no interest) and mortgages offered by government agencies and nonprofits that do not require repayment or include loan forgiveness features.

Some data from a study funded by the Ford Foundation being conducted in Philadelphia indicate that "upward rate refinancings" are occurring with regularity. Ira Goldstein of The Reinvestment Fund has found that, in a sample of Philadelphia homeowners who refinanced their mortgages, 48% refinanced a "prime" mortgage with another prime mortgage, 18% refinanced a prime mortgage with a subprime mortgage, 15% refinanced a subprime mortgage with another subprime mortgage, and only 7% refinanced a subprime mortgage with a prime mortgage.[45]

While there are many refinancings that include a mix of debt being refinanced (low-interest conventional mortgage and high-interest credit card debts, for example), the upward rate refinancing scenario is simply too common. It too often results from aggressive salesmanship or plain fraud by brokers motivated by large fees. NCLC is not aware of any legitimate case being made by the subprime mortgage industry for upward rate refinancings. The clearest examples of the "no-benefit" subprime mortgage loan are:

A) More than 50% of the prior debt refinanced bears a lower interest rate than the new loan;

B) The *interest* cost of the new loan will exceed the *APR* cost of paying out the debt being consolidated or refinanced;

C) The mortgage being refinanced was provided by a government agency or nonprofit organization at a subsidized interest rate, or with forgiveness features; or

D) Regardless of the interest rate before and after refinancing, the prepaid finance charges and closing costs are so great that the homeowner will never break even, i.e. never save enough in interest to recoup the transaction costs.

NCLC recommends that the Board define these clear categories of "no-benefit refinancings" as refinancings that are not in the best interest of the borrower, using its specific authority under 15 U.S.C. §1639(l)(2)(B). In addition, NCLC recommends that the Board's regulation defining "no-benefit refinancings" include a more general prohibition on refinancings that are clearly unsuitable and harmful to the borrower.

4. Lenders Should Disclose the Best Available Program and Rate

So-called risk-based pricing for mortgage loans is a feature unique to the subprime mortgage market. Conventional lenders generally offer fixed prices for a limited range of products. Subprime lenders have typically established minimum interest rates for each credit grade (A,B,C) and the rates often vary further based on other factors, such as loan to value ratio.[46] Brokers or originators often have the discretion to charge the borrower a higher interest rate than the minimum. There is also a great deal of subjectivity in assigning borrowers to credit grade categories, which vary from lender to lender. All of this produces extensive price discrimination, in a process about which consumers have little or no information. In fact consumer attorneys report that lenders resist producing their price lists even in response to discovery requests in litigation.

Markets do not function well when prices are secret. Lenders should be required to disclose to consumers the credit grade assigned to the consumer, and the lender's standard or minimum interest rate for that grade. Assigning a borrower with A credit to a C program should be defined as a deceptive practice, as should charging a rate higher than the standard or minimum rate, without some tangible economic benefit to the consumer, such as charging less than the standard points or other costs.

5. Failing to Report Payments to Credit Bureaus Should be an Unfair and Deceptive Practice

Failing to report positive credit history on it customers allows a high cost lender to shackle homeowners to that lender by convincing them that they have no credit alternatives. Consumers then believe that their only alternative is to refinance with that same lender because no one else will lend to them. Oftentimes, the lender solicits its customers to join its "frequent flipper program" by offering cashout refinances in small amounts and by suggesting a refinance when the consumer is behind instead of a repayment plan. In these ways, the lender can maximize its profit by charging an additional round of points and closing costs and provide little or no benefit to the consumer.

Many prime lenders will make prime mortgage to customers who have good track records of at least a year with their current mortgage lender, despite earlier credit problems. If this information is not reported, homeowners have a harder time proving this good track record. The ability of homeowners to shop for favorable terms is effectively stymied by the high rate lender. This is an unfair practice and should be prohibited.

6. Failing to Provide a Referral to an Appropriate Credit Counseling Service and Receiving Verification of Counseling Should be an Unfair and Deceptive Practice

Counseling, while it has some potential to prevent predatory mortgage practices, is not a substitute for substantive protections, and effective regulation of unfair and deceptive mortgage practices. NCLC would not support regulations merely calling for written notification to HOEPA borrowers regarding counseling services. Effective counseling needs to be adequately funded, the counselors must have sufficient training, and there must be a mechanism to insure that consumers who are the most vulnerable and most in need of counseling make use of it. NCLC supports the North Carolina statute, which makes counseling mandatory, and in the absence of which a covered high-cost loan is not valid or enforceable. >

NCLC is concerned that a mere notification requirement will only add to the deluge of documents received by prospective mortgage borrowers, and will give the appearance of reform without having any meaningful impact on predatory practices or unsuitable mortgage refinancings. >

7. Use of a Power of Sale or Nonjudicial Process, Absent a Meaningful Right to Cure and Right to Challenge an Abusive Mortgage, Should be an Unfair and Deceptive Practice

The most important tool for foreclosure prevention is to prevent loans being made that are virtually certain to end up in foreclosure. A critical part of addressing the subprime foreclosure problem is the strengthening of HOEPA's prohibition on making loans without sufficient regard to repayment ability. Having said that, NCLC recommends that the Board use its discretionary regulatory authority to define certain foreclosure practices as unfair, deceptive, or designed to evade HOEPA provisions.

Predatory mortgage loans often involve violations of existing consumer protection laws. In cases involving common law fraud, or grounds for rescission under TILA, or other serious enforceability issues, the homeowner needs access to a judicial forum to vindicate his or her defenses, and to enforce the laws being violated. All 50 states have a judicial foreclosure proceeding available for lenders to use, including the states where power of sale foreclosures are permitted.[47] However, in half the states, mortgages can be foreclosed without any judicial action.[48] In these states, the borrower may have as little time as 10 days to retain a lawyer and file a lawsuit to enjoin the foreclosure. While nonjudicial foreclosure may be appropriate for commercial loans, and conventional mortgages, it is inherently unfair in the context of high-rate mortgages to high-risk borrowers. The Board should define use of a power of sale or nonjudicial foreclosure process an unfair and deceptive practice in connection with a HOEPA covered loan.

NCLC also recommends that HOEPA lenders be barred from refusing a homeowner's tender of delinquent payments, for at least 30 days after a clear written notice of intent to foreclose is sent, containing a clear statement of the amount needed to tender to prevent foreclosure. Many states require this for all mortgages, as does the FHA mortgage program[49].

8. The Use of Mandatory Arbitration Clauses in HOEPA Loans Should be an Unfair and Deceptive Practice

Over the last few years, including mandatory arbitration clauses in consumer credit contracts has become standard operating procedure...more often than not. Creditors use arbitration clauses as a shield to prevent consumers from litigating their claims in a judicial forum, where a consumer friendly jury might be deciding the case. Arbitrators, who typically handle disputes between two businesses, are unfamiliar with consumer protection laws, and may be unsympathetic to consumers. Creditors also prefer arbitration because their exposure to punitive damage awards is dramatically reduced, jury trials are eliminated, and the threat of class actions is generally nullified.

Arbitration also limits discovery in most cases, which benefits the creditor, not the consumer, and the arbitration may cost the consumer far more than bringing an action in court. By comparison, indigents in many jurisdictions can file court actions in forma pauperis. And consumers lose their rights to appeal the decisionmaker's erroneous interpretation of the law. This allows arbitrators to ignore state or federal consumer protection statutes and judicial precedent.

Of significance to TILA is the fact that mandatory arbitration conflicts with the public purpose of TILA and its private attorney general enforcement mechanism. TILA relies upon consumers acting as private attorneys general to police creditor compliance by providing individual and class remedies. The enforcement of TILA through damages provisions is made feasible by the Act's fee-shifting provision, which mandates the award of costs and reasonable attorney fees to a prevailing consumer.

The class action remedy is an essential component to enforcing TILA's protections and is a powerful deterrent to wrongful conduct. Indeed, class actions remain the only realistic way for consumers with small monetary claims to vindicate their rights under, and to promote compliance with, TILA. Without class relief and mandatory fee-shifting, TILA would be reduced to nothing more than a mere nuisance to creditors, thus diminishing the Act's deterrent and remedial functions.

Consequently, any comprehensive law addressing predatory mortgage lending must include a prohibition against mandatory pre-dispute arbitration clauses. Proposed HR 4250 appropriately includes such a provision. Further, HUD and Treasury adopted this position their recent Joint Report.

10. The Board should Regulate Deceptive Practices in Connection with Variable Rate High Cost Mortgage Loans

Several subprime mortgage lenders are now offering "teaser rate" variable interest mortgages. The typical product is offered with a relatively attractive initial rate, good for 2 or 3 years, after which the rate will increase to an index plus a substantial margin. For example, New Century Mortgage recently securitized about 3,500 variable rate mortgages originated in the first quarter of 2000. The initial rates averaged 10.25%, and most then float to the 6-month LIBOR rate plus a margin ranging from 4.75% to 9.75%, and averaging 6.2%. The current 6 month LIBOR is 7%, so the average loan would jump from 10.25% to 13% at current rates[50].

Consumer advocates report extensive misunderstanding of these variable rate mortgages among low- and moderate-income homeowners. It is easy, and common, for brokers or originators to tout the low initial payment, while downplaying the higher monthly payment the consumer will encounter after 2 or 3 years. It is unclear whether income underwriting guidelines take into account the borrower's ability to repay the loan if interest rates rise and the payment increases to the lifetime loan cap.

NCLC recommends that the Board take at least the following actions regarding "teaser rate" or "exploding interest rate" high-cost mortgages.

First, lenders should be required to base repayment ability determinations on the *maximum* monthly payment allowed under a variable rate mortgage, to comply with the prohibition against making loans without regard to repayment ability.

Second, the Board should recommend changes in the 3-day advance HOEPA notice so it will include the maximum monthly payment possible under a variable rate mortgage.

Third, the Board should study the existing rules for disclosing the payment schedule in variable rate transactions. The existing rules do not adequately warn consumers of the extent of possible payment increases. The variable rate mortgage brochure does not give the borrower loan-specific information. We believe the clearest way to explain the difference between fixed and variable rate transactions is to give the consumer the worst-case scenario disclosure.

11. The Board Must Address the Remedies Available for Violating any Regulatory Prohibitions It Might Establish

Under TILA, the present enforcement scheme for violations of TILA is the following:

A) Statutory damages of up to $2,000 for the failure "to comply with any requirement under this part" which is Subpart B of TILA, including § 1639.[51]

B) Any failure to comply with the any requirement under § 1639 triggers enhanced HOEPA damages in the amount of all the finance charges and fees paid by the consumer.[52]

C) Rescission for the failure to provide the HOEPA advance notice or the inclusion of a prohibited loan term.[53]

Since Congress, in § 1639(l)(2), delegated to the Board the authority to prohibit acts and practices which the Boards finds to be unfair, deceptive, or designed to evade the provisions of HOEPA, a violation of such prohibitions as the Board may identify in Regulation Z arguably triggers statutory and enhanced damages. It is less clear whether creditor non-compliance would trigger rescission. Rescission should be available when any mortgage "contains a provision prohibited by this section," according to § 1639(j). Thus, the Board should take care to make clear in Regulation Z § 226.23(a)(3), n. 48 and § 226.32 that certain unfair and deceptive acts are "limitations," listed in § 226.32(d), and, therefore, trigger rescission under § 226.23.

E. The Board Should Recommend that Congress Include Open-End Credit, Prohibit Balloon Payments and Prepayment Penalties, Expand the HOEPA Notice, and Monitor Abusive Lending Practices through the Collection of Information

1. Open-end Credit

Open-ended loans secured by the home are coming into vogue with lenders. They are presently exempt from HOEPA coverage. The Board should recommend that this exception be removed. NCLC presented evidence at the 1997 HOEPA hearings that open-end credit was structured to avoid HOEPA liability. This practice has continued unabated.

Major lenders are engaging in the use of open-end loans to avoid HOEPA. Loan documents from two of them reveal this practice. See loan documents attached as Exhibits 11 and 12. In both situations, the lender made a large closed-end loan which was under the HOEPA triggers and on the same day or shortly thereafter made a smaller home equity line of credit that was over the HOEPA trigger. In one situation, Mr. And Ms Conner of Lakeview, Ohio thought they were getting one loan. Instead, they received two loans: one large closed-end loan for $69,113.14 with an APR of 15.27% slightly under the trigger and points of 7.4%, also just under HOEPA coverage. See Exhibit 11.

At the same time and for no apparent reason, Beneficial added a second loan in the amount of $16,480 at 19.650%, above the HOEPA APR trigger, and charged $480 in points. This line of credit includes a prepayment penalty. The second situation shows a remarkably similar transaction where the borrower obtained a large closed-end loan and within less than a week, the same lender constructed a second home equity line of credit.

Exhibit 12 reveals that the open-end loan amount was $12,900 at 22.9% APR. Of the $12,900, $900 or over 7% of the loan constituted points.

Every exception to HOEPA encourages lenders to craft a loan product to meet that loophole. Given the more widespread use of open-ended loans secured by real property, this loophole should be closed.

2. Balloon payments

Many borrowers do not know that the loan will contain a balloon payment until closing or thereafter. Worse yet, if a borrower inquires about the existence of a balloon payment before settlement, some lenders will lie. The Board should recommend that Congress prohibit balloon payments entirely.

For low-income homeowners who are sold a high rate home equity loan and who face no reasonable expectation of winning the lottery or inheriting a huge sum of money, balloon payments are simply an invitation to foreclosure. The current prohibition of balloons in loans under 60 months in term is inadequate. Often, homeowners are kept ignorant about the existence of a balloon payment until closing. Some lenders engaged in a pattern and practice of lying to homeowners about the existence of a balloon even when the homeowners have the sophistication to inquire. Balloons are harmful to most homeowners for many reasons, not the least of which is that they are a way of requiring refinancing. This throws the homeowner back into the home equity scam market which results in the payment yet again of points, broker fees, closing costs, and higher interest rates. [54]

3. The Board Should Prohibit Prepayment Penalties for all HOEPA Loans

Prepayment penalties are more and more prevalent in subprime mortgage loan pools. They are being used primarily to make a lender's loans more attractive to investors in mortgage-backed securities (or wholesale buyers), offering a promise of longer-lasting high yields. For example, New Century Mortgage securitized a pool of 3,500 variable rate home equity loans at the end of the first quarter of 2000, and disclosed that 78% of the mortgages feature a prepayment penalty.[55] Ameriquest Mortgage Company reports that 55% of its mortgages in the most recent pool included prepayment penalties.[56] The penalty is 6 months of interest for any prepayment greater than 20% of principal in the first 5 years. At a typical 10% subprime mortgage rate, the penalty amounts to another 5 points. In combination with frequent and ill-advised refinancings, consumers may end up paying 20% or more of their loan amount in transaction costs to refinance.>

NCLC has seen no evidence that subprime mortgage with prepayment penalties provide beneficial trade-offs to consumers, for example by offering lower interest rates than mortgages without penalties. Lack of consumer information, and the inherent complexity of these transactions, makes such sophisticated term-by-term bargaining a complete fiction in this market.

The issue of permitting or prohibiting prepayment penalties comes down to a policy choice between the harm to consumers, who rarely bargain over such terms and cannot always avoid paying the penalty, and the benefit to investors of earning above-average bond returns for longer periods without having to reinvest their funds. The subprime mortgage industry has failed to make the case that banning prepayment penalties would reduce the availability of capital for subprime mortgages to an extent that would cause concern. Indeed, it may be the excessive and constantly growing supply of capital (or demand by investors for high yield mortgage-backed securities) that causes some abusive and predatory lending practices.

Prepayments by subprime borrowers should be facilitated, not penalized. One of the common sales pitches by subprime lenders is that homeowners with poor credit histories may be able to get a subprime mortgage, make payments regularly for a year or two, and then refinance in the conventional market at better interest rates. Consumers who could actually benefit from such a process should not be penalized merely to protect the duration of investors' returns.

4. HOEPA Notice

The current mandated notice is fairly simple. The purpose of any additions to this notice should be carefully weighed with the goal of keeping the notice short and understandable. On the other hand, the notice plays a critical role in the HOEPA scheme of protecting homeowners against the worst abuses prevalent in the high cost lending market, a market in which many find themselves a captive audience due to perception, deceptive sales tactics, reverse redlining, lack of sophistication, and other factors. If homeowners can be warned off a bad loan, this preventive medicine goes a long way towards helping the market to regulate itself. That is, if fewer and fewer people borrow from the most expensive lenders, these lenders will have an incentive to lend at more reasonable rates in order to stay in business.

The notice should include some limited additional information that can assist homeowners in rejecting bad loans. For example, the "warning" section of the notice should include an introductory sentence as follows:

WARNING—this is a high cost mortgage loan. The prepaid finance charges should be listed as an aggregate under the title: Required charges to close this loan. The total of the closing costs (excluding the prepaid finance charge which would be separately listed) should also be listed under this title. The total loan amount should be included. A sample notice would then look like the following:

WARNING: This Is A High Cost Mortgage Loan.

If you obtain this loan, the lender will have a mortgage on your home.
You could lose your home and any money you have put into it, if you do not meet your obligations under the

loan.
You do not have to accept this loan just because you received these disclosures or have signed a loan application.

The APR (annual percentage rate) on your new loan will be:________
Your monthly payment will be: _______________________
[Balloon disclosure: This is a balloon loan. Even if you make all your payments you will owe $ _____________ at the end of ____ years of repayment]
[Variable rate loans] Your monthly payment can go up to: [maximum based on rate cap]

Required charges you will finance to get this loan:
prepaid finance charges:_______________________
other closing costs: ______________________
Total loan amount:___________________________

These suggestions do not complicate the existing notice but give the homeowner a better shot at deciding if the loan terms and costs are too expensive.

5. Increased Data Collection is Critical

The HMDA reporting exemption for non-depository lenders whose mortgage lending is less than 10% of their total loan origination should be removed so that complete information about the martketplace can be collected.

Further, NCLC supports the position taken by Martin Eakes, representing the Coalition for Responsible Lending at the Charlotte, NC hearing on July 25, 2000. There, he urged the Board to:

To fulfill the purposes of HMDA, the Board should add two data codes to the loan type field -- subprime and manufactured housing -- and add two data fields -- interest rate and HOEPA points and fees or total settlement charges. The main purposes of HMDA are helping determine whether lenders serve their communities' housing needs and identify possible discriminatory lending patterns. Requiring lenders to report these elements would provide objective information to help the assess the meeting of needs and help root out the practice of steering minority groups to more expensive loans than they would otherwise qualify for.

In addition, the information should provided:

1. the annual percentage rate and interest rate of the loan;

2. the principal amount of the loan and the amount financed (as defined by TILA);

3. the total closing costs, points and fees, and financed credit insurance premiums (and related products);

4. the delinquency and foreclosure rates on an annual basis (for all subprime loans, as compared to other types of loans in the total portfolio);.

5. the length of time between purchase and refinance, if any, on an aggregate basis.

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[1] The **National Consumer Law Center** is a nonprofit organization specializing in consumer credit issues on behalf of low-income people. We work with thousands of legal services, government and privates attorneys around the country, representing low-income and elderly individuals, who request our assistance with the analysis of credit transactions to determine appropriate claims and defenses their clients might have. As a result of our daily contact with these practicing attorneys we have seen examples of predatory lending to low-income people in almost every state in the union. It is from this vantage point--many years of dealing with the abusive transactions thrust upon the less sophisticated and less powerful in our communities--that we supply this testimony today. *Cost of Credit* (NCLC 1995), *Truth in Lending* (NCLC 1996) and *Unfair and Deceptive Acts and Practices* (NCLC 1997), are three of twelve practice treatises that NCLC publishes and annually supplements. These books as well as our newsletter, *NCLC*

Reports Consumer Credit & Usury Ed., describe the law currently applicable to all types of consumer loan transactions.

[2] At the end of 1980 there were 150,165 homes in foreclosure, at the end of 1998 there were 577,566. *See* Table No. 823, Mortgage Delinquency and Foreclosure Rates: 1980 to 1998, U.S. Census Bureau, Statistical Abstract of the United States, Banking, Finance and Insurance, 1999.

[3] *See*Cathy Lesser Mansfield, *The Road to Subprime "HEL" Was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market*, 51 S.C. L. Rev. 473, ___ (Spring 2000).

[4] 15 U.S.C. ' 1602(AA)(1)(B).

[5] Predatory Lending Practices, Hearing Before The House Committee On Banking And Financial Services, 106th Cong., 2d Sess. (May 24, 2000) (Testimony of Prof. Cathy Lesser Mansfield).

[6] Cathy Lesser Mansfield, *supra* note 3 at 536-37.

[7] *Id.* at Table 1. It should be noted that the HOEPA trigger is based on APR, which is generally higher than the interest rate. On the other hand, a significant difference between the APR and the interest rate on a long-term mortgage loan results from very high prepaid finance charges (points), which is another strong indicator of potential predatory practices.

[8] For example, Banc One reported in a March, 1999 prospectus supplement that its net losses as a percentage of the average amount outstanding on all serviced mortgage loans was .78% on 3/31/99. Banc One Financial Services Home Equity Loan Trust 1999-2, Prospectus Supplement at S-20. All prospectuses and supplements hereafter cited may be obtained through the SEC's EDGAR database, at www.sec.gov/edgarhp.htm. *See* attached Exhibit 1.

[9] *See* attached Exhibit 15.

[10] New Century Home Equity Loan Trust Series 2000-NC1, Prospectus Supplement, form 424(b)(5) dated March 22, 2000 and filed with the S.E.C. March 24, 2000, at page S-25. *See* attached Exhibit 6.

[11] Standard and Poors , U.S. Residential Subprime Mortgage Criteria 30 (2000) (available at www.standardpoor.com/ratings/structuredfinance/index.htm, visited 7/17/2000). *See* attached Exhibit 7.

[12] Other cost items besides credit losses going into the interest rate, such as servicing fees and the cost of funds, are generally the same regardless of the loan's credit grade, at least for loans that are pooled and securitized, since these costs are distributed uniformly to the whole loan pool.

[13] *See* Cathy Lesser Mansfield, *supra* note 3, at 536-37**.**

[14] 15 U.S.C. § 1602(aa)(2)(A).

[15] In 1980, Congress preempted the ability of states to set interest rate caps on most first mortgage loans. Depository Institutions Deregulation and Monetary Control Act of 1980, ' 501 (DIDA), codified at 12 U.S.C. ' 1735f-7a.

[16] 15 U.S.C. § 1602(aa)(4).

[17] Mary Griffin and Birney Birnbaum, *"Credit Insurance" , The $2 Billion a Year Rip-Off*, Consumers Union and the Center for Economic Justice (March 1999).

[18] *Id.*

[19] Equity Predators: Stripping, Flipping and Packing Their Way to Profits: Hearing before the Special Committee on Aging United States Senate, 105th Cong. 2d Sess. 33-34, Serial No. 105-18 (Mar. 16, 1998)(statement of Jim Dough,

former employee of predatory lender). Allegations of coercion in the sale of what is suppose to be a "voluntary" product have been the subject of federal enforcement cases and private litigation. *In re USLIFE Credit Corp. & USLIFE Corp.*, 91 FTC 984 (1978), *modified on other grounds* 92 FTC 353 (1978), *rev'd* 599 F.2d 1387 (5th Cir. 1979); *Lemelledo v. Beneficial Management*, 674 A.2d 582 (N.J. Super. Ct. App. Div. 1996), *aff'd on other grounds*, 696 A.2d 546 (N.J. 1997).

[20] Mary Griffin and Birney Birnbaum, *Credit Insurance" The $2 Billion a Year Rip-Off*, Consumers Union and the Center for Economic Justice (March 1999).

[21] Equity Predators: Stripping, Flipping and Packing Their Way to Profits: Hearing before the Special Committee on Aging United States Senate, 105th Cong. 2d Sess. 33-34, Serial No. 105-18 (Mar. 16, 1998)(statement of Jim Dough, former employee of predatory lender).

[22] *See* HUD, *Unequal Burden: Income and Racial Disparities in Subprime Lending in America* (April 2000) in which HUD discusses the results of studies conducted in Atlanta, New York, Baltimore, Los Angeles, and Chicago. Key findings of the Department of Housing and Urban Development analysis show that: 1) From 1993 to 1998, the number of subprime refinancing loans increased ten-fold. 2) Subprime loans are three times more likely in low income neighborhoods than in high-income neighborhoods. 3) Subprime loans are five times more likely in black neighborhoods than in white neighborhoods. 4) Homeowners in high-income black areas are twice as likely as homeowners in low-income white areas to have subprime loans.

[23] Depository Institutions Deregulation and Monetary Control Act of 1980, ' 501 (DIDA), codified at 12 U.S.C. ' 1735f-7a.

[24] The points are capitalized over the life of the life of the loan. Therefore, the finance charge is calculated as follows: 15% for 5 years on the proceeds which equals $2,636.60 of interest plus $1,169 in points.

[25] 15 U.S.C. § 1602(aa)(3)(B).

[26] Regulation Z § 226.32(a)(1)(ii).

[27] HUD unequivocally agrees that the borrower pays the yield spread premium. HUD Policy Statement 1999-1, 64 Fed. Reg. 10080, 10081 (March 1, 1999).

[28] OSC § 226.32(b)(1)(i)-1; 62 Fed. Reg. 10198 (March 6, 1997).

[29] "For purposes of paragraph (1)(B), points and fees shall include—

(A) all items included in the finance charge, except interest or the time-price differential…" 15 U.S.C. § 1602(aa)(4)(A).

[30]In over 50% of mortgages loans, closing costs includes a broker's fee. HR 4250 would include fees paid to brokers both directly by the borrower -- as part of the closing costs -- and those paid by the lender, which is covered in the interest rate. In the interests of simplicity of this example, we have not identified and included either broker's fee.

[31] Mansfield and White report that for 14 lenders servicing less than one-half of all subprime mortgages at the end of 1998, 72,000 homeowners are over 90 days delinquent, or in foreclosure or bankruptcy. This represents 4.65% of loans serviced, nearly double the rate for FHA and VA mortgages. Testimony of Cathy Lesser Mansfield, *supra* note 5.

[32] A single pool of 5,600 loans originated by WMC Mortgage Company in 1998 had reached a point after less than two years where a full 24.75% of the loans in the pool were in 90+ delinquency, foreclosure, bankruptcy, or already foreclosed. Testimony of Cathy Lesser Mansfield, supra note 6. United Companies Lending filed 1400 mortgages in the City of Philadelphia in the 1990's, and filed more than 400 foreclosures. Joseph DiStefano, *Foreclosures follow Flood of High-Cost Loans*, Philadelphia Inquirer, August 2, 2000 at A1. See also, Treasury/HUD Task Force Report,

at 25 (mean time between loan origination and foreclosure for subprime mortgages was 1.8 years, compared to 3.2 for conventional mortgages.)

[33] 24 F. Supp. 2d 444 (E.D. Pa. 1998).

[34] See Complaint, People of State of New York v. Delta Funding Corp., No. 99-4951 (E.D.N.Y. 1999).

[35] In re Delta Funding Corporation, Remediation Agreement (Administrative Proceeding before New York State Banking Department, September 17, 1999); People of New York v. Delta Funding Corporation, Settlement Agreement, 99-4951 (E.D. N.Y. 1999). See also Complaint, U.S. v. Delta Funding Corporation, available at: http://www.ftc.gov/os/2000/03/deltacomp.htm.

[36] Banc One Financial Services offers “Lite Documentation” and “No Documentation” programs. Banc One Financial Services Home Equity Loan Trust 1999-2 Prospectus Supplement at S-17. See attached Exhibit 1. New Century Financial’s securitized pool of variable rate subprime mortgages for the first quarter of 2000 included about 30% “stated income” loans. New Century Financial Home Equity Loan Trust Series 2000-NC1, Prospectus Supplement March 22, 2000, at S-24. *See* Exhibit 6.

[37] New Century Prospectus Supplement, at S-30, S-31; EQCC Home Equity Loan Trust 1999-3, Prospectus Supplement filed August 20, 1999, at 27 (“Equicredit Prospectus”). *See* Exhibits 6 and 8.

[38] City Fin. Services v. Smith>, Clearinghouse No. 52,489 (Ohio Mun. Ct., Jan. 4, 2000), discussed in 18 NCLC Reports *Deceptive Practices and Warranties ed.* 9 (Nov./Dec. 1999).

[39] 38 C.F.R. §36.4337; VA Form 26-6393, Loan Analysis, available at >www.vba.va.gov/pubs/homeloanforms.htm. *See* VA regulations and Worksheet in Exhibit 10.

[40] Glenn Canner and Wayne Passmore, *The Role of Specialized Lenders in Extending Mortgages to Lower-Income and Minority Homebuyers*, Federal Reserve Bulletin 709, 718 (November 1999).

[41] The current maximum total fixed debt to income ratio for FHA and VA mortgages is 41%. 38 C.F.R. §36.4337, HUD Handbook 4155.1 at 2-29 to 2-30 (available at http://www.hudclips.org/sub_nonhud/cgi/hudclips.cgi).

[42] 15 U.S.C. §1639(l)(2)(B).

[43]

[44] *Barker v. Altegra*, 249 B.R. 391 (Bankr. E.D. Pa. 2000).

[45] Preliminary results communicated by e-mail from Mr. Goldstein, complete results of the study to be published by the end of the year 2000.

[46] See FAMCO rate chart, in Forrest loan documents attached as Exhibit 9.

[47] Deanne Loonin, Gary Klein, Jonathan Sheldon, *Repossession and Foreclosures* § 14.2, (National Consumer Law Center 4th ed. 1999).

[48] Id. at Appendix F (summary of state foreclosure laws.)

[49] *Id*. *See also* 24 C.F.R. §§203.602, 203.608 for FHA loans.

[50] New Century Home Equity Loan Trust Series 2000-NC1, Prospectus Supplement, form 424(b)(5) dated March 22, 2000 and filed with the S.E.C. March 24, 2000. *See* Exhibit 6.

[51] § 1640(a)(2)(A)(iii).

[52] § 1640(a)(4).

[53] § 1639(j); Regulation Z § 226.23(a)(3), n.48.

[54] See also *Barker v. Altegra*, 249 B.R. 391 (E.D. Pa. 2000)(the judge even indicated he had a hard time understanding that there was a balloon when reviewing the papers); *Ralls v. Bank Of New York (In re Ralls)*, 230 B.R. 508 (Bankr. E.D. Pa. 1999)(court found that TILA disclosures were not clear and> conspicuous and did not reflect the legal obligations of the note because several documents provided inconsistent information on the payment schedule and whether it contained a final balloon payment).

[55] New Century Home Equity Loan Trust Series 2000-NC1, prospectus supplement dated March 22, 2000, at S-17. *See* Exhibit 6.

[56] Ameriquest Mortgage Mortgage Securities, prospectus supplement dated June 21, 2000, at S-17.