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Strategies for Combating Predatory Lending in Our Neighborhoods

Remarks by
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My thanks to the Neighborhood Reinvestment Corporation for inviting me to speak to you today. It is always a pleasure to attend one of Neighborhood Reinvestment's training institutes. These institutes have become a critically important part of training and capacity building for both NeighborWorks affiliates and other CDCs and others involved in community development around the country.

As Director of OTS and Chairman of the Board of Neighborhood Reinvestment, I am committed to furthering the work of Neighborhood Reinvestment and its affiliates, as well as helping financial institutions find ways to better meet the credit and financial services needs of their entire communities. In both capacities, I've done a lot of traveling around the country; met with many, many folks involved in community development, and with their financial partners; and seen first hand in urban and rural areas alike the exceptional work being done by you and others like you. While there is still much to be done, remarkable progress has been made. In particular, the private sector has begun to focus on the fact that meeting financial services or other needs in traditionally underserved markets is about more than meeting a legal obligation. It is about business opportunities, community advancement, and making a difference. It is rewarding to see successful partnerships involving private institutions, governments at all levels, non-profit entities, and community residents working together to build and rebuild neighborhoods and, indeed, whole towns and cities.

Unfortunately, these market opportunities have also been identified and exploited by some unscrupulous lenders. These lenders, and the practices that they engage in, threaten to undo your good work and destroy communities in their wake. Many of you have been leaders in identifying and beginning the fight against predatory lending. You and I know this is a fight that requires a coherent strategy and the involvement of the same groups who have been the community builders – government, financial institutions, non-profits, and the community itself.

The first step to developing a strategy is to identify the problem. What is predatory lending exactly?

As with many unpleasant things, you tend to know predatory lending practices when you see them, but trying to come up with a neat definition is difficult. Predatory lending can refer to a wide range of practices that range from the unethical to the illegal. Stories of lending abuses abound.

The Washington Post recently told the story of a 62-year-old retired secretary for the D.C. public school system. She is legally blind. She was called by a mortgage broker who said that he could get her a much better deal on her mortgage. At the time, she had a $ 56,000, 15-year mortgage at 10.99 percent. In the meantime, he told her to stop paying her mortgage until the new loan came through. He would take care of that. Now this retiree has a 30-year loan for $65,800 with an interest rate that varies from 11.49 to 18.49 percent. When she asked why the rate was so much higher, she was told it was because she had a bad credit record, brought on by her failure to pay her mortgage for three months, as instructed by her broker.

In a recent study on predatory lending sponsored by Neighborhood Reinvestment titled "Understanding Predatory Lending: Moving Toward a Common Definition and Workable Solutions," author Deborah Goldstein suggests that "predatory lending describes a set of loan terms and practices that fall between appropriate risk-based pricing by subprime lenders and blatant fraud." She further suggests that loans become predatory when they target a particular population, taking advantage of the borrower's inexperience and lack of information, to manipulate a borrower into a loan the borrower cannot afford to pay or to defraud the borrower. The combination of preying on financially unsophisticated borrowers with products that pyramid onerous terms and fees is at the crux of predatory lending.

Many of you have examples from your own communities. Predatory lenders operate in cities and rural areas across the country. Their activities threaten to harm not only individual borrowers, but also whole communities, the financial services industry, and our society in general.

As you have probably heard, there has been much discussion recently among federal bank regulators about the risks involved in sub-prime lending. Now, I firmly believe that responsible sub-prime lending can be – indeed, for many lenders is – part of a sound and profitable business plan that fulfills important credit needs. By recognizing and effectively managing, monitoring, and capitalizing the extra risks this lending can entail, responsible, federally-regulated depository institutions can safely and profitably extend their market reach. Predatory lending, however, is quite a different matter. These are high-risk, abusive products with a thin market

– buyers can go away and prices drop in an instant. And for loans on the edge of legality—if not over it – legal and reputational risks abound. I've said it before, and I repeat here: OTS-regulated institutions shouldn't even <u>think</u> about getting into this part of the business.

Even institutions that are not engaged in predatory lending can suffer consequences if these practices go unchecked. Good loans made by responsible lending institutions are threatened if targeted communities are suddenly destabilized by foreclosures. There is also the potential that good reputations of responsible lenders will be tarnished by the actions of those who are irresponsible.

Now, while the problem is big enough to be noticed, but small enough to target, is the time to do something about it.

We must identify and attack the vulnerabilities of this type of business operation. For predatory lenders are vulnerable — to legal action, to competitive pressures, and to consumer education.

<u>Legal Strategies</u>

Federal and state regulators, as well as law enforcement agencies, need to become more aggressive with lenders engaged in unlawful predatory lending practices — from prohibitions against fraud to the requirements of fair lending. There are several federal enforcement options and assorted new state remedies available for pursuing unscrupulous lenders. North Carolina has recently passed legislation to curb mortgage lending abuses, and the first enforcement actions are pending. Massachusetts and New York have also taken enforcement actions. New York, Illinois, Missouri and other states are considering legislative and regulatory initiatives.

But I want to emphasize the importance of stepping carefully in this area. Often, in the effort to put a halt to one problem, another may be inadvertently created. For example, in our zeal to declare some practices illegal, we must avoid overreaching and chilling the operations of the legitimate sub-prime market. The flow of responsibly delivered credit to underserved markets is critical to their survival and any legislative or enforcement solutions that might be crafted to deal with predatory lenders must proceed with this caution in mind.

And enforcement is only a piece – and, I believe, a small piece – of the strategy. For it is generally after-the-fact, limited in scope, and at best provides restitution and a preemptive warning to those not yet in the business. Frankly, enforcement rarely does anything positive – and yet positive responses to real needs are what will protect our communities and keep them growing.

The consumers who fall victim to predatory practices often have real credit and other financial needs. Many are motivated to improve their homes, but

place their trust in disreputable contractors. Others have suffered unexpected hardships that erode their already precarious financial security. Some, like our retired D.C. school system employee from the* Washington Post *story, simply want to put their affairs in a little more favorable position for the future. Driving bad actors out of the market is only part of the battle. Bringing reputable lenders into the neighborhood is where the real action is.

<u>Enhance Competition</u>

The most important place to pursue the fight against predatory lenders is in the marketplace itself. We need to focus on encouraging responsible competition in markets targeted by predatory lenders. One of the reasons predatory lenders are so successful is the absence of competition. Perceived or, let's admit it – real – risks of lending in certain communities may cause conventional lenders to serve these markets passively, or not at all, leaving a void for untrustworthy lenders to fill. To combat predatory lending successfully, lenders must create responsible credit and financial service alternatives for customers, and they must market these products and services in ways that actually reach those for whom they are intended – just like the predatory lenders are doing.

As community leaders and organizations you have an important role. You know that traditional lenders are often well-intentioned but not very good at reaching your communities. Your experience in bridging the gap between bankers and financially challenged families is key to helping eliminate the opening that predatory creditors use to drive a wedge between legitimate needs and community stability.

You can help lenders identify real risks and real opportunities in underserved markets, learn how to successfully market products and services in low-income and minority communities, and create strategies to ensure successful and responsible lending programs targeted to underserved people and communities. Regulators and community-based organizations can help identify partners within underserved communities with whom financial institutions can work.

This should be a matter of enlightened self-interest for financial institutions. Not only are there good customers out there, but existing portfolios are at risk when the communities in which they are located become targets for predatory lending. Responsible lenders working either alone or in partnership with others to develop cost-effective ways to actively market and promote competitive services in vulnerable markets can receive ample rewards. Using some of the same information predatory lenders use to prescreen and target vulnerable borrowers, responsible lenders can reach these same consumers with information about competitive loan products and other responsible financial services. There are good margins available to those who do the business right.

Community organizations must take an active part in helping foster the competitive market in under-served neighborhoods. There are several ways to do this. For example:

- Identify reliable home improvement contractors and home equity lenders, then get the word out to your community with open houses that demonstrate a job well done and responsibly financed.
- Establish early warning networks and intervention game plans for implementation when unscrupulous contractors or lenders make an appearance in your neighborhood.
- Encourage community members to build banking relationships with federally-insured depository institutions.

Helping consumers in lower-income communities develop banking relationships through education, first-time homebuyer programs, Individual Development Account programs, Electronic Benefits Transfer programs, and first-time investor programs, is an important step in pulling certain vulnerable consumers out of reach of predatory lenders.

In my many meetings with thrift executives, I encourage them to reach out to find the business opportunities in under-served markets. But outreach is a two-way street. Community representatives must do their bit by encouraging consumers to take a more sophisticated view of their financial affairs and by demonstrating the benefits of banking beyond getting a loan.

Educational Strategies

This leads to my third approach to solving the problem of predatory lending: Educate, and thereby arm, the potential victims of predatory lenders with the information they need to make sound financial choices. Those of you in the NeighborWorks family have worked hard to set new homeowners on the path of individual fiscal responsibility. But today you must educate borrowers not only against the enemy to financial discipline within, but against the enemy without who would take advantage of their newly-earned homestead. Having instilled trust, you must also instill caution.

An informed consumer, and one with options, is less likely to fall victim to loan scams. Community organizations and others (such as faith-based organizations and schools) can and do play an essential role in this education process. But many existing programs are not reaching the right audience. For educational efforts to make a difference, community organizations need to think like those targeting their neighborhoods. They need to target the very same markets and aggressively reach out to potential borrowers with information about the pitfalls of certain loan terms and conditions as well as information about alternative sources of credit.

For example, organizations that work with first-time homebuyers need to educate purchasers about potential home equity scams that may occur after they are settled into their home. It is also important to teach these new homeowners how to be discerning consumers. What is the Annual Percentage Rate, or APR, on that loan? Isn't it higher than the rate that nice roofing salesman quoted me? Why is that? Could it be that there are other fees hidden in there? What are those fees for?

Learning what questions to ask and how to evaluate the answers is critical to making an informed choice. This information should become a standard part of existing homebuyer- and homeowner-counseling curricula. Equally important is staying in touch with new homeowners after they have purchased their homes to intervene before problems arise.

Those working in lower-income neighborhoods where residents already own their homes – often free and clear – need to consider ways to reach the most vulnerable homeowners with educational materials. Community-based organizations and others need to target potentially vulnerable consumers and arm them with valuable information. Information about terms such as negative amortization, balloon payments, pre-payment penalties, or mandatory arbitration clauses will help turn an "easy mark" into a capable negotiator. Again, knowing what questions to ask can make the difference between growing old in your own home or not.

You can enlist the help of local financial institutions to develop appropriate educational materials. Encourage these institutions to distribute this information to their existing customers (such as elderly accountholders) to inform them about financing alternatives. Local schools can help by getting information to the parents of their students. Faith-based organizations can help by distributing information in houses of worship or bringing it along when visiting those that are shut-in.

This is possible. It takes the same kind of thought, creativity, and dedication you always put into the work you do. The key to success, as with most things in life, is to work together. Work with financial institutions to provide alternatives to the credit being offered by predatory lenders. Create a referral network. Contact state and federal regulatory agencies when you hear about unscrupulous contractors pursuing a neighborhood.

An innovative example of cooperation was announced in January by Boston's mayor, Thomas Menino. The mayor announced an extensive advertising campaign titled "Don't Borrow Trouble" to raise awareness about mortgage scams and help the citizens of Boston keep their homes. The mayor has committed $50,000 of the city's funds to this project and raised another $50,000 in matching funds from the Fannie Mae Foundation, Freddie Mac, and several of the trade associations that represent lenders in Massachusetts. The ad campaign will promote the Boston HOME Center as an educational resource and refer homeowners to courses offered by the City of Boston. As the mayor put it, "If we can protect a homeowner today, that's one less foreclosed and abandoned property we have to confront tomorrow."

Together we can successfully close the doors to the fast money that predatory lenders seek in these communities. And we must. Credit delivered irresponsibly – particularly to those who can least afford to lose – is worse than no credit at all. The consequences to the borrower are most certainly devastating and the ultimate implications for our communities, if left unchecked, may be equally disastrous.

This country is riding the cusp of a very healthy economy and has been for some time. This, and a lot of hard work in developing *responsible* lending programs targeted to first time and low income homebuyers, has created increased homeownership opportunities, particularly for many lower-income and minority families for whom the American dream historically has been out of reach. We have seen homeownership rates rise to their highest levels ever during 1999, with record levels of participation by minority and low-income households. We've seen communities revitalized and stabilized. All of that can be undone, however, if predatory lending is allowed to proliferate.

By employing the tactic of targeting the vulnerabilities of predatory lenders, we can beat them at their own game. Each of us – legislators, regulators, lenders and community representatives – must focus our efforts where predatory lenders are most vulnerable: By pursuing legal remedies forcefully, by competing sensibly in under-served or credit-impaired markets with responsible loan products and financial services, and by raising consumers' awareness about the impact of their choices and the alternatives available for addressing their legitimate credit needs. It's a fight we can win, and one that our communities can't afford to lose.

Thank you for your attention. I am happy to answer questions.