Testimony of Michael D. Calhoun
Center for Responsible Lending

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Ending Mortgage Abuse: Safeguarding Homebuyers
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Chairman Schumer, Ranking Member Crapo, and members of the Committee, thank you for holding this hearing to focus on abusive lending in the subprime mortgage market and solutions for encouraging sustainable homeownership. Without question, America is experiencing an alarming rate of subprime foreclosures—the highest in the modern business era. These home losses are imposing a great hardship on families and communities, and they also are having larger effects on our entire economy, as evidenced most recently by Bear Stearns' 3.2 billion dollar bail-out of hedge funds which are hemorrhaging losses on reckless and abusive subprime mortgages.[1] Senator Schumer, you and Senators Brown and Casey are proposing strong, common-sense policies to ensure that families who get subprime loans have a fair chance of success, and I commend you for your leadership on this vital issue.

In my remarks today, I will emphasize that we have not yet seen the peak of the economic destruction caused by reckless lending and dangerous loan products in the subprime market. In fact, all indicators point to home losses getting worse before they get better. I also will present recent lending data showing that, in spite of widespread concerns about subprime foreclosures, subprime lenders are continuing to make loans with abusive terms—loans that set up families to fail from the very beginning.

In recent months, journalists covering the subprime crisis have profiled some of the millions of families devastated by dangerous home loans. A recent case reported by Newsweek and other sources involved a veteran of the war in Iraq, a man from Kentucky named Shawn Howell.[2]

Mr. Howell bought a home for his wife and four children shortly before he was deployed, and he felt good about having a secure place for his family while he served his country. Following the advice of his mortgage broker, the Howells took out two adjustable-rate mortgages. The interest rate started at 5.4%, but after Howell returned from a difficult and dangerous year in Iraq, the rate shot up to 9.9%. The increase was completely unmanageable, especially since Mr. Howell was no longer receiving combat pay. He took on two jobs and made numerous attempts to contact the lender to find a way to avoid foreclosure. In spite of Mr. Howell's best efforts, the lender (Countrywide Financial) refused to modify the terms of the loan, and the Howells weren't able to sell their home. They were forced to give up their house to foreclosure, and today they are living in a trailer.

Unfortunately, as the subprime market has grown in recent years, we have heard too many stories like Mr. Howell's. I am here today as President of the Center for Responsible Lending (CRL) (www.responsiblelending.org), which was formed in response to the rise of predatory mortgage lending that has stripped billions of dollars of wealth from low- and middle-income families all over the country. CRL is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help (www.self-help.org), which consists of a credit union and a non-profit loan fund. For the past 26 years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing subprime home 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 a year.

Before I took my current position with CRL, I worked at Self Help for a number of years, where I gained direct experience lending to people with blemished credit. In that capacity, I learned a great deal about what types of subprime mortgages are likely to support successful homeownership. Lenders who care about sustainable ownership take a few basic steps before approving subprime loans. They document the borrower's income with the best information available, and make sure they have accurate property appraisals. They escrow for taxes and insurance, and they refrain from applying prepayment penalties, which bring no benefit to subprime borrowers, but only trap them in high-cost loans or drain thousands of dollars of hard-earned family equity. Lenders concerned about sustainable ownership do not saddle debt-strapped borrowers with loans designed to ratchet up in cost, and responsible lenders also take a hard look at the borrower's ability to repay the loan. These are not industry secrets, but rather common-sense best practices that responsible lenders have always used in subprime lending, and that are still the norm in the prime sector.

In addition to my background in subprime lending, I have another bit of experience—a job that doesn't appear on my resume, but I believe it is relevant to this hearing. For a while, when my children were small, I was a stay-at-home dad. I learned a great deal from this experience, including this lesson: You don't instill responsible behavior with weak guidelines and lax enforcement. The most effective way to ensure positive behavior is to establish clear, firm rules and enforce those rules with clear, firm consequences. The subprime industry, which has been growing at a remarkable pace for the past decade, has been sorely lacking in accountability and standards that would have prevented the devastating home losses occurring today.

The lack of bright-line rules have been particularly damaging in a market that offers strong incentives to do the wrong thing. Subprime mortgage brokers, lenders, securitizers, and investors are operating in a market that rewards business practices that directly undermine homeowners and sustainable homeownership. Markets function effectively when transactions are likely to benefit all parties involved, but we don't have that situation in subprime lending. The unfortunate truth is that brokers, lenders and investors have reaped enormous gains by originating loans with payments that explode in two short years, requiring homeowners, like clockwork, to refinance to a new subprime loan.

Brokers and lenders benefit from this regular and lucrative fee income, but homeowners lose the financial benefit of appreciation as their wealth is stripped away. Worse, when appreciation stops and the families cannot sell or refinance their homes, these loans bring families to foreclosure and ruin. And even with all the hard-gained knowledge we have today about the consequences of exploding ARMs, participants in the subprime market continue to market, originate and invest in them in large numbers.

It is notable that the suppliers who provide the majority of subprime loans—mortgage brokers—have the least financial interest in loan quality. According to the Mortgage Bankers Association, mortgage brokers now originate 45 percent of all mortgages, and 71 percent of subprime loans.[3] It is troubling that brokers, who have aggressively marketed dangerous loans in communities of color and low-wealth neighborhoods, and who have routinely charged excessive and unnecessary fees, have no financial interest in the ultimate success of the loans. Given the strong financial incentives to make unaffordable loans packed with fees, mere guidelines and suggestions will not be enough to stop risky loan practices and dangerous loan products.

Abusive Subprime Lending Persists Today

Even in the midst of the current epidemic of foreclosures, market forces have not reined in abusive lending. An industry publication, *Inside B&C Lending*, ran an article in mid-May that questioned whether lenders have actually tightened underwriting guidelines as much as they claim.[4] To take a more recent look at the evidence, we at CRL examined subprime loans included in 10 recent offerings of mortgage-backed securities—that is, investments made up of subprime loans. We found that these securities included significant shares of high-risk characteristics, as shown here:

Subprime Loan Characteristic	Average Share in our Sample
Prepayment penalties	70%
Stated income or low documentation	37%
Interest-only	12%
Adjustable interest rate	77% (90% of these ARMs were due to reset in 2-3 years)

Appendix 1, attached to this testimony, provides more details on our sample of mortgage-backed securities, including links to website information. In these securities, the overwhelming majority of mortgages was originated and securitized this year, well after the current crisis in the subprime market became apparent.

In today's environment of severe business losses and massive foreclosures, it is shocking to find these types of loans so prevalent in recent subprime loan originations. Here I will briefly comment on each of these categories:

Prepayment penalties:
Our analysis showed that, on average, more than 70% of the loans included in these securities came with prepayment penalties. As we recently argued before the Federal Reserve Board, prepayment penalties are an unfair practice in the subprime market because they provide no net economic benefit to consumers.[5]

Industry representatives often claim that borrowers receive a reduction in interest rates in exchange for prepayment penalties, but in the subprime market, this is not typically the case. According to quantitative research conducted by CRL, not only do prepayment penalties lock borrowers into higher-cost loans or force them to give up the wealth they have built through homeownership, but they also offer no benefit in the form of lower interest rates.[6] This finding is often confirmed in subprime rate sheets that lenders distribute to brokers to give up-to-date information on loan pricing. Rate sheets we have examined show that brokers receive a "yield-spread premium" for charging a higher interest rate than the borrower qualifies for on mortgages, often only if the broker convinces the borrower also to accept a prepayment penalty. In this way, even if there is a nominal reduction in the interest rate due to the prepayment penalty, this is offset or more than offset by the higher rate due to the yield- spread premium.

And this doesn't even account for the fact that once borrowers receive the loan, they are faced with the Hobbesian choice of remaining stuck in it and paying excess interest each year, or of getting out of the loan and forfeiting significant amounts of family wealth as a result. This situation has become more serious for families as property appreciation has slowed down in many areas of the country. A recent article in the *Wall Street Journal* highlighted this issue, noting that a high-school teacher in California seeking to refinance an option ARM discovered that he had a prepayment penalty of $18,000. An executive of U.S. Bank Home Mortgage commented, "The decrease in property values, combined with prepayment penalties, is making it very challenging for people to get out of these [adjustable-rate] loans." [7]

Not only are prepayment penalties expensive, but, as we reported in recent research on the performance of subprime loans, these penalties also significantly raise the chance that a homeowner will face foreclosure.[8] Yet, in spite of all the serious issues associated with prepayment penalties, they continue to be a staple of the subprime market.

Stated income or reduced documentation
Lenders evaluate the risk of a loan before approving it, but without adequate documentation of income, a lender's approval of a loan is meaningless.[9] Based on our review of the 10 mortgage-backed securities, we find that, on average, more than one third--37%--of these recently securitized subprime loans were approved based on stated income or reduced documentation standards for verifying the borrower's income. The vast majority of borrowers have readily documentable W-2 income; by putting them in low-doc loans, lenders are either charging them up to 1 percent higher interest for no reason, or inventing non-existent income in order to make them a loan that is doomed to fail.

As Comptroller of the Currency, John Dugan, has stated, "Sound underwriting—and, for that matter—simple common sense—suggest that a mortgage lender would almost always want to verify the income of a riskier subprime borrower to make sure that he or she has the means to make the required monthly payment. Most subprime borrowers are salaried employees for whom verifying income by producing copies of W-2 forms is just not that difficult."[10] We see no justification for lenders failing to use readily available data on a borrower's income. The reforms we are seeking would require lenders to verify and document all sources of income using either tax or payroll records, bank account statements, or any reasonable alternative or third-party verification.

Interest-only mortgages:
These loans were originally intended for high-income borrowers who used this type of loan as part of a larger investment strategy. Interest-only loans are rarely appropriate for borrowers in the subprime market, yet our analysis shows that, on average, 12% of the subprime loans securitized were interest-only loans.

Adjustable-rate mortgages:
Perhaps most surprising, over three-quarters of loans in the securities we examined came with adjustable interest rates, and over 90% of those loans are scheduled to reset to a higher interest rate within two or three years. These types of loans are called "hybrid" mortgages (also "2/28s" or "3/27s"), since they begin with a fixed-rate term for two or three years before shifting to an adjustable interest rate.

Hybrid adjustable-rate mortgages (ARMs) are structured to cause families to fail. Mortgage brokers and lenders use the initial low "teaser" interest rate to entice debt-strapped families into the loans. When the rate adjusts higher, homeowners are faced with the choice of another expensive and equity-stripping refinance or struggling to pay an unaffordable loan. Particularly in regions where housing prices are relatively flat, foreclosures are rising as many homeowners feel the pinch from "payment shock"—the large interest rate increases that result from most subprime ARMs.

Hybrid mortgages have been the predominant type of loan offered by subprime lenders in recent years, and these loans have been the largest single contributor to unnecessary foreclosures. Analysts expect payment shock to be a continuing concern. As of September 2005, about 80% of subprime home loans were ARMS—mostly 2/28 hybrid loans. "Exploding" loans or 2/28s operate as two-year loans that lead to another bad ARM or even foreclosure after the introductory teaser rate expires. Because subprime lenders typically qualify borrowers based on the introductory payment amount, most borrowers cannot afford to remain in these arrangements even if interest rates do not rise. According to Barron's, in the two year period from mid-2006 to mid-2008 homeowners can expect increased monthly payments on an estimated $600 billion of subprime mortgages.[11]

It is extraordinary that, at a time with an extremely flat and even inverted yield curve, ARMs with extremely high margins over the LIBOR index are being originated in such high volume for financially-challenged borrowers. This is even more stunning when one considers that it costs only 0.5 to 1 percent more to get a fixed-rate loan, which is less than either the increased cost of a stated-income loan for someone with fully-documentable income or many broker yield-spread premiums. Yet, in spite of widely publicized problems, subprime lenders persist in offering these dangerous loans.

This recent information from the field makes it clear that subprime lenders are continuing to make loans packed with dangerous features, and they will continue to do so until their abusive products and practices are declared illegal. As further evidence, we found that subprime lenders are continuing to place prominent advertisements designed to attract consumers to mortgages with dangerous features. Here are just two of the many examples of ads on the web that could lead borrowers to more expensive, more risky loans:

- "**Convenience.** In most cases, there's no need to hunt for tax returns, bank statements or pay stubs. Simply state your income and assets on your application"

- "NO INCOME VERIFICATION. We can do loans for the self employed or the W2 employee without requiring verification of income."[12]

<u>Inaction by the Federal Reserve Board</u>

Federal neglect has played a critical role in enabling abusive lending in the subprime market. Thirteen years ago, Congress required the Federal Reserve Board to prohibit mortgage lending acts and practices for all originators that are abusive, unfair or deceptive, but the Board has taken no action under this authority, even though borrowers, state regulators, and advocates have repeatedly raised concerns about abuses in the subprime market.

Seven years ago, members of the House Banking Committee urged the Federal Reserve to use its authority under existing federal legislation, the Home Ownership and Equity Protection Act (HOEPA), to issue regulations banning predatory lending practices that were already devastating consumers. At that time, Representative Jim Leach told the Board:

> [C]ongress…passed a law which was very strong in its sense of purpose in outlawing predatory lending, in effect, and then because Congress felt that the subtleties of this were beyond Congress, we gave to Federal regulators, most specifically the Federal Reserve Board of the United States, the authority to make definitions and to move in this direction….So the question becomes, if there is a problem out there, if Congress has given very strong authority to regulators and the Federal Reserve, our regulators, is the Federal Reserve AWOL?[13]

We applaud the Board for the recent issuance, with the other banking and credit union regulators, of the Proposed Statement on Subprime Lending, which we hope will be finalized quickly and without weakening any of its protections. But the Statement alone is insufficient, applying to only the portion of the subprime market that is originated by depositories or their affiliates, leaving no similar protections for the other half of the market that serves consumers that borrow from state-chartered finance companies.

Earlier this month, we testified at a Federal Reserve hearing and asked the Board to establish clear, bright-line rules, applicable to all mortgage lenders, to protect consumers from predatory lending practices ubiquitous in the subprime market today. In summary form, we are asking the Board to declare it to be an unfair or deceptive practice for subprime lenders to:

- Underwrite a loan that is not based, at a minimum, on the fully-indexed rate and fully amortizing payments, or to qualify borrowers on less than the full amount of their financial obligations, including property taxes, hazard insurance, and other debts;

- Exclude from the repayment analysis of a subprime loan the cost of hazard insurance and property tax escrows or to fail to escrow taxes and insurance in subprime loans;

- Fail to verify and document all sources of a borrower's income using either tax or payroll records, bank account statements, or any reasonable alternative or third-party verification;

- Make a prepayment penalty on a subprime loan;

- Fail to exercise sufficient due diligence regarding broker acts and omissions; and

- Allow deceptive subterfuge associated with abusive "piggy-back" second mortgages.

There is precedent for the Board to act, since following Representative Leach's plea in 2001, it made the extremely important and ultimately effective decision to discourage lenders from selling costly and unnecessary single-premium credit insurance. Today, the need is to address basic underwriting failures by subprime lenders under section 129(l)(2) for all subprime loans. The Board not only has the authority, but also the statutory <u>obligation</u>, to address these lending abuses under HOEPA.[14]

<u>The Borrower's Protection Act of 2007</u>

Particularly in light of the Federal Reserve's inaction to date, we are pleased that Senators Schumer, Brown and Casey have taken the affirmative step of proposing the Borrower's Protection Act of 2007. This proposal offers key protections that would help prevent unnecessary subprime foreclosures in the future, including:

- Fiduciary duty for mortgage brokers;

- Good faith and fair dealing standard for all mortgage originators;

- Require sensible underwriting to ensure that the borrower has the ability to repay a loan, taking into account payment increases, countering the practice of subprime lenders that underwrite to an artificially low initial "teaser" rate;

- Require verification of income when assessing whether the borrower will be able to sustain a loan;

- Prohibit steering (brokers may not direct a consumer to loans that are not appropriate or suitable for the them);

- Escrow accounts to pay taxes and hazard insurance on subprime loans;

- Lender responsibility for policing their associated appraisers and brokers; and

- Prohibition against originators influencing appraisal process.

In addition, Senators Schumer, Brown, and Casey have called for much needed funding to support community groups that specialize in foreclosure prevention. Senator Reed's Homeownership Protection and Enhancement Act (S.1386) is worthy of note as well as it would make important inroads on foreclosure prevention by expanding access to foreclosure prevention services for low- and moderate-income families, providing funding for homeownership prevention services, including grants and subsidized loans, and creating an affirmative duty for lenders and servicers to engage in some loss mitigation efforts prior to foreclosure.

Currently, the Federal Reserve Board is considering action on several of these items, including underwriting to account for payment increases, escrows for taxes and insurance [and] lender accountability for broker actions [prepayment penalties]. However, if the Board does not exercise its authority in this arena in a prompt and forceful way, Congressional action on the above items, in addition to those that the Board is not considering, will be crucial in providing much-needed protections for consumers in the subprime market. Here, let me briefly comment on the current problems that are driving the need for the policies included in the Schumer-Brown-Casey bill:

<u>Broker Abuses</u>:
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. And brokers hold themselves out to borrowers as a trusted adviser for navigating the complex mortgage market; why otherwise would a person engage and pay for one? Yet, in most states, mortgage brokers have no legal responsibility to refrain from selling inappropriate, unaffordable loans, or to avoid benefiting personally at the expense of their borrowers.[15] Brokers and lenders are focused on feeding investor demand in exchange for high fees, 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.[16]

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.[17] 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."[18]

Lenders should not be allowed to use their profitable relationships with brokers as a shield to make abusive loans – lenders cannot simply offload the responsibility to place borrowers in loans they can afford. At a minimum, lenders must engage in proper due diligence of the brokers they use and the brokered loans themselves. The establishment of lender liability for broker acts and omissions is a critical step to clamp down on unfair, deceptive and abusive practices.

<u>Steering families into unnecessarily expensive home loans</u>:
"Steering" is the practice of encouraging borrowers to accept higher-cost subprime loans even when they qualify for a more affordable prime loan.[19] Efficient financial markets should provide equally qualified borrowers with equally competitive prices on subprime home loans. However, both quantitative research and anecdotal evidence suggests that there are significant price disparities in subprime lending that indicate that some borrowers, particularly African-American and Latino families, pay more than necessary for subprime mortgages.

In May 2006, CRL analyzed data submitted by mortgage lenders for loans made in 2004 to assess the effects of race and ethnicity on pricing in the subprime market while controlling for the major risk factors used to determine loan prices.[20] Our findings showed that, for most types of subprime home loans, African-American and Latino families were at greater risk of receiving higher-rate loans than white borrowers, even after controlling for legitimate risk factors. In other words, if two families received subprime loans, one African American and one white, and they had the same credit score and were similarly qualified in every other way, the African-American family has a significant chance of receiving a higher-cost loan.

<u>Failure to escrow</u>:
The failure to consider payment shock when underwriting is compounded by the failure to escrow property taxes and hazard insurance.[21] When lenders include escrow funds as part of the borrower's monthly house payment, they ensure that these funds are available when due, and they also make the true cost of the loan more transparent. Responsible lenders have always understood that establishing an escrow account is even more important for lower-income borrowers or those with high debt burdens and less disposable income.

Yet, in stark contrast to the prime mortgage market, where escrows are generally required,[22] most subprime lenders make loans based on low monthly payments that do not escrow for taxes or insurance.[23] This deceptive practice gives the borrower the impression that the payment is affordable when, in fact, there are significant additional costs, and also gives unscrupulous lenders a huge advantage over lenders attempting to lend responsibly. When homeowners are faced with large tax and insurance bills they cannot pay, the original lender can benefit by enticing the borrowers to refinance the loan and pay additional fees for their new loan, or to pay the significant fees associated with force-placed insurance.

When refinances aren't possible, the results can be tragic. Just last week, the Raleigh *News & Observer*, while reporting on the trend of rising foreclosures locally and throughout the nation, described the situation of a North Carolina family that received a high-cost loan with no escrow. As stated in the article, "Cynthia Barrett McGowan wept as she described the home that was to be her legacy …. Instead, the Gastonia couple was swept up in the subprime lending mess that is roiling the housing industry. Their agent did not include insurance and taxes in escrow, requiring almost $2,000 they don't have. They couldn't refinance and now face foreclosure."

Appraisal inflation

Deliberately inflating the price of a home is a serious matter, since such false information can mean that families borrow more than the house is worth, making it difficult, if not impossible, to get out of an unaffordable loan. When lenders use inflated appraisals on loan products that already pose high potential for foreclosure, in a market where home prices are soft in many areas, homeowners are clearly set up to fail.

Consumer advocates have long expressed concerns about appraisal inflation in the subprime market, and this issue became more prominent with the notorious Ameriquest lawsuit. In 2006, Ameriquest—which was the largest subprime lender at that time—agreed to pay $325 million to settle a lawsuit brought by 33 state Attorneys General and the District of Columbia. One of the primary findings of the investigation was that Ameriquest had pressured appraisers to inflate home values.[24]

In spite of widespread publicity on the Ameriquest case, it is apparent that appraisal inflation remains a significant problem in the market. For example, the state of Ohio is suing 10 subprime originators, mostly mortgage brokers, for pressuring appraisers to inflate home values.[25] Ohio now has the third highest number of foreclosures in the country, and state leaders have identified appraisal inflation as a significant culprit. The state attorney general, Marc Dann, has been quoted as saying, "Predatory lending is driving Ohio's shameful home foreclosure rate. [This] crackdown on appraisal fraud will help protect consumers and move us one step closer to driving unscrupulous lenders out of our communities."[26]

It is heartening to note that appraisers themselves have expressed strong concerns about corruption in the lending process, and they are taking an active role in advocating reforms. Many of you here today are probably aware that the Appraisal Institute and associates have recently held extensive discussions with regulators and members of Congress to ask for regulatory reforms to ensure the independence of the appraisal process, and to stop the widespread practice of appraiser coercion.[27] I am sure you will hear more on this topic from the Appraisal Institute today at this hearing.

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

Lenders who market 2/28s and other hybrid ARMs generally 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 will rise significantly even if interest rates in the economy stay constant, giving the borrower a much higher monthly payment.[29] In fact, it is not uncommon for 2/28 mortgages to be originated with an interest rate four percentage points under the fully-indexed rate. For a loan with an eight percent start rate, a four percentage point increase to twelve percent is tantamount to a 40 percent increase in the monthly principal and interest payment amount. As the lenders well know, virtually no subprime borrower can afford such an increase.

In fact, lenders know a lot more about mortgage financing than the typical consumer, and that isn't likely to change. That is why merely adding more disclosures to the loan process will not be enough to protect people from unaffordable loans. Shawn Howell's story, cited at the opening of my remarks, highlights this point. It is clear that Mr. Howell is an intelligent man, but like many consumers, he trusted the mortgage professional who assisted him through the loan process and didn't read all the fine print included in the reams of papers presented to him when the loan closed. Any effective lending laws will prohibit abusive practices without allowing lenders the loopholes that disclosures can provide.

The predatory lending practices we are discussing here today have been ignored for far too long, and with devastating consequences to families, the communities in which they live, and the country as a whole. Thank you very much for your interest in this issue and the opportunity to testify before you today. I would be happy to answer any questions you may have.

Appendix One: Loan Characteristics from Recent MBS Deals

The statistics below are from a sampling of recent MBS issues and offerings and contain information on the loan features therein. This collection does not encompass the entire subprime MBS market but is representative of the typical makeup of subprime MBS issues.

SOUNDVIEW HOME LOAN TRUST 2007-OPT2 available at:
http://www.sec.gov/Archives/edgar/data/1403447/000088237707001693/d685433_fwp.htm
76.06% ARMs
45.95% Stated/Reduced Doc
3.34% IO
73.29% Prepayment penalty
(Originator: Option One)

SOUNDVIEW HOME LOAN TRUST 2007-OPT1 available at:
http://www.sec.gov/Archives/edgar/data/1398202/000088237707001371/d671413_424b5.htm
73.71% ARMs
52.40% Stated/Reduced Doc
4.70% IO
74.46% Prepayment Penalty
(Originators: Option One)

Merrill Lynch First Franklin Loan Trust Series 2007-4 available at:
http://www.sec.gov/Archives/edgar/data/1402720/000095012307008675/x36019fwp.txt
83.16% ARMs
27.42% Stated/Reduced Doc
4.40% IO
69.20% Prepayment Penalty
(Originators: First Franklin)

Merrill Lynch First Franklin Loan Trust Series 2007-3 available at:
http://www.sec.gov/Archives/edgar/data/1398697/000095012307008073/y35327b5e424b5.txt
83.12% ARMs
28.69% Stated/Reduced Doc
6.40% IO
68.08% Prepayment Penalty
(Originators: First Franklin)

CWABS Asset-Backed Certificates Trust 2007-7 available at:
http://www.sec.gov/Archives/edgar/data/1021913/000114420407023344/v073913_424b5.htm
66.23% ARMs
35.95% Stated/Reduced Doc
19.64% IO
68.24% Prepayment Penalty
(Originator: Countrywide)

CWABS Asset-Backed Certificates Trust 2007-8 available at:
http://www.sec.gov/Archives/edgar/data/1021913/000114420407030120/v077325_424b5.htm
65.46% ARMS
34.04% Stated/Reduced Doc
17.65% IO
69.12% Prepayment Penalty
(Originator: Countrywide)

HSI Asset Securitization Corporation Trust 2007-HE2 available at:
http://www.sec.gov/Archives/edgar/data/1323260/000114420407023098/v073805_424b5.htm
82.93% ARMs
43.25% Stated/Reduced Doc
17.04% IO
71.56% Prepayment Penalty
(Originators: HSBC/Decision One, WMC)

WaMu Series 2007-HE4 Trust available at:
http://www.sec.gov/Archives/edgar/data/1401898/000088237707001650/d684569-424b5.htm
82.02% ARMS
28.23% Stated/Reduced Doc
9.23% IO
79.44% Prepayment Penalty
(Originators: WaMu and Long Beach)

Citigroup Mortgage Loan Trust 2007-AMC4 available at:
http://www.sec.gov/Archives/edgar/data/1399477/000088237707001671/d683201_ex424b5.htm
72.02% ARMs
32.34% Stated/Reduced Doc
19.67 IO
61.44% Penalties
(Originators: Argent and Ameriquest)

Structured Asset Securities Corporation Mortgage Loan Trust 2007-BC3 available at:
http://www.sec.gov/Archives/edgar/data/808851/000114420407029665/v077232_424b5.htm
79.02% ARMs
38.59% Stated/Reduced Doc
20.01% IO
70.79% Prepayment Penalty
(Originators: BNC and People's Choice)

END NOTES

[1] Julie Creswell and Vikas Bajaj, *3.2 Billion Move by Bear Stearns to Rescue Fund*, New York Times (June 23, 2007).

[2] Dick Gordon radio broadcast, "The Story," American Public Media (June 12, 2007). *See also*, Karen Springen, "This is Not My Beautiful House," *Newsweek* web exclusive (March 28, 2007).

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

[4] *Investors Weary of Lenders' Underwriting Adjustments*, Inside B&C Lending (May 18, 2007).

[5] "Statement of Martin Eakes Before the Federal Reserve Board on the Home Ownership and Equity Protection Act" at http://www.responsiblelending.org/pdfs/Fed-6-14-07-ME-Statement.pdf.

[6] Keith Ernst, *Borrowers Gain No Interest Rate Benefits from Prepayment Penalties on Subprime Mortgages*, Center for Responsible Lending (January 2005).

[7] Ruth Simon, *Mortgage Refinancing Gets Tougher; As Adjustable Loans Reset at Higher Rates, Homeowners Find Themselves Stuck Due to Prepayment Penalties, Tighter Credit*, Wall Street Journal (February 8, 2007).

[8] Ellen Schloemer, Wei Li, Keith Ernst and Kathleen Keest, *Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners*, Center for Responsible Lending (December 2006). *See also* Roberto G. Quercia, Michael A. Stegmen and Walter R. Davis, *The Impact of Predatory Loan Terms on Subprime Foreclosures: The Special Case of Prepayment Penalties and Balloon Payments*, Center for Community Capitalism, University of North Carolina at Chapel Hill (January 25, 2005).

[9] Fitch recently noted that "loans underwritten using less than full documentation standards comprise more than 50 percent of the subprime sector . . .." "Low doc" and "no doc" loans originally were intended for use with the limited category of borrowers who are self-employed or whose incomes are otherwise legitimately not reported on a W-2 tax form, but lenders have increasingly used these loans to obscure violations of sound underwriting practices. *See Structured Finance: U.S. Subprime RMBS in Structured Finance CDOs*, FITCH RATINGS CREDIT POLICY (New York, N.Y), August 21, 2006, at 4.

[10] John C. Dugan, Comptroller of the Currency, "*Remarks Before the Neighborhood Housing Services of New York*," (May 23, 2007) at 3, available at: http://www.occ.treas.gov/ftp/release/2007-48a.pdf.

[11] *See* Jonathan R. Laing, *Coming Home to Roost,* Barron's (Feb. 13, 2006) at p.26. As a typical example, consider the situation of a borrower with an annual income of $30,354 who receives a 2/28 subprime home loan for $180,000. With a "teaser" interest rate of 7.55 percent, the borrower has an initial monthly payment of $1,265. However, the fully indexed rate climbs to 11.25 percent with a corresponding monthly payment of $1,726. Even more disturbing, the homeowner was placed in the loan with a debt-to-income ratio of 61 percent, meaning that well over half of the borrower's post-tax income would be spent on his mortgage. At the fully indexed rate, the debt-to-income ratio rises to 83 percent, a debt burden that is clearly unaffordable.

[12] *See* https://www.wellsfargo.com/mortgage/buy/loans/descriptions/mexpress; http://www.southernmortgagesolutions.net/specialty.htm; http://www.forthebestrate.com/no-money-down-mortgage.aspx

[13] Representative Leach, May 24, 2000. House Banking Committee's "Predatory Lending Practices" hearing. Available at http://commdocs.house.gov/committees/bank/hba64810.000/hba64810_0.HTM.

[14] *See* "Statement of Martin Eakes Before the Federal Reserve Board on the Home Ownership and Equity Protection Act" at http://www.responsiblelending.org/pdfs/Fed-6-14-07-ME-Statement.pdf.

[15] 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.

[16] Brokers earn money through up-front fees, not ongoing loan payments. To make matters worse for homeowners, brokers typically have a direct incentive to hike interest rates higher than warranted by the risk of loans. *See* Howell E. Jackson and Jeremy Berry, *Kickbacks or Compensation: The Case of Yield Spread Premiums* pp 121-129 (January 8,2002), at http://www.law.harvard.edu/faculty/hjackson/pdfs/january_draft.pdf.

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

[18] 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).

[19] A Freddie Mac researcher reports one out of five subprime borrowers could qualify for prime loans, (*see* 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)), and a lending industry association recently acknowledged that many borrowers placed into 2/28 mortgages could have qualified for thirty-year, fixed rate loans for a rate typically just 50 to 80 basis points (i.e., .5 or .8 of a percent) higher than the teaser rate on the loan they received. (s*ee* February 5, 2007 letter from CRL to Senators Dodd, Allard, Schumer, Reed and Bunning, attached as an exhibit to the Testimony of Martin Eakes before the U.S. Senate Committee on Banking, Housing and Urban Affairs, at p. 7 [responding to claims made by the Coalition for Fair and Responsible Lending (CFAL)], available at http://www.responsiblelending.org/pdfs/martin-testimony.pdf).

[20] 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). This research examined lending data submitted under the Home Mortgage Disclosure Act for 2004, which was the most recent data available.

[21] *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."

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

[23] *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).

[24] *See*, *e.g.*, Ameriquest Agrees to $325M Settlement with Spitzer at http://www.foxnews.com/story/0,2933,182520,00.html.

[25] Brian Louis and Sharon L. Crenson, *Ohio Sues Real Estate Firms for Pressuring Apprasiers*, Bloomberg. com (June 7, 2007) at http://quote.bloomberg.com/apps/news?pid=20601087&sid=aQdSUG9peQGM.

[26] Ibid.

[27] "AI Members Take Their Concerns to Capitol Hill," Appraisal Institute website at http://www.appraisalinstitute.org/publications/ano/default.asp?volume=8%20&numbr=7/8#3805. *See also* Kenneth R. Harney, *Appraisal Inflation*, Washington Post (April 21, 2007).

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

[29] For example, Fremont considered ability to repay based on initial payments due during the first year. 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. Option One qualified borrowers at the initial teaser rate. *See* Option One Prospectus, Option One Mortgage Loan Trust 2006-3 424B5 (October 19, 2006) 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), 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), http://www.sec.gov/Archives/edgar/data/1385136/000088237707000094/d609032_fwp.htm. Likewise, New Century's strongest underwriting practice, which is applied only to borrowers with a credit score under 580 and a loan-to-value ratio over 80 percent, is to evaluate the borrower's ability to repay the mortgage at an interest rate equal to the fully indexed rate minus one percentage point. "Best Practices Won't Kill Production at New Century," p. 3 *Inside B&C Lending* (November 24, 2006).