U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

HOUSING POLICY IN THE NEW MILLENNIUM

Breakout Session: SUBPRIME AND PREDATORY LENDING

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P R O C E E D I N G S

MR. FISHBEIN: I'm going to start, recognizing that we'll probably have somewhat of a rolling meeting for the first part of it at least. So if everybody can grab a seat.

I want to welcome everybody to this afternoon session entitled Subprime Markets and Predatory Lending. My name is Allen Fishbein and I'm a senior advisor to Assistant Secretary Apgar. My day job is working on regulating Fannie Mae and Freddie Mac, but a lot of the HUD staff had been involved in the work of the HUD/Treasury predatory lending task force which you'll hear more about. I was involved in that as well as many of the colleagues that you'll hear from around the room. Before I introduce the panelists, and we have really, I think, an excellent and diverse panel of experts, and expertise that certainly will be worth hearing from, you also have in your loose-leaf binder several papers that were prepared in connection with this which you might use for further reading after the session is over hopefully.

And I guess the last item I just want to mention by way of housekeeping is we brought copies of the HUD/Treasury task force report which I believe

is in the back somewhere and hopefully everyone will pick up a copy before you leave today. Thank you.

What I would like to do is just start off by introducing the issue and then get out of the way and really turn this discussion over to the panelists that we have and I think we're going to have plenty of time for comments and thoughts from virtually anyone in the room who wants to make those. And I do know this is a topic that people aren't shy about talking about and everyone seems to have a perspective. But to build on the themes that have been discussed in the conference, we've been hearing repeatedly about the record home ownership rates that exist in the country and how home ownership for some of the traditionally underrepresented segments of our population, the good news has been increasing as well, and also that the sustained economic success, really the largest sustained economic growth period in the nation's history, has certainly had impacts on various aspects of the housing market and probably as much as anywhere else in connection with the subjects that we're going to be talking about today.

As a result of this economic success, we've seen considerable increase in home equity that people have in their homes and, as a result of that

development and some other developments that kind of -- Secretary Cuomo was talking about stars being in alignment -- well, there has been a certain alignment of stars in connection with the topic we're talking about -- have combined to result in a giant upsurge in subprime lending and what seems to be an increase in predatory and abusive mortgage lending practices as well.

Clearly the recent developments include, as I say, this enormous expansion of credit and the subprime market in particular. There also have been some legislative developments in the '90s which have made home equity much more attractive to homeowners and also profitable to lenders, not the least of which was changes in the Tax Reform Act of '96. There also have been changes in the financial market structure, the securitization of subprime lending, which has increased the supply of capital that's available in this area. And of course there is automated technologies that are impacting and interrelating with these forces as well.

And one of the points that I think HUD has made throughout the process that it's been involved in is that subprime has a useful purpose and that allowing people to tap into this new equity in their

homes, even if they have impaired credit, might be a beneficial thing because there are people who are house rich and cash poor. But we also know that the expansion of subprime is not evenly distributed and we're going to hear more about that today and it seems to be concentrated in certain sectors.

Increased equity in the home has also meant that the less sophisticated homeowners are really subject to plundering by what Secretary Cuomo has referred to as the pirates of the new economy who use a variety of different techniques to essentially push lend, convince borrowers that they need credit.

Now, we know that not all subprime lending is predatory but virtually all predatory is subprime, or at least that's the way it appears. Secretary Cuomo referred also last night, to those of you who heard his speech, about HUD serving as a consumer protection agency. In no area it's been clearer than some of the recent steps that have been taken with respect to predatory lending. In March of this year, Secretary Cuomo announced the formation of the National Predatory Lending Task force and asked Treasury Secretary Lawrence Summers and his department to join him in creating this national task force.

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The task force approached a wide variety of interested parties, trade associations, consumer and community representatives, state and local government officials, academics, and they held a series of field hearings this spring throughout the country. And in a 10-week process, which is what it was announced this work of the task force would encompass, and I was fairly new to HUD and I kind of said 10 weeks, that isn't going to happen in 10 weeks. Well, little did I learn that this is an example of something that actually started on time and ended exactly when it was supposed to.

In that 10-week period, HUD and Treasury completed work on a report, copies of which, as I mentioned before, are available in the room, curbing predatory home mortgage lending practices. Now, that report contained 50 some odd legislative, regulatory, administrative recommendations intended to help address and curb predatory and abusive mortgage lending practices. The report really included recommendations to all levels of government, for the private sector, for nonprofit community groups and civil rights organizations, and they really boiled down to four areas.

They include recommendations for educating

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consumers and providing better disclosures, a series of recommendations to reform the Homeownership and Equity Protection act, a consumer protection law in this area, steps to increase prime lending and responsible lending practices by secondary market institutions.

Now, HUD has been moving forward since the release of that report in June. We're taking steps within its own domain. Recent actions have included a number of steps designed to tighten up and provide better protection to FHA homeowners who seem to be subjected to certain unscrupulous practices in certain parts of the country by realtors, brokers and certain appraisers. And the Department launched a three-step process.

One is to try to aid FHA homeowners who are already victims of predatory practices; secondly, to tighten up on its own procedures and try to screen out unscrupulous actors in the home mortgage market; and thirdly, to provide better means to educate and to provide counseling to prevent future FHA home buyers from getting caught in this trap. So those are some of the steps that the Department is engaged in. There are others on the way. This is a number one priority within HUD and I suspect you'll be hearing

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more from the Department regarding this in the future.

Now, with that, let me turn to our panelists. I'm going to just go through and introduce them quickly and then we'll get right into the discussion. First, you're going to hear -- if you could just raise your hand and start this going. I don't know if everyone is in order. Dan Immerbluck, who is senior vice president of the Woodstock Institute in Chicago, which is an applied research and technical assistance organization. Dan has just been a simply prolific writer and researcher in subjects like the Community Reinvestment Act and fair lending and also subprime and predatory lending. In fact, he's starting to get the reputation of the Stephen King of this field, but by the number of things that he's been cranking out and the rapid speed in which they're occurring.

We're then going to hear from Chris Herbert who has been associated with Abt Associates, a research organization that works on providing different things for HUD and other folks. He specializes in housing policy and market analysis and program evaluation and he was a project director for a PHA single family loss mitigation program and has

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done research for the Neighborhood Reinvestment Corporation on subprime lending and foreclosures in the Atlanta metropolitan area and is included -- and contributed to a paper that was included in your materials. And Dan has a paper in there as well.

The third, we're going to hear from Susan Gates, who is a director of credit risk oversight at Freddie Mac. Freddie Mac, I think most of you have heard, is some kind of emerging housing finance company that we hear from from time to time, which has done a lot of research in the subprime area and Susan is going to share some of that as well. She's also editor of Secondary Mortgage Markets, which is a key publication in this area. I certainly command your attention to those of you who don't see it regularly.

We have a potential representative from the White House, David Medine, who I heard from this morning, telling me that he may be late. Little did he know our session was going to be late and he's even later, but he had a good excuse. He said he picked up the phone and it was the President of the United States so I guess he got a better offer. But hopefully he will be turning up and we'll try to give him some time when he does appear here. David, to

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those of you who know him, is senior advisor with the National Economic Council at the White House. And if the name sounds familiar, before that, he was a long time associate director for financial practices at the Federal Trade Commission and has a lot of expertise in this area as well.

And then we're going to hear from Stella Adams who is right here on my right. Stella is the executive director of the North Carolina Fair Housing Center. We're going to hear from the state perspective. Stella was one of the leaders in a coalition that successfully lobbied and fought for and got the North Carolina legislature to enact an antipredatory lending law which has certainly stimulated a lot of debate and discussion, and which virtually every state in the country seems to be looking at in one way or another.

And last but not least, we're going to hear from Carol Hemingway. Carol is the president of Pennsylvania ACORN. ACORN, I think as you know, is the national association of community organizations that does a lot of advocacy in community lending and community reinvestment and the predatory lending area. Carol herself has long time experience in the social service area and has been part of the task

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force that's been working on predatory lending, and we're going to hear about some of the recent actions that ACORN has been involved in.

And listed on the panel, and we're going to hear from him, although not in the first part of our presentation, right on my left is my colleague from HUD, Harold Bunce, who is the associate deputy assistant in the economic analysis part of PB&R. Harold, though, has done a lot of the legwork and the research on government-sponsored enterprises which the Department uses on FHA and was very active and did a lot of research work, led to the team that did the research that was part of the National Predatory Lending Task Force report as well.

So that's our team. It's a good one. And with that, let me turn it over to Dan. I think at this point, I want to encourage you -- I got good advice here. Fred, why don't you come in and we'll fill out some of the chairs here. That way we won't let you slip out the door if things start getting too long. Why don't you come on in. We won't call on you if you don't want to be called on. Don't worry about it. Okay, they're being resistant.

Let me just say that while we do have

ample time, everybody should be able to get their

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comments, I've been asked to, by rearrangement, to limit our speakers to their opening comments. And I've been a very aggressive timekeeper so you'll be seeing these signs of one minute left. Please end like that when your time is up. Dan, why don't you start.

MR. IMMERGLUCK: All right. Thanks, Allen. I think people are scared because you called me Stephen King. Intimidated. I don't know whether that's a compliment or what. Okay. I'll stay away from moving cars for a while.

What I'm going to talk about is basically what we've called -- what I've called the dual market in home equity lending, which is based -- a lot of the stuff that I'm going to be talking about is contained in this paper that Allen referred to, which is basically a synopsis of a report we did late last year with some new background information up front based on more current research and information on the subprime market and on predatory lending.

I'm going -- I want to talk about this dual market and why we care about this dual market from really a number of perspectives, including the stuff that Harold and Chris write about in their paper. And then I'm going to talk about policy

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issues and some of the perspectives we've had, and lots of folks have had, on what the priorities ought to be on policy.

Just some of the numbers that a lot of folks may be familiar with, and I'm going to be talking about mostly Chicago numbers, but as HUD's research has shown, follow-up research has shown, these are numbers that pretty much mirror the national trend in terms of the racial segregation of this lending, although work is really done by race of neighborhood in part because of the limits on the HUMDA data and the reporting of race but also because that's how a lot of this stuff breaks out.

In Chicago, 58 percent of refinances in 1998 reported through HUMDA in African-American neighborhoods were made by HUD-defined specialized subprime lenders, where only 10 percent of white neighborhoods were. In middle income African-American neighborhoods in Chicago, that number only dropped to 53 percent and held for middle income white neighborhoods at about 12 percent. So controlling basically for neighborhood income, there is very little change in that rate.

From '93 to '98, lending refinances by subprime lenders increased by 30-fold in

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African-American census tracks. And all of these trends are similar in HUD's studies of New York, Baltimore and across the country with some cities like Atlanta and Boston and L.A. showing different patterns, primarily because kind of the different urban geography of those cities.

The stark fact that we brought out in our study, and really gets the concept across most clearly about the dual market, is that if you look at the top 20 refinancing lenders by number of applications, the lenders taking most applications in white tracks in Chicago, in the Chicago area, 18 of those -- 17 or 18 of those, depending on -- there is one that's kind of questionable whether it's really a subprime lender, are prime lenders. In black tracks, it's the exact inverse. 18 of the top 20, by application volume, are subprime lenders. So we have really an almost pure dual market in some sense.

Why do we care about this? I think there are at least -- you know, let me say up front, because it comes up every time I talk about this and every place I go, no, I don't think all subprime loans are predatory or all -- I don't think about subprime lenders -- I don't think about predatory lenders. I think about predatory loans. I think

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there may be some lenders that have more problems with their loans, more predatory loans in their portfolio and in their practices than others, but when I look at the top 20 refinance lenders in minority tracks, the Legal Assistance Foundation of Chicago has predatory lending cases with every one of them.

So the notion that there are kind of good lenders and bad lenders is not the way I think about it. I think about that there are good loans and bad loans. Some lenders may have practices that leave them with more bad loans than others, and I don't have the data to know which ones are. I have suspicions based on the activity that I've heard about and seen from people like public aid lawyers.

But the three concerns about this dual market include pricing and terms, basically fair lending. If the market is highly segmented by race or by space, then the odds of minority borrowers with prime or near prime credit receiving a high-cost loan that they shouldn't get, that in a bar market or more competitive market they wouldn't get, is higher than for a white borrower with similar credit. And that's just the expectation if you have this strong segmentation.

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The second concern is what Chris and Harold have written about, which is the high and concentrated foreclosures, but also I would add to that delinquencies because delinquencies can cause problems that don't result in foreclosures. We know from private industry survey data that, at least for a sample of large subprime lenders, a substantial sample, that for C and D lenders, the kind of highest risk lenders, the 90-day delinquency rates are 10 percent and 22 percent. That's compared to a quarter percent for prime loans. So you're talking even for C credit, which in this survey -- conservatively in this survey accounts for about 20 percent of the subprime market, and the authors of this study argue that that's an underestimate of the market, of kind of the C credit share of the subprime market, that delinquency rate is 40 times the prime delinquency rate.

Foreclosure rates for all subprime loans are more than four times the FHA rate for similar product, and in Chicago we know what FHA foreclosures have done for lots of communities in terms of negative impacts. In the Baltimore HUD study that Chris and Harold have reviewed, you've got subprime loans accounting for 50 percent of the foreclosures

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in black tracks and accounting for a much smaller share of subprime loans.

And then finally, we have the predatory lending practices, the equity stripping that we've all heard about. And the question is, what portion of subprime loans are predatory? I will only argue that if I hear the phrase "a few bad apples" one more time, I'm going to walk out of the room. We've heard from major lenders that they sell lump sum credit life insurance on 25 to 50 percent of their subprime product. This is a practice that's been almost universally condemned.

In terms of policy priorities, our priorities include stronger regulation of high cost loans through strengthening HOPA regs; through regulation, expanding points and fees definitions being primary among that and adding abusive lending practices; much more aggressive fair lending enforcement, including expanding fair lending reviews by the fed and others of bank holding companies including their prime and subprime affiliates; and much more aggressive and expanded CRA legislation, including adding finance company and emergency company affiliates into the CRA umbrella and looking at the quality as well as the quantity of lending.

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Thank you.

MR. HERBERT: It has been mentioned, the work that I did for this conference was a collaborative effort with Harold Bunce, Randy Scheessele of HUD and Debbie Gruenstein of Abt Associates. It's essentially an attempt to try to pull together four studies that have been done looking at foreclosures of subprime lenders. In those days, I think we were primarily attempting to gather basic information. The first study was done by NTIC in Chicago. It was a very ground breaking study, finding these communities, these neighborhoods, had high concentrations of predatory loans with borrowers losing their homes and set out to try to quantify it and they found that lo and behold, the number of subprime foreclosures had been skyrocketing during the '90s.

The attention that brought to this issue led Neighborhood Reinvestment Corporation to hire us at Abt Associates to take a look at Atlanta in conjunction with the commerce they were doing there and then later in Boston for a conference FDIC sponsored on predatory lending as well. Harold and his colleagues at HUD were working with community activists in Baltimore to look at the situation

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there, and so it's so good that we have four attempts to gather facts. And this paper we pulled together quickly for this conference was an attempt to try to pull together these four studies and see what they have to say.

The title I ended up coming up with -- I was told I had to come up with a sexy title so I took a headline from one of Harold's pieces that he had written about the Predatory Lending Task Force, The Smoking Gun. I'm not sure whether or not I'll change the title now, and I've tried to come up with something else that's sexy, and I think maybe the right title is more The Tip of the Iceberg. I think what Dan is talking about, when we're talking about foreclosures, it's really the extreme end of the implications of these loans in that there is a lot more -- I think what Jim Carr talked about yesterday with well stripping, which may not be from loans that are necessarily predatory but loans that are 1 percentage point or 2 percentage points higher than they ought to be for those borrowers.

I think what Dan's study shows nicely is these neighborhoods that are having just a tremendous preponderance of subprime loans doesn't necessarily seem to be warranted by the credit risk of those

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borrowers. It may just be this market segmentation. And as Jim Carr showed, a 1 percentage point increase in a mortgage rate over the life of that loan, for an $85,000 mortgage, is $20,000, and 2 percentage points is $40,000. That's a lot of money coming out of these people's pockets and into the lender's pockets. So while I'm talking about foreclosures, it's really the tip of the iceberg. Those are the loans that people couldn't make it anymore, but there is a whole lot more people out there struggling to make it that are not affordable.

Having said that, let me turn a bit to the studies. Again, before markets were picked for somewhat idiosyncratic reasons, I think it's helpful to put it in a context. Atlanta, Baltimore and Chicago all look, as Dan mentioned, like the national statistics. The level of subprime activity is about 11 percent in 1998, the share of refinance activity, similar to the nation. Boston is a lot lower. It's only 5 percent and I think there are some interesting questions there about the nature of the housing market. Boston has a small minority community and lower home ownership rate, and maybe those marks just aren't the same ripe picking as Chicago is, where there is a fairly high minority home ownership rate.

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But despite that dissimilarity, the similarity is that in each of those market areas, the concentration of subprime lending in low income and minority communities is striking. In each of those places, low income areas, subprime lenders have two to three times the market share, and in African-American communities, it's three to five times the market share. And Baltimore and Chicago really stand out where -- one minute. I thought I had 10 minutes. Pulled the plug on me. Well, let's see if I can cut to the chase.

The bottom line is that foreclosures skyrocketed. They went up from 30 to over 1,400 in Chicago in a matter of five years. In Atlanta, they went up 232 percent in three years while other lenders' foreclosures were going down 15 percent. Boston was similar.

What we find is that there is lots of reasons to believe that these loans are, as would be expected, a lot more risky than prime loans and that what we're seeing with these foreclosure trends just reflects the fact, as Dan described, that the number of originations has gone through the roof. And lo and behold, we're finding out too many years later foreclosures are going through the roof.

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What we haven't been able to tell from this study is to what extent are those foreclosure rates beyond what would be expected, and how are they just what people would expect? I've been trying to get some information from rating agencies as to how they look at these lists, and there is reason to believe that, in fact, these foreclose rates may not be that off from what would be expected on prudently underwritten subprime loans. And so three to four times the default rate or three to four times the foreclosure rate may be what would be expected.

So while the study is talking about predatory lending, is this an evidence of predatory lending, it's not clear. I believe we would like to do some more work to try to find some better benchmarks. But even if it's not symptomatic of predatory lending and simply prudent subprime lending, I think there are real reasons for concern about loss of wealth, about whether borrowers are aptly prepared to undertake these risks, and beyond that, even if borrowers were aptly prepared, the externalities on these neighborhoods that are really impacting these communities that would all argue for more government intervention.

MR. FISHBEIN: See, you got the 10 minutes

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anyway. We're going to just shift for a second if we could, and Harold wanted to make a couple of comments as well.

MR. BUNCE: I thought it best if I jumped in here since the research that Randy Scheessele, who is back in the back there, and myself did in support of this HUD/Treasury task force relates most particularly to what Dan was talking about. But a couple of statistics, I think -- and Dan mentioned some for Chicago but in predominantly black neighborhoods, 51 percent of the borrowers rely upon subprime loans compared with 9 percent in white neighborhoods. But more interesting is a statistic when you control for income.

And just focusing on borrowers instead of neighborhoods, low income borrowers, 49 percent of white borrowers rely upon subprime lending. Upper income black borrowers, 25 percent rely upon subprime lending. The 25 percent for upper income black borrowers compares to 13 percent for low income white borrowers. So you get this disparity that if you follow the mortgage denial rate studies over the years, there is this disparity that upper income black borrowers have higher denial rates than low income white borrowers. You get the same disparity

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here.

And going through the process with the HUD/Treasury report, people kept asking us, well, once you control for credit risk, these disparities might disappear, if you had FICO scores or some additional variable in addition to income. And the disparities might be reduced, but this is why I jumped in before the Freddie Mac person here, because much of Freddie Mac's research I think has been doing the more detailed -- with additional controlling for FICO scores and variables such as that.

MS. GATES: So what did we call me, Emerging Housing Finance Company? So now I know how short seven minutes going, based on the experience of my colleagues. I'm going to just cut to the chase. Freddie Mac, as you know, is a GSE. We have you all looking over our shoulders, thankfully. Got Fannie Mae over here.

Involved in subprime lending, we have done prongs of policy research around this that really stem from your mission, which is one, to ensure stable supply/low cost credit, and secondly, to expand home ownership opportunities. So in 1996 when we began looking at the subprime market, we looked at it from two perspectives. One, the market

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perspective and, two, from the borrower perspective.

We've got a limited program going on

there, and we gathered some data but not as much as we would like. Subprime loans are rather new, they're unseasoned, we don't have a lot of experience with them and this has all been in a very good credit environment, so it's difficult to put models together and figure out in the same way that we're able to do that in the prime market.

But let me tell you what we've found so far. First, it's a confluence of many factors, as people have been saying. Inefficient market, underwriting standards are not standard. One person is C, another person is A. Lack of understanding of what's happening in terms of the risks of this market. I've been doing some research on prepayment penalties and looking at why these things exist and are so prevalent in the subprime market and it does seem that the handling of prepayment risk is a very different animal in subprime.

I'm particularly talking about it's not just an interest rate thing. People want to credit cure in this market, and rightly so, and they hold that knowledge themselves. Very hard for investors to model it themselves, figure it out, hedge it with

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financial instruments.

So other things are going on there in that market that make it very peculiar and very different from a prime market. The foreclosures are simply clear evidence of, I think, a lack of understanding about the credit risk of these mortgages too. A lot of stretching, a lot of pushing the limit on what the borrower can handle in terms of capacity to pay.

Now, is it intent? It could be. And I appreciate your comment about these are predatory loans as opposed to predatory lenders deliberately doing this. There probably is -- there certainly is a malevolent intent on the part of some predator lenders. However, we're seeing in the broader context of just continual stretching, not just in subprime but in prime markets as well, push the limit, get the loans in. And foreclosures are not good news for anybody, whether it's the borrower, the community, the lender, and certainly not the investor.

And these kinds of foreclosures are really the first fruits of a very, very difficult situation, and no one would call that a profitable strategy. No predatory lender could defend that kind of strategy. Really difficult kind of thing that we're trying to

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model and trying to get our arms around so I really appreciate this information about that.

That's a market side and there are lots of things to do there. When we look at the borrower side, however, we've done two series of focus groups, one in 1997 and then one this past spring. The 1997 data really corroborated some things that Howard is talking about, what we saw with the higher preponderance of lower income and minority borrowers in this market and other demographic information.

What we went on to focus in the spring was what did borrowers really know about what they're doing and what they're getting into and we did focus on prepayment penalties as a proxy for many other mortgage terms that are out there. And I sat behind the glass wall in one of these, and it really is something that there is a large lack of familiarity with these kind of products and they're very complex, particularly prepayment penalties. There is a lot of work to do on that.

So what are we doing? I think that Fred did I's initiatives in this area stem on the market side and on the borrower's side. No credit life, no HOPA, require credit reporting, really begin to influence the market where we have a total in that

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market. On the borrower's side, we've got a Don't Borrow Trouble campaign that's running now in 12 cities. Borrower awareness, borrower education. It's not the be all, end all. It will not solve the problem but it's got to be a two-pronged approach.

MS. ADAMS: First of all, I want to get on the record and set the record straight that subprime lending is alive and well in North Carolina. I have heard rumors at the HUD/Treasury hearing that subprime lenders were saying that they had run away from North Carolina, and that the market had dried up and no one was getting loans because we had passed our antipredatory lending bill. It's just not true. It's all a fake, it's all unsubstantiated and corroborated by any statistical data that would support it.

There has been a drop in the subprime market. It was interesting to me that at the fed hearings, the subprime lenders were saying, well, we don't need any regulation and any tightening up of HOPA because the subprime market -- because of that rise in interest rates, you've run all the predators out so we don't need anything now. Well, that's the explanation they gave at the fed hearings but at the HUD/Treasury hearing, the reason that the market had

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dried up in North Carolina was because of our law.

Well, I would say that it was because of the rising interest rates. And we'll have to wait until the data comes in at the end of this fiscal year and next to see if there is a disproportionality to the drop in subprime in North Carolina versus the drop in the market as a whole. I don't think we're going to see that.

In fact, I'm a little disappointed because we had hoped that our law would prevent predatory laws from being made, yet last month, in one of our HUD ravaged -- our flood ravaged counties. Sorry about that. Love HUD, love HUD. One of our flood ravaged counties, we had a predatory lending counselor because part of our legislation said that if you're going to get one of these bad loans, you have to get counseling first.

In a three-week period, she received calls from 16 borrowers, under our new law, with these loans. We need alternative products to subprime. What hasn't been talked about here is the fact that -- well, it was alluded to is that this is an extremely inefficient market. Freddie's studies, Fannie's studies, the Office of Thrift Supervision studies say about 40 percent of the borrowers in the

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subprime market do not belong there. They could have gotten a loan in the prime market.

And what's interesting to me is when you talk about the disproportionality, when you're talking about 51 percent of African-American homeowners are getting their loans from the subprime market and 9 percent of whites and then you talk about a market inefficiency rate of 40 percent, it disproportionately impacts on the black community. It negatively impacts on my neighborhoods. And when I look in my neighborhoods, they look like war zones and they are. They're economic war zones. And there are malevolent lenders. I always have to do my cause of the day, which is the Associate-Citibank merger, which the comment period ends tomorrow so please get your comments in today.

But I've done substantial research. I've contacted 26 banking commissioners from across the country and said, just share with me what you had on file. In Washington state, they had a complaint where there were $10,000 worth of fees on an $11,000 loan, and the Associate says that this was a good loan for the borrower because it lowered their interest rate by 1 point. I mean, if that's not malevolent, I don't know what is. That's not only a

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predatory loan but I believe that's a predatory lender.

We need strengthened CRA because we couldn't comment on this through the CRA process. This purchase by Citibank of the Associate is not controlled by CRA. We need stronger CRA, we need stronger HUMDA data. We need to know who is making these loans. Many of the subprime lenders don't even have to report their loans under HUMDA. We need to know how big this market is. We need HUMDA to be expanded to include what the interest rate is and we need it to be expanded to show some things. We need to get rid of single premium credit life, HUD/Treasury, places don't back off of this one.

Single premium credit life insurance is one of the worst things. It has no benefit to the borrower. None, zero. And I can tell you that in looking at the documents I got from the different insurance commissioners and banking commissioners across the country, they are not paying off the loans. They are not paying off the credit life at what the lender credit life is valued.

So I must please end now. But these are the things that are going on. Again, I want to urge you, fight this in your neighborhoods, get

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legislation passed at the city level, at the state level, and we need to work for federal legislation. Thank you.

MS. HEMINGWAY: Just as Stella had said before, one of the things ACORN, being we are a national organization that is in 25 states and 34 cities, and we are community residents who come together that fight for any issue that impacts on our communities, predatory lending being the one that we're here to talk about.

The extent of this problem in our communities is huge. This may have been said but it is important enough to repeat. The data which HUD has reviewed, and which we have put together at various times, tells us that 50 percent more of refinanced loans in many ACORN neighborhoods are coming from subprime lenders. In the Bronx in 1998, 60 percent of the refinanced loans made to low and moderate income African-American homeowners was from subprime lenders, as was 43 percent of the refinanced loans to low and moderate Latino households. In Brooklyn, the number was 72 percent for African-Americans and 60 percent for Latinos.

As others have said before, not every subprime loan is a predatory loan. There is a good

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place for good subprime lending. Unfortunately, however, our experience in our neighborhoods tells us that the predatory lending is not a problem on some outer fringe of the industry. It is a problem with many of the loans.

Some of the terms are totally outrageous, like interest rates of 15 and 16 percent, even higher, and surprise balloon payments at the end and points and fees costing up to 20 percent of the loan. Others are not that outrageous but that doesn't make them okay. An interest rate of 11 percent for a borrower who could and should be paying 9 percent is not okay. It's tens of thousands of dollars being taken from families and neighborhoods who need them the most. This is not a market where competition has worked to give people a real choice.

The more we talk about our neighborhoods, the larger we realize what the problem is and the more we realize that we need a range of solutions. The high foreclosures numbers are terrible, but it's important to think also about the cost for the people who are being ripped off, but who are not paying these loans. For every person losing their home, there are many more paying on time by working three jobs or using the savings that they intended to use

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for their old age, or losing the equity that could have been paying for their child's education.

When loans which have people paying tens of thousands of dollars more than they should be paying are so heavily concentrated -- and so heavily concentrated in communities which are already behind economically, we all have a very serious problem.

What is ACORN doing and what needs to be done? We are attacking this problem from many angles. We think we need more legislation like North Carolina now has to outlaw clearly predatory practices. We are working and will be working on federal legislation and our state legislature, and we are working on local legislation too. And we think we need improved regulatory enforcement too. We have been pushing for this.

We also are taking our concerns directly to the lenders and to the Wall Street firms who buy these loans, demanding that they adopt ethical business practices. And we are also educating our members and making sure they know what to look for in a very direct and individual way.

In all of these areas, we think keeping up the pressure on lendings will make aid loans more available in our community, is a key piece. There is

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something wrong when the overwhelming majority of banks give satisfactory and outstanding CRA ratings for meeting community credit needs and when, at the same time, we can see that a significant number of those getting subprime loans could qualify for A loans.

What did this tell us? That we are still living in a world where there are two different financial systems, one for white people and one for people of color, one for wealthier people and one for poor people. Let us talk a little more in detail about two relative pieces of what we think of what we're doing.

Our organizing is neighborhood-based organizing. In our neighborhoods, we are trying to do many things at once. With regard to predatory lending, when we talk with people about it, we are trying to spread the word about how people can protect themselves. At the same time, we are trying to turn people's bad experiences into fuel for changes in the future so that people don't just feel bad or stupid or embarrassed about getting a bad loan. Because the truth is, this is how people feel.

They feel like it was their fault. But they can all join together with their neighbors, use

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their experiences to warn others and use their energy to fight for changes that will help remedy this situation.

One part of this is getting people involved and taking the problem directly to the lenders. Demanding change, exposing problems where we see them, asking regulatory and others to look at these violations. Over the past year or so, we have paid a lot of surprise visits to predatory lenders and to offices of Wall Street firms which fund these loans, making sure they understand that we hold them responsible for the damages being done in our communities.

Another is getting people involved with educating their neighborhoods, spreading the word so that in our neighborhoods, like in Chicago, for example, neighborhoods were making predatory free zones. That is, we have block captains on every block who are taking responsibilities to speak to people ability predatory lending, to tell them that there are alternatives out there and to tell them where they can go for help as well as to involve them in the fight for changes. We think this is the kind of education and outreach that can be part of making a difference.

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One lender we have talked with so far has agreed to set up a start in this business, and that is Ameriquest. Ameriquest, who is one of the -- is the largest subprime lender in this country, has agreed to a lending program, including loan counseling for every borrower, which would be the only lending that would be done in neighborhoods in 10 ACORN cities. The loans will have an upward limit of 3 percent on points and fees, there will be no credit insurance, there will be no prepayment penalties and the interest rate will be lower than on any other subprime loans out there because this will be discounted on the rate and because there will be no overages.

This is the only loan product which Ameriquest will sell in these neighborhoods. We are choosing -- and every single borrower will get loan counseling before the loan so that the borrowers who qualify for A loans will get A loans, and those who can't get a loan that makes sense from Ameriquest -- and some folks will probably counsel not to make out a loan at all.

The company also agreed to formally adopt a number of good best practice principles, including, for example, not selling credit life insurance for

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all of their loans and to support legislation to raise the bar further for everybody.

MR. FISHBEIN: Thank you very much, Carol. And I want to thank the panel for excellent presentations. The structure for this -- there is a reason why we have this center table. We're going to give an opportunity for folks at the table, if you want to make some brief comments in response, preferably to some of the things that the panelists said, we're going to give you an opportunity if you want to use it. You don't have to feel obligated, but we want to give a couple of you an opportunity to respond. And then we're going to work in the broader audience as quickly as we can.

This is a policy conference. There have been a lot of public policy implications for the things that have been said here today, and I just want to encourage you to kind of think in that context about how does this inform public policy that might be needed or whether public policy is needed in particular areas. So I want to give folks around the table an opportunity. Show of hands? Can you introduce yourself too, please? And you will have to speak into the microphone.

UNIDENTIFIED SPEAKER: Thank you, Allen.

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Thank you, HUD, for putting together this forum and giving us all an opportunity to be able yet again to talk about the implications of this terrible practice that's overtaking the industry and hurting so many communities and so many individuals. And thank you for giving me this opportunity to talk a little bit about what we're doing at Fannie Mae to address some of the various things that were raised in the comments that came up.

We have an 8 point strategy at Fannie Mae to try to combat and do what we can from where we sit in the marketplace. Let me go over real quickly what those 8 points are. First, we designed business guides to help inform the business that we will do in this market, we're helping to bring conventional conforming practices that can combat many of the practices that have been discussed around the table by the speakers. We have an aggressive mortgage consumer bill of rights that we're promoting. We have a broad product offering to offer alternatives to the subprime products -- excuse me, to the predatory products that are being offered in the marketplace.

We have an effort to maintain home ownership as a guiding principle in what we do both

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in terms of product design as well as servicing which in the end helps in the area of combatting some of the foreclosure practices you have spoken about. We're using technology and leveraging technology to help expand home ownership, bring more consumers into the A market, make them eligible to access credit in the A market and bring down the cost of financing.

We're also helping with home buyer education. At the corporation, we do that by partnership with intermediaries that work with consumers, and then, finally, we support the Fannie

Mae Foundation, which goes and works directly in informing consumers. Particularly right now, they have a broad campaign on financial literacy.

We also -- in terms of our business guide, we have our lender letter which addresses, again, many of the practices in terms of our policy and what we have done for our business policy. We will not buy loans where there has been steering. We will not buy loans where there has not been a check on the consumer's ability to repay that loan. We will not buy loans with excessive fees, with prepayments that have been offered without value to a consumer. We will not buy loans with single premium credit life. We will not buy loans where the servicer will not

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accurately and on a timely basis report regarding that consumer's payment so that they can credit cure and work their way into the higher markets.

We have a product, most recently, our timely payment rewards product specifically targeted to helping consumers with blemished credit that offers a lower cost alternative that can save as much as $200,000 over the life of the loan over the other alternatives that are available in the subprime market. We have technology tools such as the true cost calculator which helps consumers compare and contrast the mortgages that they're being offered so that can help them understand what they're moving into.

That's a real quick summary. I can go into a lot of detail for almost an hour, but I don't have that much time. So thank you for the opportunity.

MR. FISHBEIN: Do we have any other hopefully brief comments from folks? Mike, can you introduce yourself?

UNIDENTIFIED SPEAKER: I'm with the Office of Fair Housing and Equal Opportunity at HUD, and I would just say these studies just kind of reinforce the anecdotal evidence on the targeting by

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neighborhoods by race which comes as no surprise to us. I would like to compliment ACORN on their work, especially in terms of what they're doing on Wall Street. The GSEs are subject to a lot of scrutiny and have taken some proactive measures but the private label end of things would almost seem to be getting off scot-free, but ACORN's shedding some light where I think people don't want light shed and hopefully is having a good deterrent effect.

MR. FISHBEIN: Any other comments?

MR. CLAY: I have a question.

MR. FISHBEIN: Can you introduce yourself, please?

MR. CLAY: Phil Clay from MIT. I've gotten different -- I haven't read the report, I have just received it, but I'm wondering if we have a clear idea of where all the money is coming from. The presentation yesterday suggested that it's a lot of money. And I know Wall Street is the source of a lot of money, but some of these operators sound like they may be getting money from other places and I wonder if there is a large enterprise.

And the second question I have is, has there been research that would determine what the motivation might be for some of the predatory

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activities? I know in the Boston area, some of the community studies have suggested that some of the subprime lenders may be in a kind of -- I hate to use the word conspiracy but something like that, where if you have an elderly person who has almost paid off their home, for them to foreclose is a real windfall for somebody along the way. Maybe not the bank but certainly the developers and others who we don't know quite who they are who are somehow involved in the process.

So I hate to sound conspiratorial, but I sense that there is a lot more money than is explained by Wall Street and that there must be something other than a fast buck behind some of the schemes.

MR. FISHBEIN: Stella, it looked like you were ready to respond to that.

MS. ADAMS: Ready to go. I believe in conspiracy theories, but the money trail is a whole lot easier to find than that as it relates to subprime lenders. Most of the subprime lenders in this country that do not receive their financing through Wall Street, because, as you're right, Freddie and Fannie are not in the market heavily at all, but most of them get their financing directly

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from prime lenders. The same lenders who will not lend, in our neighborhoods, the A loans will gladly take that black A borrower from the subprime lender with the 2 or 3 or 4 percent extra interest rate that's on it.

First Union was a major lender to Delta Funding, to United Lending Companies and to the Money Store before they purchased them. Bank of America also funds numerous --

MR. CLAY: Subsidiaries of First Union.

MS. ADAMS: No. The Money Store became a subsidiary of First Union but first they were a lender. They gave them a warehouse loan, and they lended money to them to keep them liquid. Then, when the Money Store got in a little trouble, they bought them and thought they could cure it, and they ended up closing it down because it wasn't profitable once they cleaned it up.

But the prime lenders are in this market. They are making loans to these people, and they're keeping them liquid. All of the major predators who have been caught and cured have ties to Wall Street and to major financial institutions.

MR. CLAY: Why is this not a violation of CRA in the sense that not only are they not helping

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address the credit needs, they are undermining credit? Or is that not against the law?

MS. ADAMS: For a long time, they were actually getting credit for making these loans. We have, thanks to the light that HUD/Treasury's put on it, the light that the fed has put on it, are hopefully getting the regulators to stop that.

MR. IMMERGLUCK: Just to add to what Stella said, in our Chicago study, the five largest subprime lenders in minority neighborhoods, all but one are currently bank owned. So what's happened in general is they've started out as independent companies, they have raised the capital through Wall Street through securitization that's relatively costly capital. Banks have access to cheap funds, they start making loans to these guys and they say, hey, I can provide them capital cheaper if I own them. They buy them and they become part of them and the Citicorp-Associate is what that's about, what Money Store is about, that's what Equicredit and BankAmerica are all about. In fact, Equicredit recently became part of, not only a subsidiary, not only an affiliate but actually part of BankAmerica's largest bank, the actual bank itself.

In terms of CRA, there is something in CRA

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regulations that say CRA doesn't cover mortgage companies, subsidiaries or affiliates. Even if the bank owns it completely, it's at the bank's discretion whether it wants that activity to be reviewed for CRA. One of the things that it does cover, though, that is covered, is through fair lending regulations. There is nothing keeping federal fair lending regulations from looking at the race-based differential patterns between an affiliate or a subsidiary and a prime unit and a bank. It basically hasn't been done.

If they're an affiliate, this kind of arms-length affiliate, it's the fed's responsibility and the fed has said they don't want to do it basically.

MR. FISHBEIN: I also note there are a number of recommendations in the HUD/Treasury report that go to this very point, commend to your attention. This is a good segue into questions for the panelists. If we have other questions, we'll open it up.

MR. SCORZAK: It's Bob Scorzak from Housing Development Reporter. The discussion of the relationship between subprime lenders and banks and CRA raises an interesting question, I think, and that

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is the tremendous estimates of the amount of CRA-related funds that have been generated over the last 10 to 15 years in the hundreds of billions and then perhaps even more. I guess the question becomes, what proportion would anybody be willing to guess of that might be from subprime lenders?

MR. FISHBEIN: Anybody want to take a crack at that?

MR. BUNCE: CRA, for example, subprimes is mainly home purchase. It's not -- it's about 20 percent home purchase, 80 percent refinancing. And these are, for the most part, I think independent mortgage companies. Is that correct, Randy?

MR. SCHEESSELE: Yes.

MR. BUNCE: So these would not be part of the CRA game in that sense.

MR. SCHEESSELE: I would think from the past that not much of it's been CRA, credited towards CRA. And going forward, there may be increases but in the past, there has not been that much CRA in subprime.

MR. SCORZAK: Going forward because prime lenders have been doing a little bit more subprime?

MR. SCHEESSELE: Right.

MR. FISHBEIN: Questions? Yes.

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MS. TYSON: My name is Shealia Tyson. I'm a community builder in Detroit, Michigan, but I'm also on a mortgage corporation task force here in the District.

I have two questions. In terms of a study that was done on the foreclosures in Atlanta and Chicago, do any of those states have redemption periods in terms of foreclosure?

MR. IMMERGLUCK: I think most states have redemption. I don't know if there is anybody else in the room who will speak to that more directly.

UNIDENTIFIED SPEAKER: There is a redemption period in Chicago.

MS. TYSON: There is in Chicago.

MR. IMMERGLUCK: I think Georgia may be a faster foreclosure state. The Chicago study actually had completed foreclosures. The Atlanta study had notices of option sales so they were earlier in the process. So there wasn't actually a lot of houses at that point, but it was the best indication we had of the trends in foreclosures.

Now, one comment I just didn't have the time to make on Chris' stuff, on the foreclosure study, at least I've looked at the Atlanta study and the Chicago study, and the Chicago study most

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closely, and I notice more about the Chicago study than NTIC did. The proportion foreclosures due to subprime is certainly underestimated because the loans are -- the lender is identified as the current mortgagee, not as the originator. I mean, that's what you have in these data.

And actually, one of the largest lenders listed in the Chicago study is considered a prime lender and they are very large. They account for a substantial percentage, maybe 5 percent of the foreclosures, and they're classified as a prime lender. But there are many other prime lenders on the list that I talked to and said, we didn't originate those loans. They act as trustees and they show up at foreclosure and they bought the loans. So some of these data, at least the Chicago study, and NTIC is the first one to admit this, underestimate the portion that's subprime.

MS. TYSON: This leads me to another question which is actually about servicing. How do you tie the servicing into this? Because oftentimes we found out, when a foreclosure is in process, you can't even identify who the lender is.

And I have a question I want to ask Freddie Mac. I agree with you the terms are

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stretching. I do see a lot of stretching and we do think that pushes the limit in terms of real estate people and mortgage companies. But in terms of Freddie Mac's loss mitigation, is it true that Freddie uses 30 days? You can say a loaned default in 30 days as to --

MS. GATES: I was just looking at transition rates. I can't answer your question directly. I'll get back to you. But I do know that the transition rates from current to 30, 30 to 60, so forth, are much faster from what's in the prime market and we've got an early indicator system that tries to identify Richmond and Rhode Island and I think trying to get in earlier at 30 and 60 and pulling them back out is the objective on that but the skeets are much faster than current to 30.

I want to get back to your specific question. So many of them cure and go right back up, but there is a differential between how many of them are able to come back up.

MS. TYSON: Thank you.

UNIDENTIFIED SPEAKER: I have a question I wanted to pose to the panel. We've heard a lot of discussion in the research that's been done about the concentration of subprime in particular

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neighborhoods, in particular markets, and heard some suggestion about the implication. What should be done about that as a matter of policy, if anything? What could be done? Should the emphasis be on finding ways to increase prime lending in those markets or educating consumers about options or what are your thoughts? And I open it up to anybody who might have a comment on that.

MS. HEMINGWAY: I think it's a combination of things. Certainly the prime market needs to be looked at in terms of the fact that they are not directly lending money in our communities. Why is that? Why is it, you know, okay, or why are these people getting these high marks on their credit reports about what they're doing in our neighbors when actually that's not the case?

The other thing, in terms of educating the community, you know, I've been listening at different workshops and listening to speakers today talk about this whole racial discrepancy, the neighborhoods, the different issues and I constantly say this whenever I get the opportunity. It is very nice that we all come together from organizations, from different educational institutes and sit down and talk about how we should deal with this issue.

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One of the things that people need to get down pat, start having think tanks in the neighborhood. People will tell you what needs to happen. The community members can tell you what they need. If we're going to talk about regional planning, state and local planning, I sit on a task force for the Department of Transportation and we talk about the regional planning commissions. And one of the first things I noticed about these different commissions was the people who sit on there.

They would be industry heavy, people from the construction industry, people who directly had some kind of monetary investment in what happened in these different planning situations. The people who were missing were the people that this directly impacts, those people in the communities, in the different neighborhoods that this planning will directly effect. And until we get that down, that that is an important piece I think that needs to happen, we're going to always have this, like, missing gap and wonder why these different plans don't work when we talk about -- for whatever reason. So I think that is an important factor.

MR. FISHBEIN: Anybody else?

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MS. ADAMS: I think education is important of the buyer, but I don't know that you can -- this is not a problem that education is going to cure because people need money. That's why they get trapped. They need money. And so we can educate them about the fact that this is a bad loan, but if you have no other financial alternative and you need money, what are you going to do?

I have a recommendation, a policy recommendation from my friends at Freddie and Fannie and that is that you expand who you do business with and do more of your business with small community banks that are in these neighborhoods with minority banks. Right now, about 75 percent of all of your paper is with the 25 top lenders in the country.

Well, trust me, they're not serving these neighborhoods and these communities. But there are smaller community banks and maybe it's not cost-effective for you to partner with one of these banks, but maybe a regional consortium of little banks, community banks, partnering especially in rural areas, would give an alternative to the predatory lender.

In North Carolina, there are 12 northeastern counties where there is only one lender

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that's big enough to attract your attention. They have 100 percent of deposits in these 12 counties. They don't have 100 percent of loans. They have something like 20 percent of the loan volume that's coming out of these counties. The predators are getting the rest, but there is an opportunity. There are a number of minority credit unions up in those areas. There are a number of CDFIs up in those areas that maybe they could pool together and do business with you, if you could design some products that could reach these smaller entities that would serve these communities.

UNIDENTIFIED SPEAKER: We've talked about -- kind of alluded to a lot of kind of fair lending approaches, CRA approaches to get prime lenders involved. More aggressive fair lending is I think -- a few high profile lawsuits will do a lot. But at the end of the day, if a mortgage broker can make five or $10,000 on a loan and a prime lender won't work with that mortgage broker because he won't pay that, then that mortgage broker will work much harder than that prime lender to make that borrower a loan if he knows he can snooker them into a deal.

And so if you basically have some market failure where folks, either because they're desperate

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or less sophisticated, will take loans where they're paying way too much, I'm going to bet on the mortgage broker every time, even if there is regulatory pressure on the prime lenders. So unless we do something about the basically exorbitant profits available to brokers on the origination end, I don't have good prospects for all the other efforts.

MR. FISHBEIN: Can you introduce yourself?

MS. MARTINEZ: Sylvia Martinez, Federal Housing Finance Board. I think it's very telling what Jim Carr brought up in terms of a whole host of financial industry practices in certain communities that tend to reinforce each other. So when you posed the question as to whether it's education or whether it's some other alternative, I don't think it's an either/or question. I think it's both.

And I also think it's important to make the marketplace work. And for those of you who would have some hostility to that, let me tell you that in the marketplace you have competition, and what's lacking in those communities is really viable competition for not only consumers education but also competition. And to the extent that you can catalyze financial intermediaries that will work with both the lender and the borrower, it may be for an infinite

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period of time. Maybe the measure of success is when these institutions are able to hand these borrowers over to the prime lender.

Some of the small -- I think the issue of lawsuits may make some people take notice but they find some ways around it. And if you can empower the consumer with competition, with knowledge as part of a comprehensive community package, not just dealing with mortgages but dealing with financial -- I hate to say literacy because it's a very condescending term, but financial power and understanding of what's going on in the communities. I think that's the way we're going to make inroads, and not some of the this or that approach but a comprehensive approach has to be community based.

MR. FISHBEIN: Any questions? Is there a hand over here? Yes.

MS. MERRILL: Sally Merrill with the Urban Institute. I have a question that I really need to ask that turns this on its head a little bit. I do international work and, in fact, I'm about to leave for South Africa. The term predatory lending I'm sure is going to grow up there fast enough but right now, it's got a positive phrase. It's called risk-based lending and in fact it's encouraged. The

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mainstream banks are subject to usual laws but, in any event, it's primarily I think the community banks, the credit unions, the CDFIs in partnership with community groups that are going to be serving a lot of the low income market, and there have been genuine good faith efforts to figure out what the cost of increased transactions are, whether it's underwriting servicing council or whatever, as well as the genuine costs, nonpredatory, of paying for situations of increased risk. And I don't mean bond boycotts. I mean it in a little more conventional sense.

Do you know of any way that helps quantify the segue from what I'm calling risk-based pricing on a real sense into a predatory situation? There are genuine modeling efforts going on in some of these countries that need help.

MR. FISHBEIN: Let me just frame this a little bit and I'll give you a chance. A lot of research you heard today is about subprime lending done here, the same kind of research being stated about the abusive -- the part of the market that's abusive or predatory. And there is a reason for that. I think there is much less data in that area, but I think you raised an interesting question.

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Anybody want to comment?

MS. ADAMS: Didn't you all do some risk-based pricing studies, and you found that there is like two and a half points? Was that Freddie? Sorry. That there is like two and a half points of real risk associated with a subprime loan and that that risk falls as the equity increases in the home?

MS. GATES: We can get you a paper that was done by Peter Zorn and others at Freddie, and this was part of the survey research that we did looking at intrastate differentials that was followed up by focus groups. And what I think we're talking about here is there was a fair chunk of the interest rate differential that would be explained by interest rate risk and credit risk in addition to servicing. Servicing is at least 25 basis points on this kind of loan.

I think, Stella, it was that there is still about 200 basis points a year that's unexplained by just pure risk factors and so that's the next step is to go try to parse that 200 basis points to 50 and see what extent is that lack of efficiency. This competition point is very well taken, that this is kind of how the prime market was 20 years ago. There was just a lot of squish in the

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interest rates that borrowers were paying that was just partly a reflection of the lack of efficiency. And that has really tightened now, and that's why it's tough to get a loan in the prime market and why so many people have gone to subprime.

So part of that may be just a lack of competition in efficiency and what was automated to us, the lack of underwriting standards that you could compare apples to apples across the board. That's not there in subprime and you're going to pay for it. But secondly, there is probably a predatory piece of user league that's in there. We haven't quantified that yet. But that is the next research frontier here.

UNIDENTIFIED SPEAKER: Just a quick follow-up on that. Fannie Mae and Freddie Mac have made estimates of what percentage of the subprime market would qualify as kind of prime conventional loans. That's an issue I think that, in terms of Allen's questions about solutions, that it would be nice to publicize that research. I know in talking with Peter Zorn, you guys are tagged with a 35 percent estimate, but he said he hasn't looked at it in a while. And I think Fannie mentioned that half of their minus borrowers or something like that might

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qualify.

But it seems that as you get data, because you are now purchasing subprime loans, research like that would get at this question, the feasibility of solutions by the prime market or by the GSEs themselves.

MR. BUNCE: I think, just to follow that up, people kind of forget about the likely overpricing in the C and D or the B, C and D sector, meaning if I'm seeing a lot of A credit priced at a minus, then I'm going to expect to see a good amount of B credit priced at C. And in fact, this RTS study that came out recently looking at this data shows a huge amount of overlap in FICO scores when you look at the A, B, C, D, that it steps down, but every time you step, there is a huge amount of overlap between the sections.

(Inaudible.)

MR. FISHBEIN: Lisa. If you can get near a microphone, that would help.

MS. MCGUIRE: One other piece that the question of risk and pricing, when we talk to lenders about this, even if people start off defending their pricing as risk-based, they also have to admit at some point that mostly they pay -- many people in the

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process are paid based on -- at least part of their composition is an incentive system based on how much they can charge the borrower, whether that's an interest rate or points. So that the rates that people end up with are driven -- there may be sort of a baseline rate but in some way, although not based on particularly extensive data, is related to risk, although rated to risk calculated based on loans made under deceitful circumstances. So sort of what looks like the risk associated with the borrower characteristic is probably risk associated with having lied to people about their loan.

Another whole segment of the pricing is about the fact that a couple of different people along the way were making money by charging more.

MR. FISHBEIN: Introduce yourself, please.

MR. FREDERICK: Bruce Frederick, the Conventional Research Service. I just have a comment. I guess I kind of have a question. Would return to usury-isms be any kind of solution?

MS. ADAMS: Yes, yes, yes.

MR. FISHBEIN: Anybody else?

MR. CROSS: Anthony Pennington-Cross, Research Institute for Housing America. This is a really good point. You have to ask yourself, what is

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a socially acceptable reform rate on subprime loans. You're talking about C and D loans that can default at rates up to 20 percent. Is that policy today, that 20 percent default rate, acceptable? Is that usury? That's a very important question. And the regulators have to decide what is a socially acceptable default rate.

UNIDENTIFIED SPEAKER: One is what's a acceptable default rate, and another is doing usury laws.

MR. CROSS: Usury at high interest rates of the loans that are the high default rates.

UNIDENTIFIED SPEAKER: It's a little more complicated than that. One of the things that leads to high default rates, high foreclosure rates, is not interest rate regulation, but the ability for mortgage brokers to make very high fees on the front end. In a system where the originator can make very high fees on the front end and doesn't -- in fact, the worst loans that we see, that we've reviewed are not loans with particularly high interest rates. They are loans with very high fees that are termed. Those are the ones that we feel default quickest and it's because folks are not placing the risk into the interest rate and they're placing up front. That's

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why these loans are foreclosing in one or two years.

MS. FITZGERALD: My name is Eileen Fitzgerald with Housing Investment Trust. I was just wondering if Fannie and Freddie, given that the relationships between the subprime and the prime, I understand that you wouldn't purchase loans that were not acceptable, but do you have any oversight of the various alliance partners in what they're doing in the subprime market even if you're not purchasing them?

MS. GATES: I think our main focus is it's too far gone. In that prime market, anyone who is a Freddie Mac seller servicer signs on the dotted line that they're going to adhere to our policies. When they sell us loans, they provide us representations and warrants that the loans are not discriminatory, they're not predatory, they're not, no, no, so on and so forth. That is not foolproof, but that is where we begin, from there to the due diligence process where we do on-site monitoring. And now that we're getting an understanding as to what we're looking for, when we go to a prime should be that's got subprime or we go directly to a subprime counterparty, the checklist has gotten longer and that's where the HOPA funds come into play.

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Even when we won't buy HOPA funds, we want to make sure that for those folks that got HOPA, that that loner disclosed them right. Now, we don't do this with those who are doing HOPA. We don't buy it. But there is a lot you can look for under the sheets when you go into these on-site reviews. There is also credit life. And many of them haven't been attuned enough, even though it's politically correct to say, because they'll say, we really love those HOPA loans, and that's the last time we talk. It's very eye opening what you do when you go forward.

So let's say that if you're going to be a seller service center, there is a higher buyer settlement fee with Fannie Mae that you've got to fee

with and then, in addition, if you're in the subprime world, additional requirements on that. It's really a tiptoe through this, and as you've heard, we're not doing a whole lot in that market, but the goal is to begin to influence and become a lower source of financing and to open up competition. In addition to products that Fay has mentioned, we have them as well to create choice there. It's a long-term vision, but that could make a segue into some policies. The long-term vision is to improve the market, make it more involved. And we in Fannie have done that for
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years in prime.

But the short term, there has got to be some protective measures and credit life is one of them. Extra regulation of these entities would help us because we're certainly not able to be pure regulators of nonbank institutions, expanding HUMDA reporting, that there is better data. A lot of us are doing all sorts of gymnastics to get data on a subprime loan rate. It would be helpful to have that required.

And finally, just more punitive monitoring of the legal situation will help when there are underwriting talents involved. That certainly is a part we have to address.

MR. FISHBEIN: Sylvia?

MS. MARTINEZ: This is back to Harold's first question, the question in terms of what needs to be done in research, and I think the story is not in when it comes to reasons for default rate on subprime loans. Obviously if you have exorbitant fees, especially for predatory loans, that doesn't help a borrower, but I think there are other factors that may go into it and until we understand the cause, we may not be able to design the solution, especially when you're trying to get forbearance
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practices within the loan to be able to determine whether this is a household that can keep the home, and it's just a temporary setback or it's going to be something that's going to stay with that household and they would be better off not trying to keep that mortgage.

And especially when you're dealing with poverty communities that have had a dose of financial services, you run into the challenge of trying to find out what's happening to that household budget. You may have someone that has a low interest mortgage with an essentially reasonable fees that are more risk related than others. But if, on the other hand, that car loan is costing them an arm and a leg in fees because they were unable to get consumer credit, that's going to show up perhaps in default. It might be a default first on the car loan but if that means employment is lost, it becomes sort of a cyclical problem.

And so as part of the research agenda, what you really need to do is start following up what's behind some of the default rates. We also want to prevent it, but also what is behind it and I don't think we have a complete story on that.

MR. FISHBEIN: Comments?

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UNIDENTIFIED SPEAKER: I would like to make a comment on the usury-ism. As he was saying, in addition to the fact that interest rates were low, we need to redefine interest rate to include fees as part of the percentage rate. In fact, the interest rate is higher.

UNIDENTIFIED SPEAKER: It probably depends on how you define APR, but since APR doesn't include lots of things people end up seeing as fees, essentially fees, like credit life insurance, that's a problem. The other thing is, fees can be quite high without the APR moving up much. And this comes up in the kind of HOPA discussions as, do we include yield spread premiums and points and fees since they're kind of already captured in the interest rate or in the APR. And Mia Greenwich said you shouldn't think of it as an either/or because one point on points and fees can have a lot more impact than putting that into the APR. It's not as simple as interest rate usury.

I do think some way, you know, the HUD/Treasury recommendation of financing no more than three points and points and fees is the way to go and the North Carolina model is the way to go. I think it's much more important than looking at any kind of

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interest rate regulation. I think risk-based pricing, pushing things towards more interest rate sensitive financing rather than loading things up front is going to -- will have a big impact on responsible lending. A positive impact.

MS. HEMINGWAY: Years ago there was an article in The Washington Post on Capital City Mortgage. The last five years, we've been leaving a lot of victims. One of the things we do here in D.C., we came up with a welfare disclosure form which we're pushing to the city council right now, and it is our hope to get the real estate community to mete it out. The welfare disclosure will reduce things such as credit loan points and fees because we found out a lot of people didn't even know what kind of loans they had. So we figure starting there will at least educate the public what are the characteristics of a predatory loan as opposed to trying to define it.

MS. ADAMS: Talking about disclosure forms.

MS. HEMINGWAY: Disclosure. This is an education pamphlet.

MS. ADAMS: A disclosure form really needs

to come from a disinterested third party and needs to
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come real early in the process. Otherwise, it's just a license to steal. One of the things that we saw as we reviewed loans in North Carolina, as we looked at loans, is that they met a lot of the loan provisions, they met the thing and had the people sign that they had done the disclosure. I had a client, she actually had the letter. She was an elderly lady who was a paper rat and she actually had the letter from the mortgage broker who sent to her a package of stuff and said, don't worry about it being blank, sign them all and I'll fill it out later. And because he had been so sweet and so nice and was helping her get her house, you have to understand how this works on the street.

She said, okay, honey, and she signed all of these blank forms that he then filled out later. So his HUD-1 looked fine, his dealer looked fine, his disclosures all looked beautiful but they were all fraudulent, absolutely fraudulent. And the one thing I do like about this particular broker is he got the lender too because he even switched the mobile home, and they each have their own little tag. And when the lender went to foreclose, he hadn't delivered the right one so we were able to stop the foreclosure.

UNIDENTIFIED SPEAKER: The disclosure is
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almost more protection for the predatory lender than the borrower, and I can certainly envision situations where someone would try to go to court to get relief and the question would be asked, is this in fact your signature? Can you read and write English? And then Your Honor, we move for summary judgment.

MR. FISHBEIN: We're kind of reaching that stage where I want to give the panelists an opportunity to make a concluding remark if they want. Anybody want to go first? Go ahead.

MS. GATES: I think the point on credit risk is well taken. I still think of the three Cs of underwriting, capacity, credit and collateral, that all three of those are probably an equation as to what's driving the home foreclosure rates. We focus a lot on credit and that certainly gets a lot of attention, but the capacity to repay is another one and that's where these packing the fees come in and the buyers are pushed on what they cannot pay.

I just recently realized that many times PMI is the only thing that's put in the equation for the buyer. And I don't even know about title insurance. That's not shown to them as part of what they're repaying. Things like that that are really putting bias buyers in a very difficult capacity
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position. But we shouldn't forget about the collateral piece, and that's where I think a lot of inflated appraisals are aiding and abetting this

problem and that's been a real concern for Freddie Mac, on how to -- and HUD has done quite a bit to tighten up the appraisal process and make sure that your property is worth what it says it's worth.

MR. FISHBEIN: Any other comments? Want to conclude? Stella, I know you do.

MS. ADAMS: We need to attack this problem at every avenue because the effects on our communities are devastating. It is really harm, and it's not just harming the individual borrowers but it's a harm in neighborhoods and it's harming cities and it's harming economies. I sometimes think of this as a Ponzi scheme, that when it finally collapses, we're going to have a real hard time if we don't get it under control and if we don't get the bad actors out.

And there is nothing wrong with saying to somebody, you don't need that loan. And let's try to work out another way, another solution for that person. There is nothing wrong with saying, your credit is bad, and you don't need that loan, because the impact of that loan is that we have a boarded up

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house in a neighborhood that turns into a crack house in a neighborhood; that in a Chicago neighborhood turned into a place where serial killers ran rampant and all for this predatory loan. It's sort of like the mouse ate the cheese kind of thing. And so we have to really think about it not just the microeconomics of this predatory practices but the macroeconomics of it in terms of what it's doing. And as we get into a more global economy, I think some of the points that the woman from the institute made are going to be important. The Associates is the biggest lender in Japan, is one of the biggest lenders in Japan, and they make 100 percent loans in Japan until usually -- laws were put in place that capped them at 40, but I guess they can live with that.

But they make bicycle loans in Pakistan, which is a major form of transportation in that country. They're already taking these practices that they've honed on our neighborhoods and they're spilling them out in the third world where there isn't a prime market at all in many of these countries, and they're going in as the lender of choice. So we have to get control of it, we have to decide what we're going to do as a nation to

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protect -- this is, in my opinion, a national security issue because if you have neighborhoods destroyed, economies destroyed, people are going to fight to protect themselves.

MR. FISHBEIN: Anybody else? Panel?

I just wanted to say, just in closing, a few comments. We touched on it some in this discussion. I want to thank the panelists for a very excellent presentation and being pretty responsive to the questions that were thrown at them, and I think I want to give them a round of applause. The HUD/Treasury task force, as I mentioned, involved over 35 representatives from the industry and consumer and civil rights groups and public officials. We realized right at the outset that we weren't going to attempt to reach consensus among all these groups, that the issues were complicated. We do think there is a solution there, though, that can preserve the baby while throwing out the pollution, as it was referred to by Jim Carr yesterday, that some lenders are putting into the markets.

Hopefully this report is going to be a way of pushing that discussion forward. One thing for sure, I don't think this is a discussion that's going to go away. There might be a little lag time, but I

think what you could well anticipate is that we get into the next year, this will be an issue that will be reintroduced and debated in the laws of Congress, and there will be continuing discussion about how you can come up with a comprehensive approach to preserving access to credit for people who need it, at the same time making sure people aren't abused by that credit.

Thank you all for coming, and I want to encourage everybody to pick up a copy of this report on your way out, if you haven't done so already. We got our third printing of these. I think there is a lot of good information in here. Certainly a lot of questions that were raised today. And we appreciate any comments you may have on this report. Thank you.