Testimony before the Subcommittees on Housing & Community Opportunity and Financial Institutions & Consumer Credit House Committee on
Banking and Financial Services regarding the

Rewrite of Truth in Lending Act and Real Estate Settlement Procedures Act

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Chairman Lazio and Chairwoman Roukema, and Members of the Subcommittees, on behalf of our low-income clients, the **National Consumer Law Center**[1] thanks the committee for inviting us to testify today regarding the rewrite of the Truth in Lending Act and the Real Estate Settlement Procedures Act. I am also testifying here today on behalf of the **Consumer Federation of America, Consumers Union,** the **National Association of Consumer Advocates,** and the **U.S. Public Interest Research Group,** whose constituencies collectively encompass a broad range of families and households.

We have all participated in the lengthy meetings of the Mortgage Reform Working Group, and we have met extensively with HUD staff and Federal Reserve Board ("Board") staff. Each of our groups has also spent countless hours discussing and thinking about the issues of mortgage reform among ourselves, with our colleagues and our constituents. Our opinions and proposals for the overall structure, as well as the details, of mortgage reform are the products of thousands of hours of analysis by attorneys and advocates who have devoted their careers to representing consumers.

It is clear to us that the current system is not working: too many homeowners are losing their homes to foreclosure every year, and too many more are paying more than they should or they can afford for their home.[2] It does not help Americans to tantalize them with the dream of homeownership without providing the support to allow them to maintain that homeownership. A tripling of the foreclosure rate in 17 years is an indication that the mortgage marketplace is working *against* the maintenance of homeownership. Something is wrong. The mortgage industry may want regulatory reform, but homeowners need help as well.

Congress asked HUD and the Board to evaluate the issues involved and recommend how the two federallaws governing home mortgage loans should be changed. These two government agencies listened to the multitude of industry representatives, as well as consumer representatives, and issued a complex and comprehensive report. **It would be wasteful and irrational for Congress to ignore the thoughtful recommendations made by HUD and the Federal Reserve Board and consider an industry's proposal for mortgage reform.**

A federal legal structure which would significantly assist people in maintaining homeownership, without diluting the strength of the home finance industry would include the following elements:

- **Disclosure of all costs associated with obtaining a home loan in an easy to understand and uniform manner prior to the payment of non-refundable fees.** This would facilitate true shopping for all of the various loan terms which contribute to the costs of the loan. Reducing the costs on mortgages will reduce foreclosures. *HUD recommends a mechanism to accomplish this -- by allowing consumers to obtain a guaranteed rate, points and closing costs before paying significant fees to apply for the loan.*
- **Disclosure of the APR based on a finance charge calculation which includes *all* of the actual costs of the loan.** *As the Board and HUD noted, the APR is a valuable tool to compare loan products, and should be retained; and the finance charge should include all of the costs associated with obtaining the credit.*
- **A meaningful right to cancel the transaction after three days review of the material loan terms.** The right to cancel the loan under current law is important to ensure that consumers fully understand and accept the terms of a transaction that is secured by the home. *We differ somewhat with the recommendations made in the Joint Report regarding cancellation rights.*
- **Prohibitions against abusive loan terms**. The two federal agencies recognized that there is a serious problem of abusive lending in the U.S. This recognition and the thoughtful recommendations made by HUD should not ignored. *HUD appropriately proposes to expand HOEPA[3] coverage and protections to deal with specific abusive loan terms, special rules for loans initiated by home contractors, and a federal prohibition against unfair and deceptive practices in the making or collecting of home loans.*
- **Protections to facilitate the avoidance of foreclosures**. Loan modifications, loan extensions, reductions in contract interest rates to current rates, are all tools currently employed by the major lenders to avoid foreclosure, which should be made more available to all borrowers as alternatives to foreclosure. *As HUD recommends, pre-foreclosure counseling, and a federal right to cure should be uniformly available to assist homeowners in avoiding foreclosure.*

Along with appendices, this testimony has several parts:

Part I. The Failure of the Marketplace to Protect Consumers. This section describes how the mortgage marketplace has failed to protect consumers in the deregulated environment of mortgage lending. The alarming increase in the rate of home foreclosures in the United States is also addressed, as is a brief description of abusive loan terms.

Part II. **Our Response to the HUD-Board Proposal on Amending RESPA and TILA.** The consumer responses to the recommendations in the Joint Report, along with our own recommendations for revising disclosures required under RESPA and TILA.

Part III. Proposed Substantive Protections to be Included in any Mortgage Reform Legislation. Our recommendations for four types of substantive protections which must accompany the major changes to RESPA and TILA.

Part IV. Explanation of Legal and Illegal Lender-paid Mortgage Broker Fees. This section explains why we oppose any moratoria on class action suits regarding lender paid mortgage broker fees, and how this issue should be resolved in the context of mortgage reform legislation.

I. The Failure of the Marketplace to Protect Consumers

The single most expensive, complicated, and important investment most Americans make in their lifetime is thinly regulated in this nation. There are no federal or state laws that govern the maximum rates or fees that lenders can charge for loans used to purchase or refinance a home. Also, states cannot set limits on the terms lenders can impose on these loans. Other than prohibitions against discrimination in the granting of credit, the Truth in Lending Act and the Real Estate Settlement Procedures Act are the only federal or state laws that apply to these loans.[4] These two laws are thus the only significant way in which Congress has ensured that the needs of homeowners are protected and balanced against the interests of the lending industry. As a result, it is crucial that any changes to these laws -- even recognizing their current imperfect condition -- should be made only after extremely careful consideration.

Many homeowners go through the home purchase, financing and refinancing process without any problem. Many others, however, find themselves confused, feel deceived, or worse: they lose their home as a result of abusive or improper loan terms. This latter group is much larger then it should be. Indeed, according to the mortgage industry's own analysis, 39-40%[5] of all mortgage borrowers were confused by the process. Moreover, the Federal Reserve Board and HUD have recognized that the number of homeowners who are exploited in refinancing transactions is far too high. These abusive loans are an indication of a failure in the marketplace; competition and self regulation do not stop bad loans from being made. The message is, therefore, that the efforts by industry to further deregulate the home mortgage transaction will only hurt consumers. Reform of the mortgage transaction on a federal level should mean improvement for consumers, not simply repeal of current laws.

The marketplace does work to keep interest rates down and loan terms fairly even handed for many middle class borrowers who qualify for "A" credit. (But even this process can work against howeowners in the current market where the terms of the loan may change *after* the application fee has been paid.) It is clearly not working, however, for too many American homeowners who do not qualify for the best credit rating; all too often these homeowners are elderly, or minority. Nationally, 39% of households with incomes below the federal poverty level[6] own their own homes. (See Table 2.) More dramatically, 58% of older Americans who are below the federal poverty guidelines own homes. Too many of these low-income, elderly homeowners have lost equity in their homes, or their homes altogether as a result of abusive lending.

Abusive home equity lending, in particular, is a longstanding problem that exploded in the early 1990's. Vulnerable homeowners who could not access mainstream forms of credit were the focus of these abusive practices.[7] Many were forced to rely on equity loans with high rates of interest in order to finance home repairs, credit consolidation or other crucial credit needs. Refinancing low rate purchase money first mortgages with high rate first mortgage loans has become a serious problem in the low income community leading to the escalating loss of homeownership. The terms of these high rate loans are not necessary to protect the lenders against loss; indeed the terms are generally so onerous that they precipitate default and foreclosure. With these equity based loans, even foreclosure does not pose actual risk of loss to the lender. The Home Ownership Equity Protection Act passed by Congress in 1994 to address these abuses, while helpful, has not significantly reduced the abuses faced by many low-income, minority and elderly homeowners.

Mortgage Crisis for Low-Income Homeowners. A number of factors coalesced in recent years to create an ongoing mortgage crisis for low-income homeowners:

- In 1986, Congress changed the tax code to establish a tax preference for interest on second mortgages over interest on other consumer loans. This sent a pervasive message to homeowners that borrowing against home equity was sensible economic planning. The message was delivered to and received by low-income homeowners even though they benefit less, or not at all,[8] from the deductibility of mortgage interest.
- Mainstream banks nearly abandoned low income neighborhoods across the country, especially minority low-income neighborhoods. This created a vacuum for finance companies charging high rates of interest to fill. Indeed, some mainstream banks helped fill the vacuum by setting up high rate finance companies or, alternatively, by funneling cash to unscrupulous lenders.[9]
- Given appreciating real estate values throughout much of the country, finance companies are able to make loans at high rates with very little risk. Many finance companies target homeowners who have substantial equity in their homes in order to protect their investments if the borrowers do not pay. Elders are a common target for this equity based lending, because many have built significant equity in their properties over time. Based on equity, a lender is in an advantageous situation: either the borrower pays the loan back with high interest or foreclosure on the home permits a recovery from the property directly. In fact, when foreclosure occurs and the borrower's property is sold to the lender for less than fair market value (as it generally is), the lender can resell the property after foreclosure and realize the homeowner's equity. These anticipated windfalls encourage some lenders to make loans designed to result in foreclosure.
- Deregulation has allowed a wide range of marginal players into the lending and loan brokering business. Many of the historic protections against unfair lending practices, such as state ceilings on interest rates and licensing requirements, were removed or eviscerated during the 1980's. Even where licensing requirements remain, inadequate funding has led to inadequate policing of abusive lenders. A significant secondary market then developed during the 1980's creating liquidity for finance companies marketing loans with high interest rates.[10]

Rising Foreclosure Rate. It is significant that foreclosures have increased by almost four times since 1980, and that in 1997 there were over **half a million families that lost their home to foreclosure in the United States.** (See Appendix 1.) There are a number of reasons for this. We believe that one of the most significant reasons is the huge number of new loans that are being made by lenders who pay little attention to a borrowers ability to repay, and instead focus on bleeding the homeowner of the equity in the home.

Data shows that most foreclosures are caused not by homeowner mismanagement, but rather by unexpected life events which are beyond the homeowner's control such as loss of job, illness, death or divorce. Census data establishes that more than 1/3 of households in the lowest 40% of income range will experience a loss of income of at least 33% for one month in a given year. Income disruptions obviously increase the likelihood of mortgage defaults especially since the same lower income households also have low savings rates and high debt to income ratios. As family debt increases as a percentage of income,[11] families are increasingly vulnerable to the exigencies of unforeseen income decreases or increases in expenses. Problems which would be manageable for a family whose housing costs constitute 20% of the monthly budget are unmanageable when those costs are 40% of the total household expenses.

Additionally, there has been a major expansion of home equity lending[12], thus creating an additional pressure on the homeowner's budget. The median amount outstanding on mortgage debt for a typical family rose 30% between 1989 and 1995.[13]

For these reasons, the federal government cannot rely on the marketplace -- or self-regulation by the mortgage finance industry -- to police lending secured by the home. While Americans enjoy a strong home lending industry, the appropriate degree of regulation should not hamper legitimate lenders, while it will serve to protect the most vulnerable homeowners from losing their homes.

Predatory Mortgage Lending Abuses. The home mortgage abuses that too many American homeowners, at every income level, are subjected to in has been extensively chronicled in other Congressional hearings[14], and will be only briefly described here:

- **Home improvement scams,** which are home loans stemming from unsolicited sellers of home improvements in which the work is generally overpriced, and rarely performed adequately;
- **Mortgage broker kickbacks** which result in higher priced loans than the borrowers qualify for with their lenders;

·**Steering to high rate lenders**;

· **Lending to people who cannot afford to repay;**

- **Falsified loan applications** such that the loan originator pads the borrower's income to make the loan qualify, yet which leads to unaffordable payments for the borrower;
- **Incapacitated homeowners;**
- **High interest rates** which are far more than are justified by the alleged additional risks and costs of providing credit to homeowners with lower credit scores;
- **Balloon payments terms** for which the borrower has no way to meet without refinancing the loan at excessive costs or losing the home;
- **Negative or non-amortizing loans,** such that even after making loan payments for years the borrowers end up owing *more than* was originally borrowed;
- **Padded closing costs,** which can often be fees for settlement services two or three times as high as are charged middle income homeowners;
- **Credit insurance packing** with high priced pre-paid term credit insurance which add thousand of dollars in

unnecessary costs to loans for borrowers who could obtain more reasonably priced credit insurance if paid on monthly basis;

- **High and unfair prepayment penalties;**
- **Mandatory arbitration clauses,** which frequently require only the borrower to submit to it and not the lender and which can force a homeowner to pay large sums for their concerns to be addressed by arbitrators who have no incentive to follow consumer protection laws, and whose decisions are not reviewable by any court;
- **Repeated refinancings** which have the effect of bleeding the homeowner's equity from the home by *increasing* the amount borrowed exponentially in each refinancing without providing any benefit to the borrower;

- **Spurious open end loans** whereby the lender is allowed to avoid making the more comprehensive disclosures required by closed end credit, and thereby avoid any chance of the homeowner asserting the right of rescission, as well as completely avoiding the restrictions under the Home Ownership and Equity Protection Act, regardless of the cost of the loan;
- **Paying off low interest mortgages** such as purchase money loans with FHA with much higher interest rate loans;
- **Refinancing unsecured debt** for which the borrower could not lose the home, with high interest rate debt which must be paid to avoid foreclosure;
- **125% loan to value loans** which effectively prohibit borrowers from selling their homes or filing bankruptcy to escape unaffordable debt, without losing their home.

II. Our Response to the HUD-Board Proposal on Amending RESPA and TILA.

Enacted in 1974, the purpose of RESPA is to provide consumers with timely information about the real estate settlement process as well as to protect consumers from high settlement charges.[15] TILA was created in 1968 to bring honesty and accuracy to the consumer credit marketplace and to standardize the cost of credit so that borrowers could comparison shop. To that end, TILA's "price tag" disclosures of the APR and the finance charge were defined to include, in the first instance, all the costs attendant to the credit that the borrower would have to pay. As discussed below, TILA's exceptions to this definition are taking the *truth* out of the lending. Neither the interests of consumers nor the industry have been served by that development.

Content of TILA Disclosures. The two federal agencies recommend that the APR be retained, and the finance charge be expanded to include all of the costs the consumer is required to pay to get the credit. The report also recommended that the interest rate on the note be added as a new disclosure. *We endorse the Joint Report's recommendations on this point.* The Board and HUD described why these changes are appropriate:

Disclosing the two figures together, along with a revised explanation of the APR, should improve consumer understanding of the significance of the APR and make it more useful. . . Under this approach, creditors would have a clearer rule and reduce their liability concerns. The changes should also make the disclosures more useful for consumers by providing a more accurate and reliable measurement of the cost of credit.[16]

Our Recommendations On Content of TILA/RESPA Disclosures. Attached as Appendices 2 , 3 and 4 are our proposals on how the TILA and RESPA disclosures should be made on mortgage loans. We endorse most of the recommendations made in the Joint Report, although we continue to use the "amount financed," and would include specifics on all the fees (unless the consumer is provided a guaranteed rate, point and closing cost package). Appendix 2 illustrates what this disclosure would look like. Appendix 3 sets out a detailed explanation for the need to regulate *open end* credit similarly to closed end credit - a question which is not addressed by HUD and the Board in the Joint Report. Appendix 4 is an illustration of our recommendations for a disclosure form for open end mortgage loans.

Timing of Disclosures. Mortgage reform should include a means by which more meaningful information will be provided to consumers *before* money is paid to apply for loans. Under the current scheme of mortgage financing, very few consumers know with certainty the interest rate or the total points and closing costs they will be charged for a mortgage loan before they have to pay the fees for application, credit report, appraisal etc. Instead, consumers must generally pay a fairly sizeable sum to apply for a mortgage loan, the full cost of which they will not know until some later time. The effect of the current industry practice is that even sophisticated consumers find it next to impossible to ensure that they are receiving the best loan that fits their needs. Moreover, unscrupulous brokers and lenders have a virtually free hand to increase the junk fees, points and/or interest rates on the loans.[17] Low income consumers, who are less sophisticated, and perceive they have fewer market alternatives than their wealthier neighbors, are too often the victims of exorbitant up-front costs and interest rates as the result of this system. Essentially, mortgage borrowing today is like what some folks call "buying a pig in a poke." You pay before you know what you're getting.

We -- representatives of and advocates for consumers -- have proposed a system under which the borrower could pay for a “merged credit report”[18] to be supplied to several lenders for a set fee to be paid to the credit reporting agency. The consumer could then apply, at no charge, to the several lenders receiving the credit report, answer any additional questions the lenders requested, and then receive from the lenders a guarantee of a loan at a specific rate, with a fixed amount of points charged, and a guarantee of the full amount of closing costs to be charged.[19] This guarantee would be subject to two contingencies: 1) that the information supplied by the consumer regarding income and assets could be verified; and 2) that the value of the collateral -- the consumers’ residence -- was sufficient to secure the loan. Under this method, consumers would actually know the full price for a mortgage loan before they paid for it.

In the Joint Report, HUD has indicated its commitment to actually improving the system of shopping for mortgages, rather than continue the confusion. The primary mechanism for accomplishing a more open system would be to require mortgage lenders (and brokers) to provide a guaranteed interest rate and closing costs before collecting any application fees from consumers. As the charges for mortgage loans are often based on the borrower’s creditworthiness and the value of the collateral, some underwriting would have to be performed by the creditors before the guaranteed rate could be provided. To its credit, HUD agreed with consumer advocates and proposed that “consumers be provided guaranteed information about closing costs, interest rate and points early enough so that they can shop and make informed choices.”[20] The Board, on the other hand, seems to like the pig in the poke method of shopping for mortgage loans, and proposed that the current ineffective system be continued: “initial cost disclosures (including more reliable closing costs and an APR that may be firm or estimated and interest rate) [should] be provided no later than three days after application.”[21] *We agree with HUD’s recommendation to have loan information provided to consumers before significant fees have been paid.*

On the other hand, the large mortgage lenders have been pushing hard for a change in the law which would mandate a guaranteed closing costs “package, ” without a guarantee for rates and points. In this way, the lenders could market their loans based on the closing cost package. Consumer advocates have opposed the closing cost package by itself because it would be like marketing tires to car buyers before they purchase the car: a borrower would likely apply for a loan based on the guaranteed closing cost package, without receiving any guarantee of the interest rate or points. Encouraging borrowers to apply for loans based only the closing cost package would end up costing borrowers in at least two ways: 1) if the actual closing costs incurred by the lender for the loan exceeds the anticipated amount, there would be nothing to prevent the lender from increasing the interest rate or the points charged on the loan to make up for the difference; 2) in fact, there is nothing to prevent the lender from increasing the price of the loan to borrowers who have already paid so much money to apply for the loan, that they cannot afford to go elsewhere for their home loan. Unfortunately, the Board has agreed with the large lenders and has recommended that the law be changed to encourage lenders to offer these guaranteed closing cost packages[22] *We endorse the approach recommended by HUD.*

RESPA’ s Good Faith Estimate. Both the Board and HUD have proposed that lenders be allowed to continue making disclosures in the old way as well -- using the Good Faith Estimate (GFE) of the closing costs, rather than a guaranteed package. However, they recommend that the current system of providing a GFE after application be considerably bolstered by only allowing lenders to charge closing costs which exceed the GFE by a certain tolerance, and that remedies for violating the GFE be enhanced.[23] *We endorse the recommendations made in the Joint Report on improving the reliability of the GFE and establishing remedies to enforce the reliability.*

Right to Cancel or Right to Rescind. Under current law, consumers receive final, accurate disclosures only at closing. On loans not used to purchase the dwelling, the consumer has three days in which to cancel the transaction.[24] The right to cancel the transaction for non-purchase money transactions is based on the extensive analysis of the need for the right by the 96th Congress, which created it:

This provision was enacted to give the consumer the opportunity to reconsider any transaction which would have the serious consequence of encumbering the title to his home.[25]

The consequences of encumbering the home are no less serious today than they were in 1980. Indeed the explosion of foreclosures in the intervening period -- from 150,000 in 1980 to 577,000 in 1997[26] -- was likely accelerated by the escalation in home equity credit. The three day period of review of the loan documents afforded by the current right of rescission is an essential right that must be retained.

To facilitate the three day review, and limit the cancellation of the transaction after consummation, the Board and HUD have recommended that three days *prior* to closing, creditors should be required to redisclose significant changes in the APR and other material disclosures and to provide an accurate copy of the RESPA settlement statement.[27] For rescindable loans, consumers would be provided a right to a refund of fees paid, instead of the right to cancel the loan three days after closing.[28] "To ensure the consumer's protection, this pre-closing period could not be waived."[29] If those disclosures provided three days before closing turn out to be inaccurate, the lender would be required to redisclose the material information at closing, but provide a three day rescission period before dispensing the funds to the consumer. To pacify consumers who might be chagrined to find the delivery of their funds delayed for three days, (as is the current system) the Board and HUD would allow anyone to waive this right of rescission.[30] However, if the disclosures provided at closing are incorrect, consumers would not forfeit their three year extended right, even if they had waived their three day right.[31]

Several issues arise from by this proposal. The first is whether a three day right to review the loan documents *prior* to the loan closing is as good as, or better than, reviewing the documents *after* the closing. One difference between the two is when the three day review occurs after the closing, the consumer will have had the closing agent provide some verbal review of the transaction prior to the three day review period. Another is that if the consumer only receives the federally required disclosures, and not all of the papers that represent the various terms of the transaction, three days prior to closing he may not have the time to consider all of the relevant documents that will govern the transaction. On the other hand, having the documents prior to closing may encourage some borrowers to obtain professional counseling. The issue of whether to endorse the proposal to provide the disclosures prior to closing issue is not one which the consumer advocates have determined yet.

However, *we have identified one serious problem with the Board and HUD proposal on the three day review*: all of the incentives are in favor of lenders providing incorrect disclosures three days before closing, and then providing the correct disclosures at closing and encouraging the consumer to waive the right to cancel so as to receive the loan funds right away. The agencies' proposal only provides for the extended right of rescission when the disclosures provided at closing are incorrect. Yet, even if the disclosures are correct, the consumer would not have three days to review them, either before or after the closing.

The Joint Report Correctly Recognizes Serious Problems with Abusive Lending. In their Joint Report, HUD and the Board have recognized that there is a significant problem, and have recommended a number of the proposals presented by the advocates, as well as devising a few of their own.

Abusive practices continue to exist in some segments of the home-equity lending market, demonstrating the need for additional protections. ... (I)mproved disclosures may not aid comparison shopping significantly in underserved markets where there is less competition. In addition, it is unlikely that improved disclosures alone can adequately protect vulnerable consumers from unscrupulous creditors that engage in deceptive and abusive practices.[32]

Fulfilling its essential role to promote homeownership, HUD proposed an outline for reform which includes a number of aggressive measures to counter abusive lending activity. The proposals that the Board would join HUD in can only be termed "mild." *We endorse HUD's more ambitious multi-faceted approach* listed on page 75 of the Joint Report.

Part III. Proposed Substantive Protections to be Included in any Mortgage Reform Legislation.

The government, and the housing and lending industries have done an excellent job in recent years in expanding programs to establish new homeownership opportunities for low-income families. The next challenge is to enhance the long term sustainability of the homeownership experience for these families. The ultimate success of homeownership as an asset building strategy will be measured by the degree to which new homeowners are able to afford proper maintenance, avoid foreclosures, build equity in their homes, and use their equity effectively as wealth.

Suggested Remedies. As illustrated in Part I above, the market does not work to provide protections for consumers from abusive mortgage loans, because too often it is financially remunerative for lenders to encourage foreclosure. Foreclosing on a home will force a sale which almost always yields less than the home's true value, allowing the creditor to purchase the home at a discounted rate and realize yet another profit when the home is sold at full value at a later date. Not only is there always significant collateral protection on home loans, there is the very real emotional attachment that homeowners have in their homes, making the home loan the first to be repaid, and the last to be defaulted upon. There is thus generally very little risk in any loan which is secured by a home.

Should not lenders who persist in making loans which are clearly not affordable to the homeowner, and are thus designed to lead to default, refinancing, and eventually foreclosure, be held responsible for their improvident extension of credit? For example, consider the real case of a lender who makes a low-income disabled homeowner a first mortgage loan of $102,000, charging over $7600 in settlement charges. Although the homeowner's only income is $500 a month from SSI, the payments required under the loan are $914 a month for thirty years. Shouldn't a lender in this situation be held responsible for this bad judgment, and not be permitted to profit from the deliberate attempt to take the homeowner's home by way of foreclosure?[33]

If the TILA rules are changed to improve disclosures and make it easier for lenders to comply with the law's requirements, homeowners like the one in this example will have even fewer protections from abusive lenders. TILA rescission will no longer be a viable remedy because the disclosure rules will be so simple to comply with, even the most abusive lenders will find it easy to meet the requirements. Congress should establish tools designed to prevent abuses.

We propose, that along with the disclosure amendments to TILA and RESPA, four substantive provisions along the following lines be added to the new law:

1. Loan terms should be regulated based on the cost of credit.

2. More protections should be established for consumers in home improvement loans.

3. Federal law should prohibit unfair and deceptive or unconscionable acts and practices in the making of a home loan.

4. Federal protections should be established in foreclosure proceedings.

1. Loan Terms Should be Regulated Based on Cost of Credit.

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.[34] 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.[35]

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 two and a half 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 two 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 trigger for HOEPA is 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 which are just under the HOEPA triggers.

But, otherwise, HOEPA has some good ideas. It is based on 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.

The HOEPA structure is essentially good: apply prohibitions and restrictions to higher cost loans, and leave lower, more reasonably priced loans free from regulation. We propose to leave this basic structure in place while filling in the gaps.

First, rather than have only one set of triggers which determine whether a loan is either regulated or not, home loans should be regulated on a more graduated basis. Very high cost loans should have prohibitions similar to (or more stringent than) those applied to current HOEPA loans. Loans which are high cost, but not as expensive as those covered by HOEPA should also be regulated, but to a lesser extent. Lower cost loans – such as those which are commonly offered to prime borrowers as well as to subprime borrowers by non-abusive lenders -- would not be regulated whatsoever.

The federal law would thus recognize three categories of home lending: Category 1 loans would have unregulated terms because the price of these loans was less than the trigger for Category 2 loans. Category 2 loans would be those overpriced loans which are priced at rates higher than provided by non-abusive lenders; these loans would be regulated to a limited extent. Category 3 loans would be those loans which fall into a very high price range and which, like current HOEPA loans, would be closely regulated. The effect of this two-tiered approach to determine the level of regulation would be to ensure that even those expensive loans which fell just under the trigger for HOEPA loans would still have some degree of regulation.

The exact numerical triggers which would determine whether a loan fell into the high cost or into the lower priced but still expensive category should be carefully determined. The interest rate triggers would be floating -- a certain amount over the Treasury bill for an equivalent term as the loan -- just as HOEPA is now. There should also be triggers based on the percentage of the loan charged in up-front costs, based on points, and all closing costs.

Additionally, a key, and essential new regulation which would apply to both categories 2 and 3 loans would be a limitation on the financing of points and closing costs. Lenders providing category 3 loans -- the most expensive – would be prohibited from financing any points or closing costs. Lenders providing the less expensive, but still overpriced loans -- category 2 -- would be limited in the amount of points and closing costs that could be financed.

Finally, the points and fees trigger should include all points, fees, and insurance charges. Under current HOEPA law, there are confusing rules to determine which fees and insurance charges are included in the trigger for up-front costs.[36]

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 would not be 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. The closing costs trigger should include all points and all fees for closing costs.

Credit Insurance. Credit insurance is a big ticket item in each individual loan.[37] Nationally, consumers spend as much as $2.5 billion per year on credit insurance, often with little understanding of what they have bought.[38] This volume of business conceals overcharges of $900 million[39] to $1.2 billion,[40] where 40 to 50% of the premiums are paid to lenders as commissions. The marketplace has created reverse competition because credit insurance premiums are paid up front for term insurance policies which cover the whole or a significant portion of the loan term and lenders receive a commission based on the size of the credit insurance premium. Thus, lenders are rewarded for selling the most expensive forms of credit insurance, rather than the least costly to the consumer. Hence, unsophisticated consumers spend thousands of extra dollars for credit insurance which provides negligible value to them.

The remedy for the reverse competition established by the marketplace: only allow credit insurance to be sold when the premiums can be paid monthly, along with the loan payments, and the credit insurance can be canceled at any time.[41] *The Board and HUD have endorsed this proposal.[42]*

2. More Protections Should Be Established for Consumers in Home Improvement Loans.

Recognizing the high number of abuses which flow from home improvement loans, federal law should establish new protections applicable to all *home improvement loans* secured by the home. This home improvement law would ensure that a) homeowners have an effective method of enforcing their warranty rights, and b) lenders are held responsible for the actions of home improvement contractors. The new law would not limit consumers' rights under existing federal and state laws and regulations governing these contracts. [43]

One of the primary problems which arise from home improvement loans is the application of the 'holder in due course" rule. This rule generally applies to purchasers of negotiable instruments, such as mortgage loans.[44] The holder in due course doctrine protects assignees of a negotiable instruments from liability for the wrongdoing performed by the original lender though the borrower might be harmed.

Thus, generally regardless of a home improvement contractor's wrongdoing, the consumer's obligation to pay the lender/assignee continues as long as the assignee purchased the loan without notice of the fraud or other misconduct. In the mortgage context, the homeowner is left to pay the mortgage despite having perfectly valid claims and defenses arising out of the home improvement transaction. Problems often arise because some home improvement contractors are insolvent, or they disappear (and reincorporate under a new name or file bankruptcy) at the first hint of litigation.

In 1976, the Federal Trade Commission passed a rule limiting the holder in due course doctrine for the purchase of consumer goods or services.[45] The purpose of the FTC Holder Rule is to give consumers the right to assert claims and defenses against creditors in situations where a seller provides or arranges financing and then fails to perform its obligations. The FTC Holder Rule rightly shifts the risk of seller misconduct to creditors who could absorb the costs of misconduct.[46] While the FTC Rule created some protection for consumers in this context, it is limited in several ways. First, the consumer rights provided by the FTC Rule depend upon seller compliance in placing a required notice in the loan document. Second, recovery by the consumer for seller wrongdoing is limited to the amount paid under the consumer credit contract. Third, there is no private right of action to enforce the FTC Rule.

If the holder in due course doctrine were eliminated for assignees and purchasers of home equity loans (and these mortgage lenders were potentially liable for all of the claims and defenses which the borrower had against the originator), the industry would be forced to do engage in self-policing. If mortgage lenders were to be clearly liable for the claims borrowers have against the originating home improvement contractors, the mortgage lenders would more carefully screen those with whom they do business. That, in turn, should help dry up the financial lifeline that has enabled the predatory home improvement contractors to operate.

3. Federal Law Should Prohibit Unfair and Deceptive or Unconscionable Acts and Practices in the Making of a Home Loan.

Congress should flatly and unequivocally state that unfair, deceptive and unconscionable practices in the making of a home loan should be illegal. Although many states have laws prohibiting unfair acts and practices, too often these laws do not apply to loans secured by real estate, loans made by some types of lenders, or loans over a certain size.[47]

Creating a laundry list of specific activities which are illegal or restricted would simply invite resolute lenders to transform their practices in ways to avoid falling into the definitions of specific prohibited acts. Instead there should be a broad prohibition.

The following are just a few examples of unfair and deceptive practices for which we have documentation:

Some high rate lenders require homeowners to sign two loans, one which refinances first mortgage debt, and the other, a smaller second mortgage, to finance the lender costs from the first loan. The APR on the first lien loan may be under the HOEPA APR trigger. But the APR on the second lien loan is a whopping 24%.

Some lenders solicit borrowers with the promise that the borrowers can consolidate all of their debt into one payment which will cost less and save money over the term of the new mortgage. At settlement, when the borrower realizes that this claim is false, the lender or settlement agent for the lender promises that the loan will be refinanced on better terms in 6 months to a year. Further, borrowers are told, this is standard practice. Borrowers are induced to enter into the loan by these verbal statements. Many borrowers are not in a position at that point to refuse the bad deal because they have paid appraisal, application or other fees or are in danger of losing their homes. Of course, the bad loan is never refinanced or, if it is, the same lender re-charges points and fees, thus gouging the borrower yet again.

Some lenders will get homeowners to sign loan applications which inflate their incomes or add other information to the application unbeknownst to the homeowners in order to satisfy underwriting requirements. Frequently, the homeowners do not see these applications in their final form until settlement when they are asked to sign numerous documents in a rush. Or homeowners are asked to sign loan applications that are not completely filled in. The lender later adds additional information. This causes borrowers problems for two reasons: first, credit is extended when the borrower does not have the true ability to repay which leads to foreclosure; and second, the holder throws the “fraud” on the application back at the borrower later to defeat any complains that the borrower has against the loan.

4. Federal Protections Should Be Established in Foreclosure Proceedings.

Given the alarming increase in foreclosures over the past two decades, federal law must provide some additional protections to borrowers losing their homes to foreclosure.

- Increased support for housing counselors and mandatory notice regarding their availability. Good housing counselors can facilitate loan workouts that preserve home ownership, prevent foreclosure, and reduce costs for lenders. Fannie Mae, Freddie Mac, and the FHA have implemented loss mitigation tools to avoid foreclosure and housing counselors are an essential part of that process. All mortgage lenders should be required to provide some support for housing counselors and notice of the availability of housing counselors should be required before any foreclosure can proceed.
- Lenders should provide homeowners with the opportunity to pay off the arrearage and avoid foreclosure. Although this seems obvious and in the best interest of both parties, this is not always done. Lenders should be required to give notice to defaulting homeowners of the amount past due and the amount needed to avoid foreclosure prior to the addition of fees. The notice should list the various workout options available. These options have been accepted by Fannie Mae, Freddie Mac, and the FHA as appropriate loss management tools in the industry. Lenders should also be required to attempt to avoid foreclosure through various loan workout mechanisms. Further, a lender should not be permitted to unreasonably reject a workout proposal.

Part IV Legal and Illegal Lender-paid Mortgage Broker Fees.

Congress Must Protect Consumers from Improper Yield Spread Premiums. The mortgage industry seeks a moratorium on the class action suits currently proceeding under RESPA which challenge the payment of a yield spread premium to a mortgage broker by a lender. We strongly oppose any Congressional action on this issue, as it is would cause significant harm to consumers. Further, it would do little to provide assistance to the mortgage industry unless Congress also passes a statute providing retroactive immunity to the industry for illegal kickbacks. There is simply no justification for retroactive relief to the industry. Consumers have been truly hurt by the payment of yield spread premiums; paying thousands of dollars more for their loans than their lenders required.

Mortgage brokers pushing for a moratorium have analogized their request to the *Rodash* fix Congress provided to mortgage lenders in 1995. However, the mortgage broker fee *brouhaha* is only analogous to the *Rodash* fuss in one way: the mortgage industry is facing judicially imposed liability for blatantly violating one of the two federal consumer protection statutes governing mortgage loans. Unlike *Rodash*, we are *not* talking about windfalls in the tens of thousands of dollars for the failure of the lender to place the disclosure of a specific fee -- which the borrower had to pay anyway -- in the proper column. This issue is whether a yield spread premium, which significantly increases the cost of the loan to the borrower without providing any benefit to the borrower, should be legal.

A yield spread premium is a lender's fee paid to the broker for increasing the loan rate. Yield spread premiums benefit brokers. They generally provide no benefit whatsoever to borrowers, and rarely even to lenders. Yield spread premiums only increase the cost of the loan -- inflating the cost of the home -- to the borrower without providing any benefit to the borrower. The entire practice of paying yield spread premiums thrives because of reverse competition in the market: the lender with the costliest loans to the borrowers -- those paying the highest yield spread premiums -- do the best.

Brokers have been saying that yield spread premiums are justified, and indeed are good for consumers. Yield spread premiums, the industry maintains, are justified because they are typically paid to compensate brokers for covering closing costs borrowers do not otherwise need to pay. Representatives of consumers do not dispute that a consumer might decide that a higher interest rate on the loan is a good idea, if the consumer could cover closing costs in this way. However, these loans are not the subject of the litigation. This argument is a red herring: it is the industry's way of justifying yield spread premiums as providing benefits to the borrowers. Nevertheless, we agree with the idea that in limited circumstances yield spread premiums are legal under the statute, when they actually provide a benefit to the borrower equivalent in value to the cost incurred.

The cases are about situations where a consumer has paid the broker directly thousands of dollars, only to later find out that the lender also paid the broker, and the interest rate on the loan was increased as a result. Consider the *Mentecki*[48] case in which one of the named plaintiffs paid an origination fee of **$12,925** to the broker. Then, unbeknownst to the borrower, the lender also paid the broker a yield spread premium of $2,204.30. Or the *Barbosa*[49] case, in which the broker received total compensation worth 5.1% of the loan whereas brokers receive an average of 1.5% industry-wide. The yield spread premium on this $70,000 loan caused the interest rate to rise from 8.75% to 9.5%, bloating the homeowner's costs by over $18,000 over the life of the loan.

To date there have been a number of federal district court opinions and one appellate court decisions on the issue of whether a lender paid mortgage broker fee is illegal under RESPA.[50] The Eleventh Circuit court of appeals found, in *Culpepper v. Inland Mortgage*,[51] that the yield spread premium was likely to be an illegal referral fee. The court found that there were no services rendered by the broker to justify the fee for two reasons. First, the borrowers had directly paid the broker for its services in the form of an origination fee, second it was undisputed that the broker expended the same amount of effort and provided the same services regardless of whether it was able to get the lender to pay it a yield spread premium. The sole determinant of whether a premium by the lender to the broker would be paid was the interest rate on the loan.

Consumers are being harmed by the payment of yield spread premiums. The courts around the nation are busy determining whether the payment of these fees violates RESPA. It would be very damaging to consumers if Congress were to intercede in the judicial process and provide blanket immunity for lenders on this complicated issue. A moratorium on class action lawsuits only assists the industry if it is followed by retroactive protections for industry. Consumers need the protection, not lenders and brokers.

In terms of protecting homeowners, the success of the mortgage reform process hinges on Congress' insistence that consumers' needs be met. The only way this can be assured is if Congress makes this industry play by the rules. Protecting the industry from consumer friendly judicial and administrative rulings would send the wrong message.

Conclusion

This testimony does not address many of the technical questions involved in changing TILA and RESPA to coordinate the two statutes: which statutes would have to be amended, in exactly what way, for example. But it does provide an outline of how both statutes can be improved and coordinated to the benefit of both consumers and lenders. Disclosures would be simplified, uniform, and far more understandable if the finance charge includes all costs of the extension of credit, and these charges are disclosed in the same format after application and at closing. Lenders will benefit because of the simplicity in complying once the new forms are developed. Consumers willbenefit because protections will be provided on federal, uniform level against abusive loans, and foreclosures will be reduced.

Appendix 1

Foreclosure Table

Appendix 2

PROPOSED COMBINED TILA/RESPA DISCLOSURE FOR CLOSED-END LOANS

AMOUNT FINANCED	**FINANCE CHARGE**	**TOTAL # OF PAYMENTS**	**ANNUAL PERCENTAGE RATE**
Repayment terms:	1 @ $ due _____ 359 @ $ due xxx of each month		

1. The **AMOUNT FINANCED** consists of

$__________ the financed purchase price of your home/ first mortgage payoff

This includes:

$_____for the purchase of your home/or payoff of 1st mortgage.

$_____to pay off another loan secured by your home.

$_____to pay off other credit.

$___cash to you.

(NOTE: The “amount financed” may be a lesser amount than the “principal” on your mortgage note if you are financing some of your settlement costs which are also called “prepaid finance charges.”)

2. The **FINANCE CHARGE** consists of two separate kinds of charges

A._____ Interest to be paid over the life of the loan

B._____ “Prepaid finance charges,” which include settlement “closing” costs. This amount is the total of the following:

$____ (i) Prepaid interest;

$____ (ii) Per diem interest;

$____(iii) Loan discount fee;

$____ (iv) Loan application fee;

$____(v) Points, or other charges paid by you directly to the creditor at the time the credit is extended;

$____ (vi) Finder's fee, or broker's fee paid by you;

$____ (vii) Fee for an investigation or credit report;

$____(viii) Fees or premiums for title examination, title insurance, or similar purposes;

$____(ix) Fees for preparation of a deed, settlement statement, or other documents;

$____ (x) Fees for notarizing deeds and other documents;

$____(xi) Appraisal and survey fees;

$____ (xii) Fees for a closing agent; and

$____ (xiii) Any other expenses related to closing.

C. **Credit Insurance Premiums** totaling $____, which includes the following:

__________credit life

__________accident

__________health

__________other insurance written in connection with the transaction

__________GAP and debt cancellation agreements.

3. The **ANNUAL PERCENTAGE RATE (APR)** is ___________. It is the real cost of your credit, expressed as an annual percentage rate, and takes into account both the interest to be paid over the life of the loan, and the prepaid finance charges.

(NOTE: The “interest rate” of ________% on your mortgage note is lower than the APR, because the note rate only takes into account the interest to be paid over the life of the loan; it ignores the impact of the prepaid finance charges on the total cost of this loan.)

4. Amount of the fee paid by the lender to your loan broker/correspondent: $______.

5. In addition, you will need $______in cash at closing to cover the following items:

A. Any items listed above that you do not wish financed (the sum of these items is not included in the calculation of the number in this paragraph);

B. $_ for escrow of real estate taxes.

C. $_ for escrow for premiums for insurance, against loss of or damage to property or against liability arising out of the ownership or use of property.

6. Amount you will pay up-front that is not refundable if the loan does not close: $___.

7. Points or other fees to be paid by the seller at settlement: $____.

8. **Security**: You are giving a security interest in your home located at ________________________.

9. **Late Charge:** If a payment is late, you will be charged $____ or _____% of the payment.

10. **Prepayment:** If you pay off early, you will/will not have to pay a penalty.

11. **Assumption**: Someone buying your home may/may not be allowed to assume the remainder of your mortgage on the original terms.

Appendix 3

Changing Disclosure Rules for Open End Home Loans

Lenders primarily object to including all closing costs in the finance charge because they say that this makes closed end credit appear to be more expensive than open end credit. This is because currently TILA does not require any closing costs to be included in the calculation of the annual percentage rate for open end extensions of credit. Thus, if only closed end disclosure rules were changed, the fees included in the calculation for the annual percentage rate would be higher for closed end loans than the fees included for open end loans. The fair and appropriate way to resolve this for lenders and consumers alike, is to require all fees to be included in both open and closed end credit transactions secured by the home.

When the current TILA rules for open end credit secured by the home were being designed, both the fluid nature of the product and the state of technology as it then existed had to be taken into account. For example, authorizing the use of historical tables and hypothetical $10,000 loan examples reflected an attempt to balance the need to explain how an open end line credit might work to the consumer with the industry's desire to save the costs thatpersonalized predictions would incur. Because the information in this hypothetical is so unrelated to the actual loan contemplated, however, most borrowers find very little that is useful in the information provided.

Technology has now developed to the point that an individualized disclosure is possible and reasonable. In weighing the costs and benefits of more personalized, more predictive disclosures in light of more sophisticated technology, the actual comprehensibility of the disclosures must be considered. If consumers are to be legally held to their contracts, then it is vital that we do as much as possible to make sure that there is some reality to the legal premise that contracts are binding because the parties knowingly agree to the terms.

The essence of the problem for determining rules for open end credit is how to calculate the time and price for the outstanding extensions of credit. This is a problem for open end lines of credit where it is not for closed end credit because of the revolving nature of these loans. Once some money is borrowed, and some paid back, some more money can be borrowed again. It is indeed impossible for the lender to predict the amount of money which will actually be extended to the borrower, the time period and amount of repayment by the borrower, and - in most cases because open end loans are generally also variable rate loans - the applicable interest rates throughout the term of the loan.

Lenders, however, make a series of assumptions when they make disclosures on closed end loans, and on variable rate loans in particular: they assume an interest rate, and they assume that the loan will be paid back at the times and in the amounts contemplated in the loan contract. There is no reason that the Federal Reserve Board could not choose a series of reasonable assumptions to be applicable to open end credit disclosures which would then be used as the basis for the disclosures provided at the inception of the open end loan. For example, lenders could assume the following:

a) The maximum amount of the line of credit would be borrowed immediately (a fairly typical occurrence) rounded up to the nearest $5,000. For example, when a borrower is contemplating a line of credit of $37,500, information provided for a $40,000 loan is far more relevant than it is for a $10,000 loan.

b) Only the minimum required payments would be made by the borrower (also, a fairly standard scenario).

c) The interest rate over the term of the loan would be what it would have been had the loan been taken out the same number of years ago as the term is long. (In other words, if the loan term is for fifteen years, for the purposes of the initial disclosure, the interest rates for the next 15 years would be assumed to be what they had been the past 15 years.

Appendix 4

Outline of Protections to Deal with Home Improvement Problems in Mortgage Lending

Brief Overview. Would establish a new federal law which would apply to all home improvement loans secured by the home. The purpose of the new law is to ensure that a) homeowners have an effective method of enforcing their warranty rights, and b) hold lenders responsible for the actions of home improvement contractors. The new law would not limit consumers' rights under existing federal and state laws and regulations governing these contracts.

1) Coverage. Applies to all "home improvement loans." Home improvement loans are defined as those loans secured by the home which are:

a) made by a home improvement contractor; or

b) arranged for by a home improvement contractor; or

c) arranged for by a broker, to whom the homeowner was referred by the home improvement contractor; or

d) assigned from a home improvement contractor; or

e) is a refinancing of a home improvement loan when the new loan was solicited from the homeowner during a period of 5 years after the home improvements were completed.

2) Notice. Requires all home improvement loans to contain a notice outlining to homeowners as well as assignees the rights and obligations under these loans.

3) Right to Stop Payments. Allows a borrower to stop making payments on the covered loan to assert warranty claims, regardless of whether the home improvement loan notice or the FTC Holder notice was included in the loan.

4) Completion Certificate and Inspection by Lender. Establishes a complete defense to payment on a home improvement loan if payment was made by the lender to the contractor without an independent inspection finding that the home improvements were satisfactorily completed.

5) Applicability to assignees and subsequent holders. a) Applies to all assignees of the loan regardless of whether the maker included the FTC Holder notice and makes it a deceptive practice for the notices to be omitted. b) Also applies to all covered refinancers of the note to the extent of that portion of the new note which represents the debt (as well as interest and costs on the debt) made for the home improvements.

6) Judicial foreclosure. Prohibits foreclosure on a home improvement contract other than by judicial foreclosure.

Appendix 5

PROPOSED COMBINED TILA/RESPA DISCLOSURE FOR OPEN-END, VARIABLE RATE LOANS

Assuming that you borrow the maximum you are permitted under the LINE OF CREDIT, make only the minimum payments due under the contract during the term of the agreement, and do not make further draws on your LINE OF CREDIT:

1. Your beginning ANNUAL PERCENTAGE RATE (APR) is _______%. [If teaser, add: It will go up to ________% after _________month/years.] This annual percentage rate is based upon the initial amount you are borrowing rounded

up to the nearest $5,000. The APR is the real cost of your credit, expressed as an annual percentage rate, and takes into account both the interest to be paid over the life of the loan, and the prepaid finance charges.

(NOTE: The "interest rate" of ________% on your line of credit is lower than the APR, because the interest rate only takes into account the interest to be paid over the life of the loan; it ignores the impact of the prepaid finance charges on the total cost of this loan.)

a. Your minimum monthly payments would be $________. [IF TEASER, add: They would go up to _____% after ____ months/years.]

b. If this APR does not change, it would take ____ months to pay off this loan at the minimum monthly payment, plus one balloon of _____ at the end of ________years.

c. The total of your payments would be $_____.

4. Historical Information About Your Annual Percentage Rate. Your rate is based on an index. IF THE INDEX CHANGES DURING THE LIFE OF YOUR LOAN, THE SAME WAY AS IT DID THE PAST ___ YEARS (There is no guarantee it will):

a. The highest annual percentage rate would have been: _____%

b. The highest monthly payment would have been: _____

c. It would have taken _____ months of the highest monthly payments (and some lower ones) to pay off the loan, plus a balloon payment of ______ at the end of the ____ years.

d. The total of payments would have been $_____.

5. Worst Case (or Most Expensive) Example. IF THE RATE GOES AS HIGH AS IT COULD UNDER YOUR CONTRACT:

a. The highest annual percentage rate would be: _____%

b. The highest minimum monthly payment would be: ______.

c. It would take _____ months of to pay off the loan, plus a balloon payment of ______ at the end of the ____ years.

d. The total of payments would be $_____.

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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 1991), are three of twelve practice treatises which 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] The alarming 384% increase in foreclosures on homes is a clear indication that changes in the system are necessary. **Between the years 1980 and 1997, the number of foreclosures executed each year rose from 150,000 to**

over 577,000. (See Table in Appendix 1.)

[3] HOEPA stands for the Home Ownership and Equity Protection Act, 15 U.S.C. § 1639.

[4] 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. In 1983, Congress prohibited states from limiting the types of terms (such as balloon payments and negative amortization) that could be allowed on first mortgage loans. The Alternative Mortgage Transaction Parity Act of 1982 (AMTPA). 12 U.S.C. § 3800, *et seq*.

[5] Given the proclivity of many of us to want to minimize our weaknesses, we can safely assume that some additional number of mortgage borrowers were also confused, but were too embarrassed to admit it.

[6] In 1997, the federal poverty level for a family of four was set at $16,050.

[7] Dozens of examples were raised in the variety of Congressional hearings held on these issues. *Problems in Community Development Banking, Mortgage Lending Discrimination, Reverse Redlining, and Home Equity Lending: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 103d Cong., 1st Sess. 258, 260 (Feb. 17, 1993); *Hearing on S.924 Home Ownership and Equity Protection Act, Before the Senate Banking Committee*, 103d Cong., 1st Sess. (May 19, 1993); *The Home Equity Protection Act of 1993, Hearings on H.R. 3153 Before the Subcommittee on Consumer Credit and Insurance of the House Committee on Banking, Finance and Urban Affairs,* 103d Cong., 2d Sess. (March 22, 1994); *Hearing on Community Development Institutions, 103-2, before the House Subcommittee on Financial Institutions Supervision, Regulation and Deposit Insurance*, 103d Cong., 1st Sess. (Feb 2-4, 1993).

[8] Many low-income homeowners are working poor, with no tax liability, because of the earned income tax credit. Others are paying at the tax system's lowest tax rates.

[9] The term "reverse redlining" has been coined to describe a practice wherein banks make loans at one rate in white communities through their banking arm and at another higher rate in communities of color through separate finance company subsidiaries. Evidence in a case brought in Atlanta, for example, established that black borrowers were charged 11.06% in up front fees by Fleet Finance Co. (a subsidiary of Fleet Bank). White borrowers were charged 8.26%.

[10] *See* examples referred to in Footnote 7.

[11]The Federal Reserve Board concludes that one in nine families face debt payments that are higher than 40% of annual income. The rate rises to one in six families among those earning less than $25,000 per year. "Family Finances in the U.S.: Recent Evidence from the Survey of Consumer Finances" at 21, Table 14, *Federal Reserve Bulletin*, January 1997. *See* Pearlstein, "Trendlines: The Fed's Knowledge of Wealth", *Washington Post,* p. E1 (1/23/97).

[12] Canner, Durkin, & Luckett, "Recent Developments in Home Equity Lending," *Federal Reserve Bulletin,* April, 1998.

[13] *Id.*

[14] Most recently, these were illustrated in the hearings before the Senate Special Committee on Aging, Mar.16, 1998. *Also see,* the hearings referred to in Footnote 7.

[15] 12 U.S.C. § 2601(a).

[16] Board of Governors of the Federal Reserve System, Department of Housing and Urban Development, *Joint Report to the Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act*, July, 1998 at XI (hereinafter "*Joint Report*").

[17] The numerous class action lawsuits challenging the payment of yield spread premiums to mortgage brokers is a primary example of consumers who have found they received mortgage loans which were more expensive than they should have. *See* discussion of these cases and citations in Part IV of this testimony.

[18] A "merged credit report" is comprised of information from all three credit reporting agencies.

[19] All closing costs charged by the lender to close the loan would be included in this guarantee. Some expenses would be excluded from the guarantee closing costs package, such as certain truly optional expenses, such as owner's title insurance, as well as expenses unrelated to the loan itself, such as hazard insurance and property taxes.

[20] *Joint Report* at XVII.

[21] *Id.* At XIX.

[22] *Joint Report* at 32. The encouragement for the guaranteed closing cost package is significant indeed: the Board has proposed that any lenders which offer a package of settlement services at a guaranteed price should be granted an exemption from § 8 of RESPA for all those services which are included in the package of settlement services. *Id*. At XV. HUD, however, would only permit the § 8 exemption to guaranteed closing cost packages when the interest rate and points are also guaranteed, as well as closing costs. *Id*. At 29.

[23] *Id.* At 32.

[24] Actually, the consumer has the right to cancel the transaction three days after the last of the following three events: 1) delivery of all material disclosures, 2) delivery of the notice of the right to cancel, and 3) consummation of the loan. 15 U.S.C. § 1635(a).

[25] S. Rep. No. 368, 96th Cong., 2d Sess. 28, *reprinted in* 1980 U.S.C.C.A.N. 236, 264.

[26] *See* Appendix 1.

[27] *Joint Report* at 48.

[28] The agencies rationale for this is: "Consumers would have three days to review disclosure information and decide whether or not to complete the home-secured transaction, instead of reviewing loan documentation within the three days after closing and deciding whether or not to rescind the loan." *Id.*

[29] *Id.*

[30] *Id.* at 49.

[31] *Id.*

[32] *Id. at 51*.

[33] The facts of this case are those of Mrs. Rodash in *Rodash v. AIB Mortgage Co.*, 16 F.3d 1142 (11th Cir. 1994). Mrs. Rodash was able to rescind her loan because of the non-compliance with the disclosure rules under TILA. These rules have now been changed, thereby preventing many homeowners like Mrs. Rodash from using TILA's compliance rules to prevent foreclosure.

[34] *Problems in Community Development Banking, Mortgage Lending Discrimination, Reverse Redlining, and Home Equity Lending, Hearings Before the Senate Committee on Banking, Housing and Urban Affairs*, 103d Cong., 1st Sess. (Feb. 3, 17, 24, 1993); *Hearing on S. 924 Home Ownership and Equity Protection Act , before the Senate Banking Committee,* 103d Cong., 1st Sess. (May 19, 1993); *The Home Equity Protection Act of 1993, Hearings on H.R. 3153 Before the House Committee on Banking, Finance and Urban Affairs,* 103d Cong., 2d Sess. (March 22, 1994).

[35] 15 U.S.C. § 1602(AA)(1)(B).

[36] *Id.*

[37] For individual borrowers, the costs of a credit insurance policy are huge in relation to the loan amount. For example, a Georgia homeowner paid $2,200 for a credit life insurance policy sold to her in connection with a home-secured loan with a principal of $40,606.26. The cost of this insurance added over 5% to cost of the loan. Nevertheless, this loan is not covered by HOEPA because the credit insurance premiums are allowed to be excluded from the closing cost trigger in HOEPA under current law.

[38] *Credit Life Insurance Hearing Before the Subcommittee on Antitrust, Monopoly and Business Rights of the Senate Committee on the Judiciary*, 96th Cong., 1st Sess. 48 (1979) (statement of Robert Sable).

[39] *Id.* at 3.

[40]*Id.* at 7 (testimony of James Hunt). *Credit Life Insurance: The Nation's Worst Insurance Rip Off,* Statement of Consumer Federation of America and National Insurance Consumer Organization (June 4, 1990), updated (May 20, 1992 and July 25, 1995).

[41] 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 US LIFE Credit Corp. & US LIFE 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).

[42] *Joint Report* at 74.

[43] *See* Appendix 5 for an outline of our proposed Home Improvement Protection Law.

[44] Morton J. Horwitz, The Transformation of American Law, 1780-1860, at 213-215. A promissory note is an unconditional promise to pay a fixed amount of money, with or without interest, that is payable to order or to bearer, is payable upon demand or at a definite time, and does not state any other undertaking. U.C.C. § 3-104(a), (e) (1990). The actual note or loan document signed by a borrower secured by a mortgage is ordinarily considered a negotiable instrument and bought and sold on the secondary mortgage market. For a more in depth discussion of this doctrine, *see* Julia Patterson Forrester, *Constructing a New Theoretical Framework for Home Improvement Financing*, 75 Or. L. Rev. 1095, 1103-09 (1996).

[45] 16 C.F.R. § 433.

[46] Forrester, *supra* Footnote 44, at 1108.

[47] For a compilation and description of the state UDAP statutes, *see* The National Consumer Law Center, *Unfair and Deceptive Acts and Practices,* App. A (4th ed. 1997).

[48]*Mentecki v. Saxon Mortgage*, 1997 WL 45088 (E.D. Va. Jan. 10, 1997), *related decision* Civ. A. No. 96-1629-A (E.D. Va. Jan. 31, 1997).

[49] *Barbosa v. Target Mortgage Corp.*, 968 F. Supp. 1548 (S.D. Fla. 1997).

[50] District court decisions holding that yield spread premiums may be illegal include: *Briggs v. Countrywide Funding Corp.*, 931 F. Supp. 1545 (M.D. Ala. 1996); *Martinez v. Weyerhaeuser Mortgage Co.* 959 F. Supp. 1511 (S.D. Fla. 1996); *Mentecki v. Saxon Mortgage*, 1997 WL 45088 (E.D. Va. Jan. 10, 1997); *Dubose v. First Security Sav. Bank* 974 F. Supp. 1426 (N.D. Ala. 1997); and *Briggs v. Countrywide Funding Corp.*, 931 F. Supp. 1545 (M.D. Ala. 1996). Cases holding that yield spread premiums are not illegal under RESPA, 12 U.S.C. § 2607(a), include *Barbosa v. Target Mortgage Corp.*, 968 F. Supp. 1548 (S.D. Fla. 1997); *Hastings v. Fidelity Mortgage Decisions Corp.* 984 F. Supp. 600 (N.D. Ill. 1997); and *Culpepper v. Inland Mortgage Co*. 953 F. Supp. 367 (N.D. Ala. 1997).

[51] 132 F.3d 692 (11th Cir. 1998).