STATEMENT

BEFORE THE

SPECIAL COMMITTEE ON AGING

OF THE

UNITED STATES SENATE

ON

"PREDATORY LENDING: ARE FEDERAL AGENCIES PROTECTING OLDER AMERICANS FROM FINANCIAL HEARTBREAK"

FEBRUARY 24, 2004
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WASHINGTON, D.C.

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Good morning Chairman Craig, Ranking Member Breaux, and Members of the Special Committee on Aging. My name is Lavada DeSalles. I am a member of AARP's Board of Directors. I appreciate this opportunity to testify on a matter of great concern to us – the practice of predatory mortgage lending.

The American mortgage finance system is justifiably the envy of the world. It has offered unparalleled financing opportunities under virtually all economic conditions to a very wide range of borrowers who, in no small part, have contributed to the highest homeownership rate in the nation's history – 68.6 percent.

Over 80 percent of persons 65 and older are homeowners. For older Americans, home equity has consistently been a primary source of wealth – today, accounting for approximately $2 trillion among persons 62 and older or roughly one-half of the wealth of older persons.

The process of obtaining a home mortgage has changed dramatically. Many of us remember when getting a loan meant walking into a bank or savings and loan, filling out paperwork, going home, and waiting – sometimes days – for a call from the bank as to whether the loan was approved. Not so today. Technological advances have increased the speed and efficiency of lending decisions. TV, newspapers – even the Internet – are full of ads that offer 'instant credit,' and 'guaranteed loans.' A recent study by AARP found that approximately 7 of 10 older homeowners reported having received information offering them the opportunity to borrow money against the equity in their homes. In addition, ill-intended home improvement contractors go door-to-door, 'finding' home repair 'emergencies' with home-secured loan documents in-hand and ready to sign.

The types of loans that are available to today's borrowers have expanded well beyond the 'prime' products traditionally offered at banks. Subprime lending has grown – and grown rapidly. In 1994, the $35 billion in subprime mortgages represented less than 5 percent of all mortgage originations. By 2002, subprime lending had increased to $213 billion or 8.6 percent of originations (subprime originations in recent years have represented as much as 13 percent of the mortgage market).

AARP's concern regarding the growth of the subprime market is based on numerous studies that indicate that older homeowners are more likely than younger borrowers to receive a subprime loan. This is a concern because the subprime market appears to be the primary source of predatory lending practices – in particular, subprime refinancings (as opposed to first purchases), since that's where there's home equity to skim, and as Willie Sutton said, 'that's where money is.'

In addition, AARP is concerned that aggressive 'push marketing', often conducted by subprime lenders, leads to loans that are 'sold, not sought.' In a recent study, nearly two-thirds (61%) of older borrowers with refinanced subprime loans, reported that the broker/lender – not themselves – initiated the contact. Over one-half (54%) of these older borrowers with refinanced subprime loans reported to have responded to 'guarantee' ads or sales calls.

AARP continues to be concerned by research findings that the percentage of foreclosures associated with subprime mortgages appears to be increasing. Studies in both urban and suburban areas have found that the volume of foreclosures associated with subprime loans has increased considerably in recent years. For older persons, the impact of foreclosure can be devastating – not only the loss of a

lifetime of savings, but the loss of one's home and a lifetime of memories -- even one's independence.

AARP has seen the devastation wrought by predatory loans upon older homeowners and has been active in working to eliminate predatory lending through litigation, advocacy, and education.

The following cases are but two examples of the problems faced by borrowers receiving predatory loans. In the early 1990's, First Government Mortgage and Investors Corporation (First Government) operated as a mortgage broker, charging older clients sixteen points plus very high interest charges for outrageously expensive and unaffordable mortgage loans. Over the years, First Government expanded its business and became a mortgage banker (i.e., making loans through other brokers and then selling these loans to banks and other secondary market purchasers). While First Government changed its pricing practices throughout the years, the hallmarks of its business operations remained deception, unaffordable pricing and bait and switch. AARP estimated that at least one-half of the foreclosure cases that we handled throughout the 1990's came from loans originated by First Government.

In 2000, AARP represented eleven older Washington, D.C., homeowners in a lawsuit against First Government, several mortgage brokers, title companies, and the lenders who purchased their mortgage loans from First Government.[1] These older homeowners alleged violations of the federal consumer credit laws -- Truth in Lending Act (TILA) and Home Ownership Equity Protection Act (HOEPA) and deceptive practices, including high-pressure tactics employed to get them to take out loans and erroneous or misleading information that hid the actual interest rates and costs of the loans. The original plaintiff, Betty Cooper, was an older, wheelchair-bound African-American widow, living on a monthly pension. She experienced a bait and switch of her interest rate that resulted in unaffordable monthly payments. In addition, she was charged a hidden broker fee that cost her a steep **8 percent of the mortgage**, **and an unexplained balloon mortgage payment**. Many of the other older homeowners with First Government loans were similarly surprised to learn that their mortgage loans included large balloon payments. Moreover, despite the fact that the borrowers provided their tax returns to the brokers, in many cases, the broker and lender created phony tax returns which grossly inflated their income or invented jobs to make it appear that they would be able to afford the mortgage payments. Yet, each of these victims was struggling to make monthly payments because First Government made them loans with monthly payments 48-100 percent of their monthly incomes, with effective annual percentage rates as high as **266 percent**.

Approximately one year into the case, First Government filed for bankruptcy, initially in what appeared to be a ploy to derail the litigation. When that course of action proved unsuccessful, First Government converted to a liquidation. Unfortunately, bankruptcy filings by predatory lenders and brokers are all too common. Were it not for the important ability to hold loan purchasers, also known as assignees, responsible for at least some of the bad acts of the originating lender, many victimized, older homeowners would lose their homes. During the three years of litigation, many of

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[1] *Cooper v. First Government Mortgage &Investors Corp., et al*, 1:00-CV-00536 (D.D.C. 2000). *See also,* 238 F. Supp. 2d 50 (D.D.C. 2002); 2002 U.S. Dist. LEXIS 21821, 206 F. Supp. 2d 33 (D.D.C. 2002), 2002 U.S. Dist. LEXIS 12219; 216 F.R.D. 130 (D.D.C. 2002), 2002 U.S. Dist. LEXIS 26661; 216 F.R.D. 126 (D.D.C. 2002), 2002 U.S. Dist. LEXIS 26666.

the brokers, loan purchasers and title companies settled their claims, leaving only a few parties, including First Government, to appear to face the opening day of trial in March 2003.

After hearing the homeowners' stories and testimony from one of the brokers, the jury in *Cooper* found First Government's conduct to be "outrageous," and in "willful disregard of the plaintiffs' rights," and the defendant was found to be in violation of the DC consumer protection laws, as well as TILA and HOEPA. Approximately $300,000 in compensatory damages was awarded to these victims. This federal court jury also awarded $4,125,000 in punitive damages. While First Government's bankruptcy makes collection of the majority of these damages virtually impossible, the homeowners are seeking to collect on bonds which the District of Columbia required First Government to purchase as a condition of doing business.

A second case has been recently filed which involves a mentally impaired, West Virginia couple, and highlights the issue of federal preemption -- which is making it increasingly difficult for victimized homeowners to obtain redress when they are deceived by predatory mortgage lenders. In *Phillips v. Coast to Coast Mortgage, et al*[2], the Phillipses, who subsist on a limited income of Social Security benefits, were threatened and tricked into mortgaging their debt-free home by an unlicensed mortgage broker. The broker asserted that they would lose their home if they failed to pay off car loans. A grossly inflated appraisal enabled the broker to make a $28,800 loan that was 240 percent of the home's appraised value. The borrowers were charged more than 10 percent in fees for an adjustable rate mortgage. The mortgage had an initial teaser rate of 12.5 percent which could increase to18.5 percent, but not decrease. The overvaluation of their home, combined with a significant prepayment penalty, have made refinancing impossible. These features, combined with the steep rise of their monthly mortgage payments, will inevitably lead to default and foreclosure for these homeowners.

The loan was made by the lending division of Superior Bank, a failed, federally-chartered savings bank. The bank was using a mortgage securitization scheme, creative accounting, and an elaborate corporate structure to strip home equity from homeowners nationwide, including hundreds of West Virginia homeowners. The Federal Deposit Insurance Corporation (FDIC) has reported on the misuse and demise of Superior Bank by Coast-to-Coast, Superior's parent company, through a securitization scheme that stripped millions of dollars, most of which were derived from the securitization of risky subprime mortgage loans. As master lender, and prime mover in the scheme, Coast-to-Coast controlled the structure and cost of the mortgage loans and enjoyed enormous profits. When Superior eventually collapsed, it triggered losses to the Savings Association Insurance Fund estimated at between $424-$525 million.

Coast-to-Coast and the other entities sued for this unconscionable and fraudulent loan seek to avoid responsibility for their own deceptive and fraudulent activities by seeking to enfold these actions within the cloak of Superior's preemption. According to its theory, Coast-to-Coast was free to direct the making of loans through unlicensed brokers, could profit, without risk from fraudulent and inflated appraisals, and could benefit enormously from unconscionable and deceptive loan practices -- practices that were required by its own scheme -- with impunity. This alarming tactic, in which Coast-to-Coast and other defendants are attempting to evade responsibility for their own violations of state contract and common law, challenges the authority of the states to protect their

[2] *Phillips v. Coast-to-Coast Financial Corp., et al.,* 03-C-153 (Mc Dowell Co. WV 2003).

citizens in the most basic areas of contract law and consumer protection and is becoming a regular feature of predatory lending defense. Abusive assertion of preemption is becoming a frequent defense in the predatory lending industry's battle to evade responsibility for its illicit actions.

AARP's advocacy efforts have included a multi-year campaign at both the state and federal levels. AARP has worked diligently – with industry, consumers, and policymakers alike – to protect older homeowners (such as the two cases just described) from abusive lending practices, and has actively pursued legislative solutions in more than one-half of the states. AARP has advocated, following the structure used in HOEPA, to prohibit inherently abusive lending practices, such as 1) financing single premium credit insurance and other debt cancellation agreements and 2) refinancing loans that do not provide a tangible net benefit to the borrower (i.e., loan flipping). In addition, AARP has advocated that high-cost loans (i.e., loans with very high interest rates and fees) subject borrowers to greater dangers, and should be subject to additional restrictions (that do **not** include interest rate caps), including: 1) limiting prepayment penalties and fees; 2) prohibiting mandatory arbitration clauses; and, 3) prohibiting the making of loans based solely on the value of the home rather than the borrower's ability to repay (asset-based lending).

AARP has also been active at the federal level, supporting anti-predatory lending legislation and regulation. Moreover, AARP has testified before numerous House and Senate committees, as well as the Departments of Housing and Urban Development (HUD) and Treasury, expressing concerns about predatory lending and the need for stronger protections. AARP has submitted comments to the Federal Reserve Board supporting amendments to Regulation Z to strengthen HOEPA and to the Office of the Comptroller of the Currency (OCC) in opposition to its recently adopted rules.

AARP is pleased to report that as a result of our efforts, and the efforts of many others, including leading lenders, the Government-Sponsored Enterprises (GSE's), and other stakeholders, significant market changes have occurred. For example, major lenders no longer include single premium credit insurance in their loans. In addition, recently Freddie Mac and Fannie Mae each announced that they will not purchase loans that include mandatory arbitration clauses. At least 18 states[3] have enacted laws that expand on the HOEPA protections. These laws generally cover more subprime loans and provide greater protections for borrowers facing foreclosures than HOEPA.

However, AARP continues to work with consumer advocates, policymakers, credit rating agencies, and major purchasers of mortgage loans to provide foreclosure protections for older borrowers victimized by predatory lenders. It must be noted that, even with the previously noted protections for high-cost loans, unless there is some deterrent to the purchase or assignment of possible predatory loans by the secondary market, predatory lenders will continue to receive capital, and will continue to make unaffordable loans.

In addition, AARP continues to be extremely concerned about the recent actions regarding state preemption by the OCC and Office of Thrift Supervision (OTS) and their impact upon older borrowers. Neither of these agencies has adopted strong regulations that protect borrowers from predatory practices. In addition, enforcement limitations are likely to mean that, in reality,

[3] Arkansas, California, Colorado, Connecticut, Florida, Georgia, Illinois, Kentucky, Maine, Nevada, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, and South Carolina.

victimized older borrowers will not be able to avoid a foreclosure that was caused by predatory lending practices.

AARP's efforts have also included an educational campaign, titled "*They didn't tell me I could lose my home*." Educational materials, tips on shopping for mortgages, and media messages are among the resources offered to educate homeowners about predatory mortgage lending. AARP has sponsored local "consumer universities" that include workshops on avoiding predatory lending, as well as statewide 'Predatory Lending Sabbath" days in several states.[4] Finally, AARP has partnered with legal services providers to train attorneys who work with victimized homeowners about the legal issues surrounding predatory loans.

In summary, homeownership is the great American dream – a commitment to personal financial security and to economic growth, creating economic prosperity for families and communities. According to one recent study, 83 percent of Americans believe that owning a home is a good investment. For older households, home equity is a key component of wealth among older households.

Assuring that older mortgage refinance borrowers obtain appropriate loans is critical to ensuring the current and future financial security of millions of older Americans. Predatory lending harms both homeowners and legitimate lenders. AARP looks forward to working with you, Chairman Craig, and with the other Members of this Committee, to find effective and appropriate methods for eliminating egregious lending practices that prove devastating to older persons and their families.

[4] Including Georgia, New York, Maryland, California, South Carolina.