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Before the U.S. Senate Subcommittee on Interstate Commerce, Trade & Tourism

"Federal Trade Commission Reauthorization"
September 12, 2007

Chairman Dorgan, Ranking Member DeMint, and members of the Subcommittee, thank you for holding this hearing and considering this reauthorization in the context of the current turmoil in the subprime mortgage market. I serve as the President of the Center for Responsible Lending (CRL) (www.responsiblelending.org). CRL is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices.

We also have direct experience as a subprime lender. CRL is an affiliate of the Center for Community Self Help (www.self-help.org), which consists of a credit union and a non-profit loan fund. For the past 26 years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families, those often targeted for subprime loans. Self-Help has provided over $5 billion of financing to 55,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across the country. Our loan losses have been less than one percent per year.

Through this lending experience, I understand the benefits of subprime loans that contribute to sustainable homeownership. Unfortunately, when it comes to fair, affordable mortgages and opportunities for lasting homeownership, the subprime market's record is sorely lacking. The Center for Responsible Lending estimates that 2.2 million families have lost or will lose their homes as a result of abusive subprime loans made in recent years. That is one in every five subprime loans made in 2005 and 2006, a rate unseen in the modern mortgage market. When we consider the subsequent loans subprime borrowers have been refinanced into, the probable foreclosure rate jumps to over one third of all subprime borrowers.

My main messages to you today are these:

1) Problems caused by the subprime market are severe and widespread.
2) Abusive loans led to today's devastating foreclosures, and we need to keep reckless lenders off the streets.
3) The FTC could play a vital role in restoring integrity to the subprime market and reducing abusive home loans.

I. The Current Situation: An Epidemic of Foreclosures

Last December, the Center for Responsible Lending published a report that represents the first comprehensive, nationwide research projecting foreclosures in the subprime market. The report, "Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners," is based on an analysis of over six million subprime mortgages, and the findings are disturbing. Our results show that despite low interest rates and high housing appreciation during the past several years, the subprime market has experienced high foreclosure rates comparable to the worst foreclosure experience ever in the modern prime market. We also show that foreclosure rates will increase significantly in many markets as housing appreciation slows or reverses. As a result, **we project that 2.2 million borrowers will lose or have lost their homes and up to $164 billion of wealth** in the process. That translates into foreclosures on one in five subprime loans (19.4 percent) originated in recent years.[1]

Since we issued that report, the condition of the subprime market has deteriorated rapidly, and subsequent events have shown our projection to be conservative. A recent study by the investment bank, Lehman Brothers, shows that the number of 2006-originated loans likely to face foreclosure is 30 percent.[2] Headlines appear daily in the news detailing the negative ripple effects of bad subprime loans that have extended to investors and financial interests in many places throughout the world.

At the same time, many in the lending industry still fail to acknowledge the scope of the problem, the damage caused by reckless lending practices, and the need for more than cursory solutions. As recently as last month, the Mortgage Bankers' Association denied that subprime foreclosure rates are of concern for the economy.[3]

Yet, the Mortgage Bankers' own figures show that the problem is severe and widespread. Last week, the MBA released the "Second Quarter National Delinquency Survey," the latest figures available on the performance of home loans. The survey shows that mortgage loans entering foreclosure have increased in 47 states since this time last year. On average, the increases were 50% higher. Only four states-- North Dakota, South Dakota, Utah and Wyoming—did not experience increases in new foreclosures. Less than two percent of the American population lives in those states.

While the rate of subprime foreclosures is alarming today, the worst is still ahead. With 1.7 million foreclosures predicted to occur in the next two to three years, it is imperative that Congress take action to assist homeowners struggling today, not just protect future subprime borrowers.[4]

Several factors have driven massive home losses, including dangerous products, loose underwriting, broker abuses, investor demands, and federal neglect. In the context of today's hearing, I will focus on reckless lending, dangerous loans, and the need to strengthen protections on the federal level.

II. The Role of Reckless Lending

Under typical circumstances, foreclosures occur because a family experiences a job loss, divorce, illness or death. However, the epidemic of home losses in today's subprime market is well beyond the norm. Subprime lenders have virtually guaranteed rampant foreclosures by approving risky loans for families while knowing that these families will not be able to pay the loans back. Subprime lenders flooded the market with high-risk loans and made them appealing to borrowers by marketing low monthly payments based on low introductory teaser rates.

One of the key findings in our research on subprime mortgages is that subprime mortgages typically include characteristics that significantly increase the risk of foreclosure, regardless of the borrower's credit.[5] Since foreclosures typically peak several years after a family receives a loan, we focused on the performance of loans made in the early 2000s to determine what, if any, loan characteristics have a strong association with foreclosures. Our findings are consistent with other studies: increases in mortgage payments and poorly documented income substantially boost the risk of foreclosure. For example, even after controlling for differences in credit scores, these were our findings for subprime loans made in 2000:

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

Lenders and mortgage insurers have known for decades that these features increase the risk of foreclosure, yet these characteristics—adjustable-rate loans with prepayment penalties, made with little documentation—describe typical subprime mortgage loans made in recent years.

A significant culprit in today's foreclosure was the proliferation of hybrid adjustable-rate mortgages ("ARMs," called 2/28s or 3/27s), which begin with a fixed interest rate for a short period, then convert to a much higher interest rate and continue to adjust every six months, quickly jumping to an unaffordable level. Commonly, this interest rate increases by between 1.5 and 3 percentage points at the end of the second year, and such increases are scheduled to occur even if interest rates in the general economy remain constant.[6] This type of loan, as well as other similar hybrid ARMs (such as 3/27s) have rightfully earned the name "exploding" ARMs.

A. Loose Qualifying Standards and Business Practices

The negative impact of high-risk loans could have been greatly reduced if subprime lenders had been carefully screening loan applicants to assess whether the proposed mortgages are affordable. Unfortunately, many subprime lenders—as well as lenders writing "non-traditional" mortgages such as "payment option ARMs" and interest-only loans—have been routinely abdicating the responsibility of underwriting loans in any meaningful way.

Lenders today have a more precise ability than ever before to assess the risk of default on a loan. Lenders and mortgage insurers have long known that some home loans carry an inherently greater risk of foreclosure than others. However, by the industry's own admission, underwriting standards in the subprime market have become extremely loose in recent years, and analysts have cited this laxness as a key driver in foreclosures.[7] Let me describe some of the most common problems:

Not considering payment shock: Lenders who market 2/28s and other types of high-risk mortgages often do not consider whether the homeowner will be able to pay when the loan's interest rate resets, setting the borrower up for failure. Subprime lenders' public disclosures indicate that most are qualifying borrowers at or near the initial start rate, even when it is clear from the terms of the loan that the interest rate can (and in all likelihood, will) rise significantly, giving the borrower a higher monthly payment. For example, as shown in the chart below, publicly available information indicates that these national subprime lenders, who were prominent in recent years, do not adequately consider payment shock when underwriting ARMs:

Sample Underwriting Rules For Adjustable Rate Mortgages[8]

LENDER	UNDERWRITING RULE
OPTION ONE MORTGAGE CORP	Qualified at initial monthly payment.
FREMONT INVESTMENT & LOAN	Ability to repay based on initial payments due in the year of origination.
NEW CENTURY	Generally qualified at initial interest rate. Loans to borrowers with FICO scores under 580 and loan-to-value ratios of more than 80% are qualified at fully indexed rate minus 100 basis points.

These underwriting rules indicate that lenders routinely qualified borrowers for loans based on a low interest rate when the cost of the loan is bound to rise significantly—even if interest rates remain constant. In fact, until very recently, it was not uncommon for 2/28 mortgages to be originated with an interest rate four percentage points under the fully-indexed rate. For a loan with an eight percent start rate, a four percentage point increase is tantamount to a 40 percent increase in the monthly principal and interest payment amount.

Failure to escrow: The failure to consider payment shock when underwriting is compounded by the failure to escrow property taxes and hazard insurance.[9] In stark contrast to the prime mortgage market, most subprime lenders make loans based on low monthly payments that do not escrow for taxes or insurance.[10] This deceptive practice gives the borrower the impression that the payment is affordable when, in fact, there are significant additional costs. Given that the typical practice in the subprime industry is to accept a loan if the borrower's debt is at or below 50 to 55 percent of their pre-tax income, using an artificially low monthly payment based on a teaser rate and no escrow for taxes and insurance virtually guarantees that a borrower will not have the residual income to absorb a significant increase whenever taxes or insurance come due during the first year or two, or certainly not when payments jump up after year two.

A study by the Home Ownership Preservation Initiative in Chicago found that for as many as one in seven low-income borrowers facing difficulty in managing their mortgage payments, the lack of escrow of tax and insurance payments were a contributing factor.[11] When homeowners are faced with large tax and insurance bills they cannot pay, the original lender or a subprime competitor can benefit by enticing the borrowers to refinance the loan and pay additional fees for their new loan. In contrast, it is common practice in the prime market to escrow taxes and insurance and to consider those costs when looking at debt-to-income and the borrower's ability to repay.[12]

<u>Low/no documentation</u>: Inadequate documentation also compromises a lender's ability to assess the true affordability of a loan. Fitch recently noted that "loans underwritten using less than full documentation standards comprise more than 50 percent of the subprime sector . . ..."[13] "Low doc" and "no doc" loans originally were intended for use with the limited category of borrowers who are self-employed or whose incomes are otherwise legitimately not reported on a W-2 tax form, but lenders have increasingly used these loans to obscure violations of sound underwriting practices. For example, a review of a sample of these "stated-income" loans disclosed that 90 percent had inflated incomes compared to IRS documents, and "more disturbingly, almost 60 percent of the stated amounts were exaggerated by more than 50 percent."[14] It seems unlikely that all of these borrowers could not document their income, since most certainly receive W-2 tax forms, or that they would voluntarily choose to pay up to 1.5 percent higher interest rate to get the "benefit" of a stated-income loan.[15]

<u>Multiple risks in one loan</u>: In addition, regulators have expressed concern about combining multiple risk elements in one loan, stating that "risk-layering features in loans to subprime borrowers may significantly increase risks for both the…[lender] and the borrower."[16] Previously I described a brief overview of the increased risk associated with several subprime loan characteristics, including adjustable-rate mortgages, prepayment penalties, and limited documentation of income. Each of these items individually is associated with a significant increase in foreclosure risk, and each has been characteristic of subprime loans in recent years; combining them makes the risk of foreclosure even worse.

B. Broker Abuses and Perverse Incentives

Mortgage brokers are individuals or firms who find customers for lenders and assist with the loan process. Brokers provide a way for mortgage lenders to increase their business without incurring the expense involved with employing sales staff directly. Brokers also play a key role in today's mortgage market: According to the Mortgage Bankers Association, mortgage brokers now originate 45 percent of all mortgages, and 71 percent of subprime loans.[17]

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

First, unlike other similar professions, mortgage brokers have no fiduciary responsibility to the borrower who employs them. Professionals with fiduciary responsibility are obligated to act in the interests of their customers. Many other professionals already have affirmative obligations to their clients, including real estate agents, securities brokers and attorneys. Buying or refinancing a home is the biggest investment that most families ever make, and particularly in the subprime market, this transaction is often decisive in determining a family's future financial security. The broker has specialized market knowledge that the borrower lacks and relies on. Yet most mortgage brokers deny that they have any legal responsibility to refrain from selling inappropriate, unaffordable loans, or to put their own financial interest ahead of their clients'.[18]

Second, the market, as it is structured today, gives brokers strong financial incentives to ignore the best interests of homeowners. Brokers and lenders are focused on feeding investor demand, regardless of how particular products affect individual homeowners. Moreover, because of the way they are compensated, brokers have strong incentives to sell excessively expensive loans. They earn money through up-front fees, not ongoing loan payments. To make matters worse for homeowners, brokers typically have a direct incentive to hike interest rates higher than warranted by the risk of loans. In the majority of subprime and similar transactions, brokers demand a kickback from lenders (known as "yield spread premiums") if they deliver mortgages with rates higher than the lender would otherwise accept. Not all loans with yield-spread premiums are abusive, but because they have become so common, and because they are easy to hide or downplay in loan transactions, unscrupulous brokers can make excessive profits without adding any real value.

Experts on mortgage financing have long raised concerns about problems inherent in a market dominated by broker originations. For example, the chairman of the Federal Reserve Board, Ben S. Bernanke, recently noted that placing significant pricing discretion in the hands of financially motivated mortgage brokers in the sales of mortgage products can be a prescription for trouble, as it can lead to behavior not in compliance with fair lending laws.[19] Similarly, a report issued by Harvard University's Joint Center for Housing Studies, stated, "Having no long term interest in the performance of the loan, a broker's incentive is to close the loan while charging the highest combination of fees and mortgage interest rates the market will bear."[20]

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

C. Abusive Loan Terms: Prepayment Penalties and Yield-Spread Premiums

Prepayment penalties—an ”exit tax” for refinancing or otherwise paying off a loan—are a destructive feature of the subprime market that lock borrowers in to high-cost loans, and make it difficult for responsible lenders to refinance them into lower-cost loans. Today prepayment penalties are imposed on about 70 percent of all subprime loans,[21] compared to about 2% of prime loans.[22] This disparity belies any notion that subprime borrowers freely "choose" prepayment penalties. All things being equal, a borrower in a higher-cost loan, or in an unpredictable, adjustable rate loan with a very high margin, would not choose to be inextricably tied to that product by a high exit tax.[23] With common formulations of 6 months' interest, or amounts of approximately 3% of the principal, the amount of equity lost is significant. For a $200,000 loan, a 3% prepayment penalty costs borrowers $6,000, eating almost entirely the median net worth for African American households.[24]

It has long been recognized that prepayment penalties trap borrowers in disadvantageous, higher cost loans. Indeed, this is the penalty's purpose – in industry parlance, to "build a fence around the borrower" or "close the back door. Less well known is the fact that these penalties also increase the cost of the loan at origination because they are linked to higher rates on loans that pay higher so-called "yield-spread premiums" to brokers.[25] Thus, contrary to the claims of some lenders, prepayment penalties do not decrease, but, rather, frequently increase the cost of subprime loans.

Yield-spread premiums are a bonus paid by the lender to the mortgage broker as a reward for placing the borrower into a higher cost loan than the borrower qualifies for. Lenders are willing to pay the premium only where they are sure that the borrower will remain in the higher-cost loan long enough to enable the lender to recoup the cost of the premium from the borrower.

It is important to note that the lender does not allow the broker to get any yield-spread premium if the loan has no prepayment penalty, a result that is common in the subprime sector. Yield-spread premiums and prepayment penalties are intertwined in a way that is harmful to consumers and detrimental to competition. For a fuller discussion of these issues, please refer to our recent comment letter to the Federal Reserve Board, submitted on August 15.[26]

D. Racial Steering

Eliminating the practice of steering borrowers to pricier and riskier loans is also critical to assuring a fair marketplace that does not impose a discrimination tax on borrowers of color. We know that for borrowers of color, the odds of receiving a higher-cost loan are greater, even after controlling for legitimate risk factors, such as credit scores.[27] We are long past the time when we can—or should—close our eyes to this. Tax cuts are popular in Washington. Ending the discrimination tax on mortgage lending is a tax cut that is long overdue, and prohibiting steering is the way to do it.

It serves the interest not only of homeowners, but of the world economy, to assure that all families seeking loans who qualify for lower-cost prime mortgages should receive a prime mortgage, not a subprime loan. We know that far more people have been placed in high-cost loans than should have been.[28] Since it is now abundantly clear that "risky loans," as much or more than "risky borrowers," are a threat, market professionals – loan originators, whether brokers or retail lenders – should be required to assure that borrowers are put into the rate they qualify for. Market incentives that encourage originators to put as many people as possible into the priciest (and most dangerous) loans possible helped make this problem; prohibiting those incentives is a necessary part of the solution.

The subprime market has long cited "riskier borrowers" or "credit-impaired borrowers" as its justification for the higher prices on these loans. The argument is that investors need the higher prices to justify their risk, yet that extra price burden for the subprime loan puts credit-strapped borrowers that much closer to the edge.

III. Federal Neglect and the Potential Role of the FTC

Policymakers have long recognized that federal law—the Home Ownership and Equity Protection Act of 1994 (HOEPA)—governing predatory lending is inadequate and outdated. Although the Federal Reserve Board (hereinafter, the "Board") has the authority to step in and strengthen relevant rules, they have thus far refused to act in spite of years of large-scale abuses in the market, though they will reportedly propose some regulations this year. Other federal regulators with relevant authority, such as the Office of the Comptroller of Currency, have very done little enforcement, and they have been slow to enact rules. The result: For the majority of subprime mortgage providers, there are no consequences for making abusive or reckless home loans.

On July 25 this year, we joined the Consumer Federation of America and other concerned groups in presenting testimony before the U.S. House Committee on Financial Services.[29] In part of that testimony, we discuss the important role the Federal Trade Commission could play in eliminating abusive lending practices in the home loan market. The FTC brings two particular strengths:

First, the FTC is the agency with long experience in interpreting and enforcing the law against unfair and deceptive acts and practices (UDAP) in commerce, having been in that business for well over half a century. This experience contrasts sharply with that of the banking regulatory agencies, who only recently even gave thought to utilizing such authority.[30] In addition to longer experience with UDAP concepts, the FTC is also the agency whose chief job is to protect consumers from unfair and deceptive acts in commerce, and to protect the integrity of the marketplace for honest and ethical competition. Though the agency, like several others, could have done more to prevent the current subprime debacle, it makes little sense to prevent the agency with the most experience.[31]

Second, the FTC is also the agency with the fewest conflicts of interest since, unlike the bank regulatory agencies, there is no structural conflict of interest—it is not dependent upon assessments for its funding, does not need to compete with other regulators for entities to regulate, and its primary role is to protect consumers, not bank profitability.

With these strengths in mind, we offer two recommendations:

1. Enhance the power of section 5 of the FTC Act by expanding the rule-making and enforcement authority of the agency.

Section 5 of the Federal Trade Commission Act prohibits unfair and deceptive acts and practices in trade and commerce. Expanding the regulatory and enforcement authority of the Federal Trade Commission related to mortgage lending—and many other aspects of consumer financial services—would enhance the capacity for appropriate federal regulatory response, as the Consumer Federation of America, we at CRL, and others recommended in earlier Congressional testimony.[32] The FTC is the agency charged with primary interpretive and enforcement authority under Section 5, but the Act places that authority as to federally chartered depositories institutions with the federal financial regulators.[33] Though the FRB, NCUA and OTS have rule-making authority under the FTC Act, and others have enforcement authority as well, removing limits on the FTC's capacity to act makes sense.

While more could have been done with their rule-making authority, the FTC has promulgated two rules that have been effective in curbing abuses in the consumer finance area. The first, the "anti-holder rule," abrogates the holder in due course rule for credit sales where the seller refers the borrower to the lender or arranges or assigns the sales financing.[34] (A "holder in due course" is any subsequent owner of a check, note or other financial instrument of value.) That rule is based on the principle that, after the interest in a debt obligation is transferred, it is fundamentally unfair to separate the borrower's obligation to pay for a good or service if the provider of that good or service failed in its legal and contractual obligations to the borrower.

The anti-holder rule provides an important object lesson for the current foreclosure crisis. It recognized that when the ultimate owner of the obligation sought payment from the consumer, the consumer's "right" to seek redress against the originator while still obligated to pay the current holder was largely theoretical. It further recognized that those who were in the business of buying up credit obligations were in a far better position to police the marketplace of originators than consumers. That model demonstrates that accountability up the chain is workable, and the FTC should be commended for recognizing that.

Another FTC rule that brought significant reform to the market is the Credit Practices Rule, which eliminated abusive contractual remedies that were standard practices in the finance company industry.[35] This rule was aimed at contracts that provided powerful remedies to finance companies in non-negotiated contracts that denied due process and other legal rights to borrowers. Though vociferously opposed by the industry, the FTC recognized that industry wide practices can be—and sometimes are—inherently unfair or deceptive, and should be simply banned. Their authority to do so has been upheld by the courts,[36] and the practical sense of doing so without doing harm to the marketplace has been upheld by history.

Finally, states should be permitted parallel enforcement authority under Section 5 or their state analogues. It adds considerably to the available resources—more "cops on the beat"—and, like the FTC, they have experience, and are less subject to conflicts.

2. Create a private right of action under Section 5 of the FTC Act.

Currently, harmed consumers have no right to enforce the federal FTC Act: only public enforcement is possible. Even absent the intrinsic conflicts of interest, enforcement agencies such as the FTC have limited resources. When problems become the rule in an industry, rather than the exception, as is the case recently, public resources will simply never be adequate. Regulatory investigations are also very time consuming, and hold no remedy for homeowners who face foreclosure today. It is imperative that consumers be able to wield their own tools when they need them.

Though consumers in many states can invoke their state unfair and deceptive acts and practices law, there are significant gaps, such as exclusions for "regulated entities." Further, with the overly expansive assertion of preemption of state law by federal banking regulators, it is unclear whether we are about to see a constriction in the ability of consumers to use their state UDAP laws.[37]

IV. Conclusion

The mortgage industry has argued for years that regulation of subprime lending would have the unintended consequence of restricting credit, but it is now apparent that the current tightening of credit has been caused by the lack of adequate regulation and the reckless lending that followed. If subprime lenders had been subject to reasonable rules—the kind of rules that responsible mortgage lenders have always followed—we wouldn't have the problems we're seeing today.

Common-sense protections would prevent this catastrophe from happening again. We need a combination of sensible state laws backed by a strong federal floor. In recent years, many states have taken action to curb specific predatory lending practices, but federal regulators have remained largely passive until recently, and still have a ways to go. These recommended changes to the FTC Act will help protect families from abusive financial practices and help restrain the market from the excesses of recent years in the future.

END NOTES

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[1] A full copy of the "Losing Ground" foreclosure study and an executive summary appear on CRL's website at http://www.responsiblelending.org/issues/mortgage/reports/page.jsp?itemID=31217189.

[2] Mortgage Finance Industry Overview, Lehman Brothers Equity Research, p. 4 (December 22, 2006).

[3] Comment letter from the Mortgage Bankers Association to the Board of Governors of the Federal Reserve Board, p. 4, dated August 15, 2007.

[4] Moody's Economy.com, "Into the Woods: Mortgage Credit Quality, Its Prospects, and Implications," a study incorporating unique data from Equifax and Moody's Investors Service (2007).

[5] See note 1.

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

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

[8] *See* Option One Prospectus, Option One Mortgage Loan Trust 2006-3 424B5 (October 19, 2006) available at: http://www.sec.gov/Archives/edgar/data/1378102/000088237706003670/d581063_424b5.htm; Fremont Investment and Loan Prospectus, Fremont Home Loan Trust 2006-1 424B5 (April 4, 2006) available at: http://www.sec.gov/Archives/edgar/data/1357374/000088237706001254/d486451_all.htm **;** Morgan Stanley Prospectus, Morgan Stanley ABS Capital I Inc. Trust 2007-NC1 Free Writing Prospectus (January 19, 2007) available at: http://www.sec.gov/Archives/edgar/data/1385136/000088237707000094/d609032_fwp.htm; *Best Practices Won't Kill Production at New Century*, p. 3 Inside B&C Lending (November 24, 2006).

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

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

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

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

[13] *See Structured Finance: U.S. Subprime RMBS in Structured Finance CDOs*, p. 4 Fitch Ratings Credit Policy (August 21, 2006).

[14] Mortgage Asset Research Institute, Inc., *Eighth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association*, p. 12, available at http://www.mari-inc.com/pdfs/mba/MBA8thCaseRpt.pdf (April 2006); *see also* 2007 Global Structured Finance Outlook: Economic and Sector-by Sector-analysis, FITCH RATINGS CREDIT POLICY (New York, N.Y), December 11, 2006, at 21, commenting that the use of subprime hybrid arms "poses a significant challenge to subprime collateral performance in 2007."

[15] Traditional Rate Sheet effective 12/04/06 issued by New Century Mortgage Corporation, a major subprime lender, shows that a borrower with a 600 FICO score and 80% LTV loan would pay 7.5% for a fully-documented loan, and 9.0% for a "stated wage earner" loan.

[16] *See* Interagency Guidance on Nontraditional Mortgage Product Risks, note 42.

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

[18] About one-third of the states have established, through regulation or case law, a broker's fiduciary duty to represent borrowers' best interests. However, many of these provisions are riddled with loopholes and provide scant protection for borrowers involved in transactions with mortgage brokers. In other states, the question has not been specifically addressed.

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

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

[21] *See, e.g.* David W. Berson, *Challenges and Emerging Risks in the Home Mortgage Business*: *Characteristics of Loans Backing Private Label Subprime ABS*, Presentation at the National Housing Forum, Office of Thrift Supervision (December 11, 2006). According to MBA data, there was a 69.2% penetration rate for prepayment penalties on subprime ARMs originated in 2006. Doug Duncan, *Sources and Implications of the Subprime Meltdown*, Manufactured Housing Institute, (July 13, 2007). A recent CRL review of 2007 securitizations showed a penetration rate for prepayment penalties averaging over 70%.

[22] *See* Berson, ***id.*** A recent MBA analysis shows that 97.6% of prime ARMs originated in 2006 had no prepayment penalty, and 99% of 2006 prime FRM had no penalty. Doug Duncan, *id.*

[23] Marketing jargon in the industry is more honest about the role of prepayment penalties, along with high-LTV loans: "Build a fence around the customer:" or bring them in and "close the back door" are phrases that surfaced during regulatory investigations of subprime lenders in which one of the authors of this Comment was involved.

[24] Indeed, according to one study, it would exceed the median net worth in 2002 for African American households ($5,988). And it drains almost 7% of the median net worth for white households that year

($88,651). Rakesh Kochhar, *The Wealth of Hispanic Household: 1996-2002* p. 5, (Pew Center for Hispanic Studies), http://pewhispanic.org/files/reports/34.pdf

[25] Christopher A. Richardson and Keith S. Ernst, *Borrowers Gain No Interest Rate Benefits from Prepayment Penalties on Subprime Mortgages*, Center for Responsible Lending (January 2005),

[26] Comment letter from the Center for Responsible Lending to the Board of Governors of the Federal Reserve Board (August 15, 2007).

[27] Debbie Gruenstein Bocian, Keith S. Ernst and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, Center for Responsible Lending (May 31, 2006). Study finds that African-American and Latino borrowers are at greater risk of receiving higher-rate loans than white borrowers, even after controlling for legitimate risk factors. For example, African-American borrowers with prepayment penalties on their subprime home loans were 6 to 34 percent more likely to receive a higher-rate loan than if they had been white borrowers with similar qualifications.

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

[29] Testimony of Travis Plunkett, *Improving Federal Consumer Protections in Financial Services*, Hearing Before the House Financial Services Committee, (July 25, 2007)

[30] The FTC has had UDAP authority to protect consumers for nearly 70 years. Though the bank regulatory agencies were granted parallel enforcement authority in 1975, it is only since 2000 that they have recognized that. Even so, they have been parsimonious in utilizing it in the context of mortgage lending, for example, the OCC's action against a small bank, Laredo National Bank, # 2005-142. In contrast, the FTC took enforcement action against a non-depository subprime lender that was at the time among the top originators of subprimne loans, the Associates, FTC v. Associates First Capital, (http://www.ftc.gov/opa/2002/09/associates.shtm#) and other major predatory lenders, such as First Alliance Mortgage Company (FAMCO) and Delta Funding, in cooperation with other agencies. Abusive practices in servicing is another major problem in the mortgage context, and the FTC brought an action against Fairbanks, a major subprime servicer, (The FTC has a list of predatory lending cases on its web site, http://www.ftc.gov/opa/2002/07/subprimelendingcases.shtm.

[31] It has been suggested that Congress may need to make clear to the FTC that it will gain this authority only if it commits to using it in an appropriate fashion. *See* Test. of Travis Plunkett, note 30.

[32] See note 30.

[33] 15 U.S.C. Sec. 45, 12 U.S.C. Sec. 57a(a), 57a(f). *See also* Julie L. Williams & Michael S. Bylsma, *On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks*, 58 BUS. LAW. 1243 (2003).

[34] 16 C.F.R.433.

[35] 16 C.F.R. 444.

[36] American Financial Serv. Ass'n v. Federal Trade Commission, 767 F.2d 957 (D.C. Cir. 1985).

[37] For example, given the OTS' position that its rules "occupy the field," what will be the impact if it promulgates UDAP rules, as it has recently proposed? (OTS Adv. Notice of Proposed Rule Making , Unfair or Deceptive Acts or Practices, Dkt. ID OTS-20007-0015 (http://www.ots.treas.gov/docs/7/73373.pdf).