



expanding economic opportunity

2009-2010 ASSETS & OPPORTUNITY SCORECARD

PREDATORY MORTGAGE LENDING PROTECTIONS

OVERVIEW

Predatory or abusive mortgage lending refers to a range of practices, including deception, fraud or manipulation, that a mortgage broker or lender may use to make a loan with terms that are disadvantageous to the borrower.¹ Predatory lending occurs primarily in the subprime market, which makes higher-interest loans to consumers with poor credit histories. African-American and Hispanic borrowers are disproportionately affected, as they are more likely than whites to get subprime loans.²

Between 1994 and 2005, the subprime mortgage market grew from \$34 billion to \$665 billion.³ During that period of growth, experts warned of the potential for a foreclosure crisis. As predicted, the eventual collapse of the housing market was fueled by high-cost, high-risk subprime loans that borrowers could no longer afford. In 2001, predatory mortgage lending in the subprime market was estimated to cost Americans \$9.1 billion per year;⁴ in the wake of this crisis, it is clear that the cost far exceeds even this estimate. Today, millions of Americans have lost their homes to foreclosure; 8.1 million more are expected to face foreclosure over the next four years;⁵ and still millions of others have been affected by the spillover effects of reduced property values, lost jobs and devastated communities.

WHAT STATES CAN DO

Although the federal government recently strengthened lending standards,⁶ there is still a significant role for states to play in addressing predatory mortgage lending. States can restrict the terms or provisions of mortgage loans, strengthen regulation of mortgage lenders and brokers, require lenders and brokers to engage in sound underwriting practices and ensure that laws on the books can be enforced to protect consumers.

ELEMENTS OF A STRONG POLICY

Based on the Center for Responsible Lending's expertise in the field of responsible lending policy, CFED considers a state's anti-predatory mortgage lending policy strong if it meets the following criteria:

1. Does the state protect consumers against unscrupulous lending practices?

■ Does the state ensure that brokers act in the interest of the borrower?

Mortgage brokers and other non-bank lenders originate 63-81% of all subprime home loans.⁷ Brokers are generally regulated at the state level, but such regulation is primarily limited to licensure rather than substantive lending standards. States should establish regulations to ensure that brokers act in the interest of the borrower.

■ Does the state prohibit "steering" borrowers to high-cost loans? Predatory

¹ *Consumer Protection: Federal and state agencies face challenges in combating predatory lending.* (2004, January). Washington, DC: U.S. General Accounting Office, pp.3-4. Retrieved July 28, 2009 from www.gao.gov/new.items/d04280.pdf.

² *A Snapshot of the Subprime Market.* Durham, NC: Center for Responsible Lending. Retrieved July 28, 2009 from www.responsiblelending.org/mortgage-lending/tools-resources/snapshot-of-the-subprime-market.pdf.

³ Schloemer, E., Li, W., Ernst, K. & Keest, K. (2006). *Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners.* Durham, NC: Center for Responsible Lending, p.7.

⁴ Stein, E. (2001, October 30). *Quantifying the Economic Cost of Predatory Lending.* Durham, NC: Center for Responsible Lending, p.2. Retrieved July 28, 2009 from www.selegal.org/Cost%20of%20Predatory%20Lending.pdf.

⁵ *Projected Foreclosures By State.* (2009). Durham, NC: Center for Responsible Lending. Retrieved July 15, 2009 from www.responsiblelending.org/mortgage-lending/tools-resources/projected-foreclosures-by-1.html.

⁶ The Federal Reserve's final rule, approved in July 2008, amends Regulation Z (Truth in Lending) and was adopted under the Home Ownership and Equity Protection Act. Retrieved from <http://edocket.access.gpo.gov/2008/E8-16500.htm>.

⁷ Ernst, K., Bocian, D. & Li, W. (2008, April 8). *Steered Wrong: Brokers, Borrowers and Subprime Loans.* Durham, NC: Center for Responsible Lending. Retrieved May 1, 2009 from www.responsiblelending.org/pdfs/steered-wrong-brokers-borrowers-and-subprime-loans.pdf.

mortgage lenders may “steer” families – through aggressive sales tactics and sometimes outright discrimination – into subprime mortgages, even when the family could qualify for a mainstream loan. States should ban steering for all home loans.

- *Does the state prohibit broker “kickbacks”?* A yield spread premium (YSP) is a bonus a lender pays to reward a mortgage broker for steering a borrower into a higher-cost loan than one for which the borrower qualifies. States should ban YSPs for all home loans.

2. **Does the state ban prepayment penalties for all home loans?** Prepayment penalties are a particularly egregious lending practice that penalizes homeowners who improve their credit and could qualify for a lower-cost refinance loan. States should ban prepayment penalties on all home loans.
3. **Has the state implemented strong, enforceable underwriting standards?**
 - *Does the state prohibit lenders from making subprime loans that the borrower does not have the ability to repay?* Subprime lenders often fail to consider a family’s ability to repay a mortgage, including taxes and insurance. States should require lenders to evaluate a borrower’s ability to repay based on accepted underwriting standards. Although new federal rules⁸ require lenders to adhere to similar guidelines, federal enforcement has been inconsistent. Thus, states should implement “ability to repay” standards enforceable by state regulators.
 - *Are lenders required to verify a subprime borrower’s income before making a loan?* In some cases, lenders do not require proof of income, making an already risky loan more dangerous. States should require lenders to review standard documents to verify a borrower’s income. As with “ability to repay” standards, federal enforcement of new rules has been inconsistent. States should implement income verification standards that are enforceable by state regulators.
 - *Does the state prohibit unnecessary refinancing of loans?* A lender “flips” a loan by refinancing it to generate a fee without providing benefit to the borrower. Flipping can drain home equity and increase monthly payments. States should require that refinancing results in a reasonable, tangible net benefit to all borrowers.
4. **Does the state include mortgage lending in basic consumer protection laws?** State Unfair and Deceptive Acts and Practices (UDAP) laws are consumers’ main protection from a range of predatory, deceptive and unscrupulous business practices. However, some states’ statutes do not cover credit transactions. Thus, homeowners are not protected against predatory mortgage lending. States should close loopholes and ensure that all credit transactions are covered under UDAP statutes.

WHAT STATES HAVE DONE

Thirty-five states and the District of Columbia have taken some action to curb predatory mortgage lending; of these, nine have made major improvements. Twenty-three states have reined in unscrupulous lenders and egregious lending practices; six ban prepayment penalties; nine enforce sound underwriting practices; and 26 have UDAP laws covering mortgage lending.

For more information on this policy measure, [Predatory Mortgage Lending Protections](http://scorecard.cfed.org), and more, go to <http://scorecard.cfed.org>.

In the *2009-2010 Assets & Opportunity Scorecard*, the 50 states and the District of Columbia were rated on their existing mortgage lending protections and policies. The ratings were based on the criteria described above.

⁸ The Federal Reserve’s final rule, approved in July 2008, amends Regulation Z (Truth in Lending) and was adopted under the Home Ownership and Equity Protection Act. Retrieved from <http://edocket.access.gpo.gov/2008/E8-16500.htm>.