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PREDATORY LENDING AND REVERSE REDLINING: ARE LOW-INCOME, MINORITY AND SENIOR BORROWERS TARGETS FOR HIGHER-COST LOANS?

HEARING

BEFORE THE

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CONTENTS

MEMBERS

WITNESSES

SUBMISSIONS FOR THE RECORD

PREDATORY LENDING AND REVERSE REDLINING: ARE LOW-INCOME, MINORITY AND SENIOR BORROWERS TARGETS FOR HIGHER-COST LOANS?

THURSDAY, JUNE 25, 2009

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to call, at 11:05 a.m., in Room 2118, Rayburn House Office Building, The Honorable Carolyn B. Maloney (Chair) presiding.

Representatives present: Maloney, Hinchey, Cummings, Snyder, Brady, Burgess, and Campbell.

Staff present: Gail Cohen, Nan Gibson, Colleen Healy, Aaron Kabaker, Barry Nolan, Aaron Rottenstein, Justin Ungson, Andrew Wilson, Chris Frenze, Rachel Greszler, Robert O'Quinn, Jeff Schlagenhauf, and Jeff Wrase.

OPENING STATEMENT OF THE HONORABLE CAROLYN B. MALONEY, CHAIR, A U.S. REPRESENTATIVE FROM NEW YORK

Chair Maloney. Good morning. I would like to welcome all of our distinguished panel members here for the hearing that we are having today. We are here to examine the economic impact of reverse redlining where minority borrowers and senior citizens have been targeted to receive unnecessarily expensive mortgages.

I thank Congressman Cummings and his staff for their help in bringing witnesses here from Baltimore, Maryland, one of the several states and localities that is investigating or have recently brought suits against lenders over practices that may have violated fair lending or civil rights laws by deliberately steering minorities and the elderly into more costly subprime loans.

Two years ago, problems in the subprime mortgage markets touched off an economic crisis that is still unfolding. Today, almost one-in-six subprime mortgages is in foreclosure, compared to one-in-40 prime mortgages in the United States, and this chart is there to reflect this for the audience.

[The chart titled "As Bubble Bursts, Subprime Foreclosures Skyrocket" appears in the Submissions for the Record on page 34.]

As subprime foreclosures have risen over the past two years, minority homeownership rates have fallen at a much faster pace than for non-minority homeowners. The pain of rising foreclosures is being felt in communities all across the country as the ripple of mounting losses spreads to borrowers, lenders, governments, and neighborhoods.

In some areas, once thriving neighborhoods have been transformed into boarded-up ghost towns. Concentrated foreclosures have spillover effects on neighboring properties, increasing crime and vandalism and lowering surrounding property values.

A fundamental problem is that the financial incentives of mortgage companies and mortgage brokers are not aligned with the best interest of their borrowers. Higher commissions for higher interest loans creates the incentive for mortgage brokers to sell the most expensive products to those who can least afford them.

Low or no documentation loans, which rely on stated income rather than a W–2 form, provide an avenue for lenders to evade state laws by making loans appear affordable even when they are not. Evidence continues to come to light that many of the subprime borrowers who had paystubs to prove their employments and may have qualified for prime loans were steered into more costly no-doc loans by some lenders.

In my home state of New York, Brooklyn and Queens have the highest concentrations of low and no documentation subprime loans compared to other parts of the state. There is a particularly high concentration of these loans in Astoria, which I have the honor of representing.

Congress and the president have taken steps to strengthen the economy, keep families in their homes, expand affordable mortgage opportunities for families, and rein in abusive lending, but more must be done to stop bad loans from being made in the first place. We need to return to sensible principles that require lenders to assess borrowers' ability to pay over the whole life of the loan, but we also need to strike a balance between making sure borrowers can repay the loans they get and helping borrowers who can repay a loan get one.

I have high hopes that the president's proposed Consumer Financial Protection Agency will play a key role in strengthening consumer protections against predatory practices in the future. The administration's proposal to eliminate the current preemption of state laws regarding anti-predatory lending for national banks, thrifts, and federal credit unions will allow steps to adopt and enforce stricter laws for institutions of all types regardless of the charter.

Stopping abusive lending practices that have contributed to the current foreclosure crisis and returning to healthy, fair lending principles will provide a sound basis for economic growth and recovery. I look forward to the testimony of our witnesses today, and I thank my colleagues for coming. And I recognize the ranking member, Mr. Brady, for 5 minutes.

[The prepared statement of Representative Maloney appears in the Submissions for the Record on page 35.]

OPENING STATEMENT OF THE HONORABLE KEVIN BRADY, A U.S. REPRESENTATIVE FROM TEXAS

Representative Brady. Thank you, Chair Maloney, for calling this hearing. I am pleased to join with you in welcoming the panel of witnesses testifying before the committee this morning.

Racial discrimination lending is immoral. It is also illegal under the Equal Credit Opportunity Act.

Recent studies suggested discrimination is generally limited to minority applicants with low incomes or poor credit and employment history. Moreover, discrimination occurs primarily in the price of credit rather than its availability. This practice is known as reverse redlining.

Nevertheless, distinguishing between racial discrimination, misguided efforts to shoehorn marginal borrowers into subprime mortgage loans to buy homes as prices escalated, and simple greed by unethical lenders is not easy.

From 1995 to 2007, the federal government encouraged mortgage lenders to loosen underwriting standards and offer exotic alternatives to fully amortizing fixed-rate 30-year mortgage loans in order to increase the rate of homeownership among low-income and minority families.

Mortgage lenders obliged knowing that they did not have responsibility for the performance of mortgage loans they had extended once these loans were sold to issuers for securitization. The deterioration of underwriting standards and the development of subprime mortgage loans combined with an overly accommodative monetary policy to inflate a huge housing bubble.

As in past bubbles, both borrowers and lenders became increasingly reckless. In some cases, individuals misled lenders to secure subprime mortgage loans to speculate in housing. In other cases, lenders took advantage of unsophisticated families by placing them in subprime mortgage loans they didn't understand and couldn't afford.

In either case the results are the same: Many families found themselves under water and a tidal wave of defaults and foreclosures followed once the housing bubble burst. This has been especially difficult for low-income and minority families.

Individuals must be fully aware of mortgage terms and the financial burden they are assuming before closing. Improving financial education would help families to understand mortgages and other financial products and to avoid credit problems in the future.

In conclusion, exploiting the complexity of mortgage contracts to please borrowers is not an acceptable business practice. Full disclosure and transparency should be part of the solution. Loan originators and issuers of mortgage-backed securities should also be required to retain skin in the game to discourage lenders from knowingly extending mortgage loans that aren't likely to be repaid and to discourage issuers from placing such loans in mortgage-backed securities.

And finally, excessive debt burdens, although all too common, make it very hard for families to get ahead over the long run. Better financial education could help people to avoid at least the most financially burdensome kinds of loans available.

And I yield back, Madam Chair.

[The prepared statement of Representative Kevin Brady appears in the Submissions for the Record on page 35.]

Chair Maloney. I thank you.

And the chair recognizes Congressman Cummings for 5 minutes. Congressman Cummings was instrumental in putting this hearing together. He helped bring many of the witnesses from Baltimore, Maryland, which is one of the several states that is investigating and recently brought suit against practices that have allegedly violated civil rights and fair lending practices.

I would also like to state that I have several amendments on the floor and may have to be on the floor, and Mr. Cummings has agreed graciously to chair this committee in my absence.

So, Mr. Cummings, for 5 minutes, and thank you for your work in this area and for helping me with this hearing.

OPENING STATEMENT OF THE HONORABLE ELIJAH E. CUMMINGS, A U.S. REPRESENTATIVE FROM MARYLAND

Representative Cummings. Thank you very much, Madam Chairlady. And I want to thank you and staff for bringing about this hearing.

I requested this hearing following a *New York Times* report on June 7th detailing new developments in the lawsuit filed by my hometown of Baltimore against Wells Fargo. The article described affidavits that were recently filed by the City of Baltimore that included staggering claims about Wells Fargo employees steering African-American citizens toward high-cost loans loan products to boost company profits and reward employees with monetary bonuses and trips.

The affidavits also claim that the true opinion of the Wells Fargo firm toward their clients was reflected in their use of racial epithets to describe African Americans. The city's contention is that the discriminatory lending practices pursued by Wells Fargo promoted high-cost loan instruments which led to foreclosures far in excess of what the rate of foreclosure might otherwise have been.

That, in turn, has led to declines in property values in many neighborhoods as well as in increased crime, increased costs for city services, loss of tax revenues, all on the backs of an increasingly burdened city and population. With home values still falling and the national unemployment rate now exceeding 9 percent, there has been a seemingly unending flood of foreclosures that has taken and continues to take an immeasurable toll on all of our communities and on the overall economy, and on our tax base.

Obviously the proliferation of subprime and other alternative loan products in communities across this nation contributed significantly to the foreclosure crisis. So in order to progress toward a complete economic recovery, we need to fully understand exactly what got us where we are today, and that means that we need to understand both the specific financial transactions and the regulatory failures as well as, frankly, the assumptions and the attitudes that led firms to target certain groups for some of their most questionable transactions.

The subprime loans, which were created to increase homeownership in low-and middle-income sectors, turned into vehicles for enriching lenders, brokers, and investors. We also know, from research done by Mr. Carr and the National Community Reinvestment Coalition, that there is a racial and ethnic disparity in the distribution of these high-cost loans.

They found that low-to moderate-income African Americans were at least twice as likely as low-to moderate-income whites to receive high-cost loans in the 47.3 percent of areas they examined. The disparity continued into the higher income brackets as well.

Dr. Squires has read very eloquently—written very eloquently—that, "clearly not all subprime loans are predatory, but virtually all predatory loans are in the subprime market." That is why it is so important for us to ensure the protection of homebuyers, and President Obama has taken a decisive first step in this direction with the proposed Consumer Financial Protection Agency.

As I say so often, I live in the inner, inner city of Baltimore, and the people on my block are my neighbors, my constituents, my friends, and they are struggling and they need help. And they need help now. I am determined to do everything I can to do for them for—from hiring dedicated staff to deal with constituent mortgages to getting people a seat at the table with their lender, as we did recently, putting 1,000 borrowers together with 19 lenders at our foreclosure prevention event. And I am glad to say we were able to save a lot of people from losing their homes.

The witnesses before us have also done their part. I commend all of them for their work protecting the interests of home borrowers and communities. I am particularly pleased to have Commissioner Raskin with us. She remains vigilant in exercising all the rights she has under the Maryland law and her efforts have lead to the enactment of new mortgage fraud protections by the Maryland General Assembly.

And again, Madam Chairlady, I am very pleased to be here, and I am going to be a little bit in and out myself because I—called for another hearing with Bernanke, which we are doing also, and I have an amendment on the floor. But I will be in and out. But thank you.

[The prepared statement of Representative Elijah E. Cummings, appears in the Submissions for the Record on page 36.]

Chair Maloney. Thank you.

Congressman Burgess for 5 minutes.

OPENING STATEMENT OF THE HONORABLE MICHAEL C. BURGESS, M.D., A U.S. REPRESENTATIVE FROM TEXAS

Representative Burgess. Thank you, Madam Chair, and I too want to welcome the witnesses here this morning and thank them for testifying before us today. Certainly the topic of reverse redlining and mortgage discrimination is one that is important, and hearings like this are an important part of understanding all of the factors that contributed to the breakdown in the mortgage market. And I appreciate the opportunity for additional examination of that today.

The area in Texas that I represent has generally been spared by some of the more severe consequences of the nationwide recession, but not entirely. And part of my district—that part that is represented by the southeast quadrant of the city of Fort Worth—certainly could fall into the description of being underserved.

We have many low-income residents; we have very high infant mortality rates, falling property values, and crime. It is a part of my district that continues to struggle and an area that I have expended a great deal of effort in trying to assist in my capacity as their Representative.

The foreclosures in southeast Fort Worth are high. It is difficult to obtain the data, but the sense I get is it is less from the aberrances in the loan market and more from the consequences of the economic downturn and increasing unemployment. Then the lack of recovering a job after someone has lost a job—very difficult for someone without income to maintain house payments, and certainly going to be difficult for someone without a job to initiate a mortgage in the first place, especially given what we have recently been through.

Southeast Fort Worth certainly meets the description of the type of community at risk for the behavior that is being examined today, so I am anxious to hear more and learn more about the topic. And Madam Chairman, I will yield back my time and I thank you for the consideration.

Chair Maloney. Thank you.

Maurice Hinchey, from the great state of New York, is recognized for 5 minutes.

OPENING STATEMENT OF THE HONORABLE MAURICE D. HINCHEY, A U.S. REPRESENTATIVE FROM NEW YORK

Representative Hinchey. Well, thank you, Madam Chairman, for holding this hearing. It is on a very important subject.

And I want to thank all of you for being here—the four of you—for joining us. And I am very anxious to hear what you are going to say.

The economic circumstances that this Congress is attempting to deal with is probably the most serious and severe since the 1930s, and the way in which it is being addressed is, to a large extent positive, but I don't think it is nearly going as far as it needs to. There is an awful lot more work that needs to be done.

The predatory lending—and that predatory word, I think, is very appropriate—is a major part of the problem, and the so-called subprime mortgage lending reached its peak just 3 years ago. The effects of that are now very, very prominent across the board and they have had a very negative impact on a whole host of people.

And in addition to that negative impact, what we have seen over the course of the last several years—even a little bit longer than that—is a larger separation of income between the very wealthy and the very poor, and a decline in the number of middle-income people. The middle-income population of this country shrank, and we know that the middle-income people are the ones who drive most of the economic progress here.

So we have a major problem ahead of us. We are now addressing it in the context of a bill called the Consumer Financial Product Safety Commission Act of 2009, which, like so many of the other things that have been done so far, proceeds to move us in the right direction, but I don't think it does so nearly far enough.

There is an awful lot of work that needs to be done, and any insight that you have—and I know that you have a lot— to this particular problem would be very helpful to us, particularly how this bill might be improved.

What are some of the additions that could be added to it? What are some of the strengths that could be included within this legislation to help us deal more effectively with this very serious and deepening economic problem?

So I thank you all very much for being here, and I am very anxious to listen to what you say. Thanks very much.

Chair Maloney. Thank you very much.

And Congressman Snyder, from the great state of Arkansas, for 5 minutes. Thank you.

Representative Snyder. Thank you, Madam Chair. And thank you for putting together this hearing. I think this is a great opportunity to talk about these issues, and I believe that I am more interested in hearing the witnesses than hearing myself, so I will yield back. Thank you.

Chair Maloney. Okay. I would now like to introduce our panel of witnesses and thank them again for being here.

Jim Carr is the chief operating officer for the National Community Reinvestment Coalition, an association of 600 local development organizations across our nation dedicated to improving the flow of capital to communities and promoting economic mobility. He is also a visiting professor at Columbia University in New York City.

Prior to his appointment to NCRC, Mr. Carr was senior vice president for financial innovation, planning, and research for the Fannie Mae Foundation and vice president for housing research at Fannie Mae. He has also held important posts as assistant director for tax policy with the U.S. Senate Budget Committee and research associate at the Center for Urban Policy Research at Rutgers University.

He holds a bachelor of architecture degree with honors from Hampton University, a master's of urban planning degree from Columbia University, and a master's of city and regional planning from the University of Pennsylvania.

Welcome also to Dr. Gregory D. Squires. He is a professor of sociology and public policy and public administration at George Washington University. Currently he is a member of the advisory board of the John Marshall Law School Fair Housing Legal Support Center in Chicago, Illinois, and the Social Science Advisory Board of the Poverty and Race Research Action Council in Washington, D.C.

Prior to joining the faculty at George Washington, he taught at the University of Wisconsin, Milwaukee, and served as a research analyst for the U.S. Commission on Civil Rights. He received his M.A. and Ph.D. in sociology from Michigan State University, and his B.S. in journalism from Northwestern University.

Welcome also to Sarah Bloom Raskin. She has been Maryland's commissioner of financial regulation since 2007. Commissioner Raskin was previously banking counsel to the U.S. Senate Committee on Banking, Housing, and Urban Affairs. She also worked at both the Federal Reserve Bank of New York and the Joint Economic Committee of Congress.

Welcome back.

Commissioner Raskin is on the board of directors of the Conference of State Bank Supervisors and serves as the chair of the Federal Legislation Committee. She also was recently named as chair of the Regulatory Restructuring Task Force, a group of state banking commissioners who are developing principles for evaluating regulatory restructuring proposals.

Commissioner Raskin received her law degree from Harvard Law School. She received her undergraduate degree in economics from Amherst, and she is a recipient of the James R. Nelson Award in Economics.

Robert J. Strupp is the director of research and policy with the Community Law Center in Baltimore, Maryland, which provides legal representation and advocacy to grassroots organizations, nonprofits, and small businesses. Mr. Strupp serves on the Homeownership Preservation Coalitions in Baltimore and Prince George's County and chairs the Coalition's Enforcement Committee.

Mr. Strupp has served on numerous real estate fraud work groups including the Maryland Governor's and Attorney General's working groups on foreclosure and lending law reforms.

I thank all of you for being here, and please proceed Mr. Carr.

STATEMENT OF JAMES CARR, CHIEF OPERATING OFFICER, NATIONAL COMMUNITY REINVESTMENT COALITION, WASHINGTON, DC

Mr. Carr. Chairman Maloney and other distinguished members of the committee, good morning. My name is James H. Carr, and I am the chief operating officer of the National Community Reinvestment Coalition. On behalf of our coalition, I am honored to speak with you today.

NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services for working families and communities. NCRC is also pleased to be a member of a new coalition of more than 200 consumer, civic, labor, and civil rights organizations called Americans for Financial Reform that is working to cultivate integrity and accountability within the U.S. financial system.

Members of the committee, a major reason for the continuing and protracted economic downturn we are experiencing is that the problem that precipitated the collapse of the credit markets and the economy is a foreclosure crisis that continues to worsen. Already this year more than a million homes have been lost to foreclosure and 5 million more homes are at risk over the next 3 years, and that is assuming that the new Making Homes Affordable program achieves all of the successes expected by the administration.

Many blame the foreclosure crisis on the Community Reinvestment Act and on arguments that financial institutions were forced to lend to unqualified low- and moderate-income and minority households. Both these assertions have no basis in fact or logic.

According to the Federal Reserve Board, only 6 percent of high-cost loans to low- and moderate-income households were covered by CRA regulation, and the Center for Responsible Lending has found that less than 10 percent of subprime high-cost loans were to first time homeownership. Failure to regulate adequately the U.S. mortgage market allowed deceptive, reckless, and irresponsible lending to grow unchecked until it eventually consumed the financial system.

Almost every institutional actor in the mortgage finance process played a role, including brokers, lenders, appraisers, Wall Street bond rating agencies, investment banks, and more. This is not an equal opportunity economic crisis. Although the national unemployment rate is an uncomfortable 9.4 percent, the rate for African Americans is still, for example, 15 percent, and for Latinos approaching 13.

The unemployment rate for non-Hispanic whites, by comparison, remains under 9. Because African Americans and Latinos have so few savings, they are poorly positioned to survive a lengthy bout of unemployment. As a result, potentially millions of African-American and Latino middle-class households could see themselves falling out of the middle class before this economic crisis is over.

Moreover, African Americans and Latinos were targeted disproportionately for deceptively high cost loans. According to a study by the U.S. Department of Housing and Urban Development, subprime loans are five times more likely in African American communities than in white communities, and homeowners in high-income black neighborhoods are twice as likely as borrowers in low-income white neighborhoods to have a subprime loan.

The result is that blacks and Latinos are overrepresented in the foreclosure statistics. African Americans, for example, have experienced a full 3-point drop in—3 percentage point drop—in homeownership since this crisis began.

Further, research by the National Community Reinvestment Coalition found that predatory lenders aimed their toxic products particularly at women of color. And because African-American children are more likely to reside in female-headed households, children—black children—are disproportionately harmed as a result of the foreclosure crisis and its attendant stresses.

In separate research, "The Broken Credit System," NCRC also found that predatory lenders targeted the elderly. Although African Americans and Latinos on average have lower credit scores than do non-Hispanic white consumers, the extreme levels of lending disparity in the U.S. mortgage market have little to do with differences in the credit quality of the borrowers.

Fannie Mae has estimated that roughly 50 percent of consumers in the subprime market could have qualified for prime loans. In fact, in 2006 more than 60 percent of subprime borrowers had credit scores that could have qualified for prime mortgages. In response to the magnitude and complexity of the current crisis, a three-fold response is essential.

First, we must stem the current foreclosure crisis. The Making Home Affordable program is the most comprehensive and effective program that has been enacted to date since the crisis began, but success there is still measured in the thousands and the problem is growing in the millions. We need a broader response.

Second, we need to focus on those communities that were disproportionately harmed as a result of unfair, reckless lending and help to rebuild them rather than just stabilize them so far behind where they are today. And third, we need to enact comprehensive anti-predatory lending legislation. We need to expand and enforce the CRA law. And we need to enact a financial consumer protection agency.

In conclusion, Nobel Prize-winning economist Joseph Stiglitz has observed the financial system discovered that there was money at the bottom of the wealth pyramid and it did everything it could to ensure that it did not remain there. Stated otherwise, the business model for many financial institutions was to strip consumers of their wealth rather than build and improve their financial security.

Ironically, most solutions to date have focused on rewarding the financial firms and their executives that created the crisis, but in spite of more than $12.8 trillion of financial support in the form of loans, investments, and guarantees, this approach is not working because consumers continue to struggle in a virtual sea of deceptive mortgage debt and with a financial system that remains unaccountable to the American public. Now is the time to shift the focus away from Wall Street and onto Main Street in order to put America back on the firm financial footing.

Thank you very much. I have a longer extended written statement that I would like to submit to the record.

[The prepared statement of James Carr appears in the Submissions for the Record on page 37.]

Chair Maloney. Thank you very much for your testimony.

Dr. Squires.

STATEMENT OF GREGORY SQUIRES, PROFESSOR OF SOCIOLOGY AND PUBLIC POLICY AND PUBLIC ADMINISTRATION, AND CHAIR OF THE DEPARTMENT OF SOCIOLOGY AT GEORGE WASHINGTON UNIVERSITY, WASHINGTON, DC

Mr. Squires. Chairperson Maloney and all members of the committee, I want to thank you for holding this hearing and for addressing what is, unfortunately, one of the most challenging sets of issues that we have to face today, and I want to thank you for inviting me to participate. I actually have one very simple message that I would like to leave with you today.

To date, most of the discussion of subprime lending and the economic fallout has focused on the sins of various individual actors—homeowners who have bought too much house, lax if not fraudulent underwriters; incompetent if not corrupt appraisers and rating agencies; lax regulators; greedy investors and more. What is lost in much of this discussion is the critical role that has been played by the broader context of surging economic inequality and persistent racial segregation, which has incubated the rise in subprime lending and the economic fallout.

So my basic message is that any response to these problems—the sets of problems that we are all taking about—requires that we address this broader context of economic inequality and racial segregation as well as the lending practices of particular lenders and the regulatory actions of our regulatory agencies.

Just a couple of revealing statistics on inequality: Since the mid-1970s, compensation for the 100 highest paid chief executive officers increased by $1.3 million, or 39 times the pay of the average worker, to $37.5 million, or more than 1,000 times the pay of a typical worker.

Perhaps more interesting for our discussion today, in 2007 the 25 top hedgefund managers took home a combined $22 million, compared to the $14 million that they took home in 2006, while thousands of people were losing their jobs in financial services; and in 2007, the top five each took home $1 billion.

Perhaps more significant is what is happening at the neighborhood level. Between 1970 and 2000, the number of high-poverty census tracts grew from 1,200 to 2,500 and the population of these neighborhoods grew from 4 million to 8 million. The number of middle-income tracts has declined from about 58 percent to 40 percent of all tracts, and many poor people who used to live primarily in middle-income tracts are now living primarily in poor tracts.

In terms of segregation, we see that racial segregation has declined in recent years between blacks and whites, but in those big cities like Baltimore, Detroit, Chicago, New York, and so forth, where the black population is concentrated, segregation has persisted at hyper-segregated levels and Hispanics and Asians have actually become more segregated from whites in recent years.

Just a few numbers showing how loan patterns have followed: The percentage of high-cost loans—this is in 2006, when subprime lending was at its peak—the percentage of borrowers who took out high-priced loans, it was 46 percent in low-income areas, 16 in high-income. It was 49 percent in minority areas, 18 percent in white areas. And subsequent research has shown that these disparities persist after we control on credit rating, income, and other economic characteristics.

And it is no accident. We have heard about Wells Fargo. There are many other incidents where people were targeted and steered from one set of loans to another. The New York Times report that was referred to earlier pointed out that the targets of these loans were "mud people," and the loans were characterized as "ghetto loans."

But in research I have done with colleagues we have found that levels of segregation have an impact above and beyond the level of racial concentration and racial composition of neighborhoods. For example, we found in the 10 most segregated metropolitan areas, the share of borrowers who took out high-priced loans was 31 percent, compared to 20 percent in the least segregated areas.

Far more significant is that race and ethnicity remain a statistically significant predictor of the level of subprime lending after you control on credit rating, poverty, employment, percent minority, and level of education. So segregation itself is not just a reflection of the subprime lending, it is one of the factors that has contributed to the level of subprime lending.

So what do we do? I would like to suggest several policy responses in each of three different areas—one set of policies to deal with the broader economic inequality, one set to deal with housing and segregation, and finally, a set of policies to deal with lending practices.

In terms of the broader patterns of inequality, the first thing I would recommend is that the Congress enact the Employee Free Choice Act to strengthen the role of unions. We need to index the minimum wage so that it keeps up with increases in the cost of living. We should increase the earned income tax credit to bring more working families above the poverty line.

We should expand living wage programs where recipients of government contracts, and economic development subsidies, are required to pay their employees a wage that will rise them above that which requires further government support. We should enact the Income Equity Act, which was proposed by former Minnesota Congressman Martin Sabo, which would deny the corporate tax deduction when executive compensation exceeds 25 times the pay of the lowest paid employee.

There are a number of land-use and housing policies that could be implemented. In the Twin Cities, they have used tax-based revenue sharing, whereby the property tax increases in the wealthiest neighborhoods are used in part to finance development throughout the metropolitan area. Inclusionary zoning laws, which require developers to set aside a share of new homes for low-and moderate-income families, have been developed in literally hundreds of communities in the United States. We need more.

We need more mobility programs to help families who want to move to low-poverty areas to be able to do so. HUD should be required to steer more of its Housing Choice Voucher program to people who are interested in moving to low-poverty neighborhoods.

We could require recipients of the low-income housing tax credit to provide incentives to families so that more can move to low-poverty neighborhoods. And Congress could enact the Housing Fairness Act of 2009, which would dramatically increase the power of nonprofit fair housing organizations which have been so critical for enforcing the Fair Housing Act.

Let me just say a couple of things specifically about lending and lending regulation. The National Mortgage Reform and Anti-Predatory Lending Act would go a long way towards eliminating the kinds of— abuses that we have talked about here.

The Community Reinvestment Modernization Act of 2009 would bring the non-depository lenders who are responsible for the subprime problem under the authority of the CRA and would dramatically reduce the likelihood of foreclosure and related types of economic fallout from occurring in the future. The creation of a Consumer Financial Protection Agency, if in fact given appropriate rulemaking and enforcement authority and given the ability, the authority to hire adequate, competent staff, would go a long way in moving us in the right direction.

So finally, let me just say that while much attention has been and should be focused on the behavior of lenders and other housing providers and the regulatory agencies, we need to spend more time looking at the broader context of inequality that has nurtured the predatory lending policies and practices that have brought our economy to the state that it is in today. Thank you.

[The prepared statement of Gregory Squires appears in the Submissions for the Record on page 39.]

Chair Maloney. Thank you. Ms. Raskin.

STATEMENT OF SARAH BLOOM RASKIN, COMMISSIONER OF FINANCIAL REGULATION, STATE OF MARYLAND, AND CHAIR OF THE CONFERENCE OF STATE BANK SUPERVISORS (CSBS), BALTIMORE, MD

Ms. Raskin. Chairman Maloney and members of the committee, thank you for inviting me to testify today at this important hearing. I am especially honored to return to the Joint Economic Committee where I was an intern and which first provided me with the standards of good policymaking that I have kept as a touchstone throughout my career.

Now, as the chief financial regulator for the state of Maryland I am pleased to share information about our state's challenges in responding to the subprime lending crisis as it has manifested itself in Maryland. Our state is ravaged by the fallout from irresponsible lending—too many loans that never should have been made, poorly underwritten, if at all, with features and loan terms that make it clear that the chance for success was limited. And all too often, these loans have had a disproportionate impact on minority communities.

The Urban Institute published a study last month of subprime lending in 100 metropolitan areas. The study controlled for income levels and concluded that the neighborhoods hardest hit by the subprime crisis have been those where minority residents predominate. The fallout is evident in foreclosures throughout our state, particularly Baltimore City and Prince George's County.

Under a new law reforming the foreclosure process in our state, secured parties must send a notice of intent to foreclose to homeowners at least 45 days prior to docketing the foreclosure. My office receives copies of these notices, and they come in by the box load.

In the past 12 months, over 100,000 notices of intent to foreclose have been sent to Maryland borrowers and to our office. Each day we struggle to input the information into our database and to send early outreach letters to the borrowers regarding options for assistance and warning about foreclosure scams.

As the Commissioner of Financial Regulation, it is my obligation to pursue, within the boundaries of my authority, those who engage in violations of all our laws, including our anti-predatory lending laws. State regulators have a long history as the first line of protection for consumers. It was the states that first sounded the alarm against predatory lending and brought landmark enforcement against some of the biggest subprime lenders.

While the big cases have received most of the recognition, success is sometimes better measured by those actions that never receive media attention. In 2007 alone, states took almost 6,000 enforcement actions against mortgage lenders and brokers, and this number doesn't include the unreported investigations and referrals for criminally-punishable fraud and other crimes.

When most people talk about predatory lending, they think about the mortgage context. However, it is worth noting that the span of predatory lending practices includes consumer loans and lending transactions that have nothing to do with mortgages but contain features and terms that are high-cost and have confusing, if any, disclosure. Payday loans, payday loan brokering, and refund anticipation loans are but some of the set of ever-evolving predatory practices.

In addition to investigating and taking enforcement actions against predatory lending behavior, we have also taken innovative regulatory and legislative action. For example, we have implemented anti-steering regulatory changes that require mortgage lenders and brokers to provide information about prime loans to borrowers who are being offered high-cost loans.

The span of our legislative and regulatory changes are detailed in my written testimony, which I submit for the record. Suffice it to say that these are all important steps. Unfortunately, national banks are not subject to any of them.

Despite these enforcement and legislative successes, state actions have been hamstrung by the dual forces of preemption of state authority and lack of federal oversight. The authority of state banking commissioners to craft and to enforce consumer protection laws of general applicability was challenged at precisely the time it was most needed, when the amount of subprime lending exploded and riskier mortgage products came into the marketplace.

The laws passed by state legislatures to protect citizens and the enforcement actions taken by state regulators should have alerted federal authorities to the extent of the problems in the mortgage market and should have spurred a dialogue between state and federal authorities about the best way to address the problem. Unfortunately, this didn't occur. Had the federal regulators not adopted preemptive policies, I suggest we would have fewer home foreclosures and may have avoided the need to prop up our largest financial institutions.

At the same time that preemption of state consumer protection powers gained ground, federal agencies failed to fill the gap in regulation with uniform market-wide standards that ensured lenders did not engage in fraudulent, deceptive, or unfair lending practices and to respond to the crisis.

Congressman Cummings has seen this close-up effort in his efforts to gather information about mortgage modification. My office gathers modification data, and when this data indicated that loan modifications were not sustainable, we required servicers to report the impact of modification on the borrower's monthly payment.

It was clear to us that this topic should be aired. Unfortunately, the federal regulators resisted. They dutifully reported that modifications were re-defaulting at high rates, but resisted drilling into the nature of these modifications. Thankfully, congressional action led by Congressman Cummings helped change things, and earlier this year the OCC began collecting similar data regarding monthly payments.

The void created by preemption and the failure of federal oversight added a number of impediments for state banking commissioners in crafting legislation and in pursuing enforcement actions against predatory lenders. While it is too late to remove some of these impediments, there are some obstacles that can be eliminated to restore to state bank commissioners the ability to successfully regulate lending in the future.

Congress should promptly eliminate federal preemption of the application of the state consumer protection laws to national banks. The magic of federalism is that if one level of government falls asleep at the wheel or has too much to drink at the party, another can drive everybody home safely. But when the federal regulators preempt the states' best laws, you take away the keys to the car and our license to drive.

Together, with our nation's 50 banking commissioners and with the Conference of State Bank Supervisors, I am supportive of provisions contained within President Obama's recently proposed financial regulatory reform plan that would grant state authorities the ability to promulgate statutes and regulations that would apply to all financial firms operating in our state, to examine for compliance of these statutes and rules, and to take enforcement actions against those entities that were found to be out of compliance with these statutes. This structure would create a floor for all lenders but still permit states to protect their citizens through more robust legislation and regulation.

To sum up, there are lessons to be learned. The movement to erode state authority to enforce state and federal consumer protection laws must cease. Attempts to exclude state bank regulators from enforcing consumer protection laws has significantly contributed to the distress our residents have endured as a result of these difficult economic times.

Thank you for the opportunity to testify.

[The prepared statement of Sarah Bloom Raskin appears in the Submissions for the Record on page 45.]

Chair Maloney. Thank you. Mr. Strupp.

STATEMENT OF ROBERT STRUPP, DIRECTOR OF RESEARCH AND POLICY, COMMUNITY LAW CENTER, BALTIMORE, MD

Mr. Strupp. Good morning, Madam Chair, members of the committee. I am honored to have this opportunity to testify before you this morning. I am the director of research and policy with the Community Law Center in Baltimore, Maryland, and for over 22 years the Community Law Center has been a leading voice in Baltimore for preventing and eradicating blight and returning vacant and abandoned property to productive use.

The Community Law Center seeks solutions to the predatory and deceptive real estate transactions that have caused foreclosures and that have led to many of the housing challenges facing communities throughout Maryland. While I will try and focus my remarks this morning on Baltimore, I did want to share at the beginning a study from Chicago that exemplifies why this is a redlining issue, why this is an issue of concern with regard to discrimination.

Research conducted by the Chicago Reporter, an online magazine in Chicago, showed that African Americans earning more than $100,000 a year were more than twice as likely to receive high-cost loans than white homeowners earning less than $35,000 a year, and this would be true in any urban area—any part of our country. And so this is an example of what is going on.

In 2000, at the behest of Senator Barbara Mikulski and Senator Paul Sarbanes, the United States Department of Housing and Urban Development established a Baltimore City Flipping and Predatory Lending Task Force, and I am proud to say that the Community Law Center was the staff for this task force, which had served as a laboratory to develop creative solutions to problems arising in Baltimore and nationwide from the abuses in the FHA mortgage program.

In the beginnings of the 1990s, foreclosures in Baltimore were running at about $1,500—1,500 a year, excuse me. In 1999, that number rose to 6,000 a year as a result of the FHA fraud.

The task force was instrumental in cleaning up some of the fraud that was going on with regards to FHA transactions, but as that was happening, the subprime loan products were emerging and providing an entirely new problem for Baltimore and around the country, specifically since a drop in foreclosures as low as 829 for the city of Baltimore in 2005. Unfortunately, in the first quarter of 2007, that number was 941. In 2008 it had risen to 1,474. And in 2009, 1,471.

Currently, Baltimore is on track for over 5,000 foreclosures once again for the year 2009, so there has been a steady increase in the foreclosures following the emergence of the subprime and predatory lending practices.

This committee, actually, in 2007, had commissioned a report that showed that in Baltimore there would be a—I am sorry, in Maryland there would actually be a $2.73 billion loss in property values related to the wealth of Maryland residents and a $19.1 million loss in property taxes due to the subprime mortgage crisis. Between 2004 and 2006, subprime lending for the purchase of homes and refinancing continued to rise, and by the fourth quarter of 2006 and the third quarter of 2007 the growth in Maryland's prime and subprime foreclosure inventories was more than twice the national average.

In 2000 there were 1,474 foreclosure filings, and as I said, the numbers have risen considerably now since the subprime mortgage crisis. Based on filings from part of 2007, the study that was done by the Baltimore Homeowner—commissioned by the Baltimore Homeownership Preservation Coalition from the reinvestment fund showed that a disproportionately large share of foreclosure filings—73.5 percent—were found in communities that are more than 60 percent or more African American in Baltimore.

These are just part of the story showing that African Americans and others of minority class, people of color, are being directed to loans that they didn't necessarily need to be placed into, and that is the key of the predatory part of this, is that folks were preyed on.

There were many who were put into subprime loans who may have qualified for a better loan based upon credit reports, based upon job status, but there was a clear pattern in practice, as has been evidenced by the Wells Fargo case, of placing people who would have qualified for better loans into these dangerous high-risk loans based upon their color. And this is reverse redlining.

There was a study done and a statement made by a mortgage lender in the late 1990s that predicted that low-income borrowers are going to be the leading customers going into the 21st century. This was a target. This was a plan of lenders that these homeowners—minority homeowners—would be the focus of their profit. And they did that by placing minority homeowners into loans that they didn't necessarily need to be placed into, and either they could have qualified for much better loans or they were not ready to be homeowners at all, and I suggested that is certainly possible in some cases, where homeowners were given loans before they really were ready to be homeowners. And of course, that has somewhat been exemplified through the increase of housing counseling and pre-purchase counseling that we now see in the industry.

But clearly, the Wells Fargo case and the statements of the mortgage officers who have come forward is suggestive that the discriminatory practices were well deep into the practices of this lender, and the statements of other lenders and others representing the lending industry clearly acknowledge that there was a targeted focus on African Americans, in particular.

And the allegations in the Wells Fargo case specifically relate, as articles have indicated—news articles have indicated—on the bank's mortgage resource division, which was set up in 2001, and one of their former employees has said that this unit was targeting black communities by sending out fliers, visiting churches, and hiring minority employees to close deals.

This was a tactic of trying to earn the trust of African Americans by essentially affinity—affinity relationships—and coming and speaking in churches on Sunday evenings at barbeques and picnics and what have you, and saying, "We can help you own a home and we can bring you—come to our office or we will come to you and we will show you how you can own a home, too, and you can own a larger home than you might even think you can own because we can place you into one of these exotic products."

And this was going on throughout Baltimore and throughout the state of Maryland. Prince George's County, as many of you know, leads the state of Maryland in foreclosures, and in the first 3 months of 2009 Prince George's County has actually had about 3,000 homeowners who are either late in their payments or facing foreclosure. This is an across-the-state problem——

Chair Maloney. Would you summarize? Your entire statement will be in the record——

Mr. Strupp [continuing]. Thank you.

Chair Maloney [continuing]. And we are under tight time constraints with the legislative agenda on the floor, so if you could summarize quickly.

Mr. Strupp. So in closing, there is ample evidence that the—that redlining was going on, that targeted lending to African Americans of high-risk loans was going on. And we believe that this, you know, clearly requires regulation. It requires better law enforcement.

And if I might just conclude by saying that in the current legislation, one of the things that I would ask to be looked at is improved regulation of the modification process—the loan modification process. Thank you.

[The prepared statement of Robert Strupp appears in the Submissions for the Record on page 48.]

Chair Maloney. Absolutely. That is part of what we are looking at in Congress. Thank you for your testimony.

Commissioner Raskin, you touched upon this in your testimony, but I would like some more information on this important issue: The OCC preempted state anti-predatory lending laws on the bases of fostering competition between state and national banks and to create a better and more innovative banking system.

I, for one, voted against this preemption because the leadership on the state level in New York, and the city level, were doing a very fine job in combating predatory lending practices and were very active in that area, so to me it was very disturbing that this action took the place of our laws.

And I would like your comments from the ground in Baltimore, Maryland. Do you think that this preemption has had that effect? Can you explain further what this preemption meant? And you mentioned in your testimony your support for President Obama's decisions to change this direction in his proposed regulation, so from your perspective, could you give us some examples and better understanding of this? Thank you.

Ms. Raskin. Sure. The preemption policies of the OCC and OTS, which are the federal agencies that regulate national banks, have been in place, really, for quite a number of years, and they have been moving in such a way that they have become ever more expansive and growing.

So while there is complete, you know, settlement in the law regarding operating subsidiaries of national banks and whether those operating subsidiaries are subject to state or federal supervision, the problem with preemption is that the underlying law has been expanded way beyond the boundaries of what it was originally intended to do, and this creeping preemption, as we like to call it, has had the effect, really, of cutting off all efforts at the state level to do any meaningful consumer protection.

So, for example, at the state level we will see bills regarding consumer protection efforts on credit cards, consumer protection efforts regarding payday lending, consumer protection efforts regarding refund anticipation loans, and to the extent any of those legislative initiatives touch upon or have anything to do with a national bank, you will hear from the federal agencies that those actions are preempted. And that has had a chilling effect at the state level and has kept states from being more robust, in my opinion, in the area of consumer protection.

Chair Maloney. Thank you.

And the fact—and I believe it was you, Dr. Squires, who brought up the fact that African American women are more likely to be mortgage-holders.

Or was it you, Mr. Carr? Yes. Mr. Carr.

I thought it was interesting when you said that they were more likely to be mortgage-holders compared to other women of color, or non-minority women, as well as the fact that these same women are more likely to be steered into higher-cost loans, regardless of income group. I found that statement quite disturbing.

And according to a study that we recently did in the Joint Economic Committee, African American female householders are experiencing a very high level of unemployment during this recession, more so than other categories.

And do you expect foreclosure rates to rise even more sharply due to these unemployment numbers, and are there additional measures, other than the increases in unemployment benefits and food stamps in the stimulus package, that we should consider to help the families that are considerably stressed because of their being exploited in the subprime loan market and also the unemployment that they are experiencing now?

Mr. Carr. Thank you.

Mr. Carr. Yes. Absolutely.

First of all, this foreclosure crisis is nowhere near over. What has happened over the last year is it has morphed in its character and it is much more difficult to address now, so where we were mostly dealing with loans that were going to foreclosure because of the product, we are now dealing with loss of income or absolute loss of job through unemployment. So for every new 100 unemployed people we can expect up to 40 new foreclosures, and so that is an extraordinary number if you look at just the first quarter of the year in terms of unemployment. That added another 800 potential foreclosures to the statistics, which is why they are growing so large.

Even to the extent that they look not so—I mean, even to the extent they look bad now, if you dig in and look at some of the underlying data, you will see that a lot of homes are in default but in fact they are not actually going through the foreclosure process, which means there is even a backlog of foreclosures that is waiting to happen, probably during the second half of this year, which is why we have been advocating a much broader approach—something like a Homeowners Loan Corporation, because there really isn't a response to the foreclosure crisis to the extent that it is driven by unemployment.

To the extent that an individual actually becomes evicted from their home, that is where real damage occurs at a community level and at a national house price level.

So we need to address keeping people in their homes through modifications that can be made on a much broader scale, and we also need to address the impact of foreclosures that are going to occur where people just simply can't afford a mortgage because they are unemployed.

With respect to the female-headed household, the study that we did showed that African-American female-headed households were disproportionately targeted for predatory loans, and because African-American children tend to live disproportionately in the female-headed household, they will be disproportionately hurt, in terms of potentially needing to change schools, lose their social networks, and have long-term socioeconomic damage, as well as loss of wealth.

As we all know, African-American households and Latino households can't afford to lose any more wealth. On average, they have about $10 and $12, respectively, to every $100 of wealth of non-Hispanic white households, and that wealth gap is growing. It is estimated that African Americans could end up in this recession experiencing the greatest loss of wealth since Reconstruction.

Chair Maloney. Thank you very much.

The chair grants herself an additional 2 minutes on a very important question. Many economists have come before this committee and told us that if we don't put a floor on the foreclosures and the tumbling house prices and the, really, freefall in the housing market, that we will not turn around this economy.

As you know, Congress has stepped forward with a number of efforts to allow loan modifications, including more assistance to the servicers and many steps to help people stay in their homes. And very briefly, I would just like to go down, if any of you have any comments on what we could do additionally to help this foreclosure crisis that is in our country.

And why don't we start with you, Mr. Strupp, and go down very quickly? And this is a critical issue that policymakers are studying and grappling with. And we have made many efforts to try to stop it, but it hasn't been able to have the impact that we had hoped.

Mr. Strupp. Thank you very much. Actually, this is a pet project of mine, and what is strikingly missing from, I think, all the proposals and the legislation that have been submitted to date is a moratorium on foreclosures—a federal moratorium. The FHA did do that in Baltimore as a result of the discovery of the fraud. It has been done in the past, and I believe it should be done here.

And you are right, Madam Chair, until we actually stop the foreclosures, we are going to continue to see deterioration of home values, the continued deterioration of the economy.

And a foreclosure moratorium coupled with an attempt at loan modifications, such as what Sheila Bair has proposed, along with some percentage of 31, 35 percent, what have you, of income being paid monthly by homeowners—some combination of that is my recommendation, and we do need to have that moratorium. And it was proposed by Senator Obama when he was running for president, and I think it should be part of the package.

Chair Maloney. Thank you.

Commissioner.

Ms. Raskin. Yes. Clearly the number of foreclosures continues to increase. There have been a number of efforts put in place to try to address the rising numbers.

One initiative that we took in Maryland that had some traction was to put in place servicer agreements with various mortgage servicers which held servicers to different obligations regarding the way they negotiate with homeowners and taking certain steps regarding getting those loans modified. And that is one thing we have been able to do which has had some success.

Chair Maloney. Thank you.

Dr. Squires.

Mr. Squires. I think reforming the bankruptcy law would be one important step. Up until now, almost all these loan modification programs have been strictly voluntary, and the fair housing groups—consumer groups—have been advocating this for years, but so far that has not been an option.

Many states do have moratoriums in place. I think there is something like 14 or 15 states at least that have them in place right now, but that leaves most states unprotected. And I don't know if this is—maybe this isn't related to your question, but I think one of the issues we need to think about is what is happening to renters in the process. According to the Low-Income Housing Coalition, as many as 40 percent of the people who are losing their homes in urban areas because of foreclosures are renters, and they are obviously, you know, innocent victims of this process.

Chair Maloney. I want to thank you, and I am sure you are aware that the House passed a bankruptcy bill and passed it to the Senate, where it is awaiting movement forward. Thank you.

Mr. Carr. Yes. I would like to just reinforce the need for bankruptcy reform. It was part of the president's Making Home Affordable proposals, and it is one of the weaknesses. That is, the stick is left out; only the carrots are in.

What we have proposed in the National Community Reinvestment Coalition way back in January of last year in testimony to Congress was the establishment of an emergency homeowner loan program that was built on the basis of the original homeowner loan corporation. We called it HELP Now—Homeowner Emergency Loan Program.

Essentially, we had proposed a reverse auction program whereby the federal government buy from financial institutions toxic assets and modified them in mass, in bulk. In other words, eliminate this voluntary process where a consumer has to come forward, but the federal government actually take those loans and proceed to contact the borrowers and modify the loans.

We don't believe that that would work now because the generosity of the financial subsidies to the financial system have been so great that we don't think financial institutions would take part in a reverse auction. So we have since modified that proposal and suggested that the federal government exercise the right of eminent domain, to buy those loans at a reasonable discount.

The reason the reasonable discount is important, because that subsidy comes out of the lenders who actually made those loans and profited from them, and we would use that discounted amount from the sale, transfer that to the actual cost of loan modification, rather than sending the cost all to the federal taxpayers, which is what happens now. We——

Chair Maloney. Thank you so very much. My time is expired. Mr. Brady, for 7 minutes?

Representative Brady. Thank you, Chair. I think clearly greed drove this foreclosure crisis, all along the line from investors to lenders to borrowers, and I think that it was combined with good intentions over the past 2 decades by lawmakers to try to move people into homes, and who later sort of turned a blind eye to some of the consequences of these regulatory and statutory provisions.

I don't think, honestly, that the answer to predatory lending is to strip the workers' rights to secret ballot. Under that thinking, we would pass cap and trade because we would all grow better looking and would learn a second language immediately.

I do think that there is no simple solution. I think that is why Congress' efforts last session—HOPE for Homeownership program—was a failure. We have made some changes, but again, we are seeing even those loans modified a very high default rate on it. This is a tough problem to solve.

Two questions I wanted to ask, the first one to Mr. Carr and the rest of the panel get your view on something.

Looking at ways to prevent in the future—according to the Government Accountability Office, with the exception of loans covered under the Homeownership and Equity Protection Act, there are no federal statutes that expressly prohibit making a loan that a borrower will likely be unable to pay, other than generally under the Safety and Soundness set of requirements.

For loans that are covered under the Homeownership and Equity Protection Act, making a loan without regard to a borrower's ability to repay isn't prohibited unless it can be demonstrated that an institution has engaged in a pattern of practice of doing so. The Office of Comptroller of Currency prohibits national banks or their operating subjects from making consumer loans based predominantly on the foreclosure or liquidation value of a borrower's collateral.

Here is the question, Mr. Carr: Should Congress prohibit all lenders from intentionally making loans to consumers that lenders know ex-ante, before the event, that consumers cannot repay except by foreclosure or liquidation value of the collateral? So should we expressly prohibit lenders from making loans that they know will not be repaid?

Mr. Carr [continuing]. Yes. Absolutely. If, in fact, the financial institution has the information to understand that a consumer cannot repay the loan, they shouldn't extend it.

But I would go even further than that. I would say that on the very front end of the process, the broker who is actually offering that loan should have a fiduciary responsibility to tell the truth and give the best advice they can to the consumer.

One of the things that is so interesting about this foreclosure crisis is that at almost any point in the process we could have eliminated the crisis we had. So, for example, if we simply had not had Wall Street bond rating agencies stamping triple A on bonds that we knew were junk bonds, it would not have happened. So yes, I would agree.

Could I make just one quick point, though, on the loan modifications, because this is important? Many people have been scratching their heads to try and understand why loans, once they were modified, were still going to foreclosure. And there was such a paucity of information on that until the very end of last year, when it was revealed that more than half of the loans that were being modified were actually either leaving the payments the same or increasing them; a very small amount were actually lowering them.

So it was a process that made no sense.

Representative Brady. Well, I think, too, part of it is trying to figure out how you can help people who found themselves in tough situations—lost a job or lost valid income. How do you help them? And how do you address a colleague back home I talked to whose retired mother in Nevada took out three zero down payment, adjustable rate balloon payment notes to make investments in three homes she hoped would, you know, make money? And obviously these—our answers and solutions haven't fit those groups very well. So thank you for your comments.

There are a lot of things that contribute to this. I want to ask the rest of the panel—in 1992 there was a landmark study published by the Federal Reserve Bank of Boston. It found that minority applicants for home mortgage loans in Boston were more likely to be rejected than white applicants, even after adjusting for a number of differences.

In response to that study, the Federal Reserve Bank issued regulatory guidance to encourage banks to adopt more flexible underwriting standards for home mortgage loans.

Among other things, banks should be willing to consider ratios above the standard 28, 36, you know, the net—gross net income devoted to the house payment, that they should allow gifts, grants, or loans from relatives, nonprofit organizations, or municipal agencies to help cover the down payment and closing costs. They should accept unemployment benefits, which are by definition temporary, as a source of income in covering those debts.

Other federal regulators soon adopted this guidance, which became standard for evaluating the CRA performance of banks. The question is, however unintentional, did this Federal Reserve guidance contribute to the deterioration of underwriting standards? Did it deteriorate—contribute to the spread of subprime residential mortgage lending, inflation, ultimately, of the housing bubble, and the large number of home foreclosures among those low-income minority families probably least able to weather a tough economy or make the payments in the first——

And why don't we start with you, Mr. Strupp, and we will work it down the panel?

Mr. Strupp. Well, thank you, Congressman. I think that—remember, there is a difference between subprime and predatory, and of course a lot of what we are talking about today is what was predatory, but——

Representative Brady. Not always——

Mr. Strupp [continuing]. But not always. There certainly are predatory subprime loans. And I think that there was—certainly making loans more available and relaxing underwriting standards made more people able to borrow, but that did not suggest—does not suggest that irresponsible lending was being condoned or should have been condoned. And I think that is the distinction, is that it was still expected that lenders who were going to be making these more relaxed loans—FHA was making more relaxed loans as well—that that was the whole purpose of the FHA by its creation, was to make low-and moderate-income families available—make loans available to them. But that did not mean that what they were going to be borrowing was going to be something that they——

Representative Brady [continuing]. Right.

Mr. Strupp [continuing]. Could not sustain——

Representative Brady. No, I agree with you. I can't think of a lawmaker, a regulatory body, a reserve bank who said, "Let us set out to inflate the housing bubble and get people into mortgages they can't afford." I don't think that occurred throughout the process.

But trying to identify things that contributed to it that we ought to go back and revisit as a way to prevent them in the future in a reasonable way.

Mr. Strupp. And I think it may well be fair to say that certainly the creation of more relaxed loan products was—contributed to the problem, and those products were then abusively given to borrowers who should not have been given them. So I think that you could connect those dots and say that subprime loan products were abusively given to borrowers to whom they were not designed for. So yes.

Representative Brady. Good point.

Commissioner.

Ms. Raskin. Yes. I think that more flexible standards should not have ever been equated with weak regulatory standards. In other words, once the more flexible guidance was put in place, it was incumbent upon the regulators, as examiners, to examine for those standards.

So I think that the breakdown occurred at the regulatory oversight piece of the, you know, of the equation, which ties back into your question regarding ability to repay and the ability to repay standard, which is something we have adopted in Maryland. It is law in the state of Maryland now. And ability to repay standard must be shown for every loan, and our examiners examine against that law. So we——

Representative Brady. When did you put that law in place?

Ms. Raskin [continuing]. We put that in place in 2007—early 2008, yes—that is exactly right, but it also goes to the question about what we can do to keep this from happening again.

Representative Brady. Yes. I appreciate that. And you have a unique perspective, so thank you.

Yes, sir, professor.

Mr. Squires. I don't think the increase in flexibility was any kind of meaningful contribution to this problem. The fact that lenders were encouraged to be more flexible is not an invitation to be irresponsible, to not verify income, to not do sound underwriting.

We have long had character lending that people have used to help out friends and people that they knew. It seems to me there is nothing wrong with encouraging people to try to reach out—lenders to reach out to communities that they had not traditionally served, but to do so in a responsible way.

It is important to keep in mind that the CRA, which has gotten some criticism, has in the statute language requiring safe and sound lending. Lenders have an affirmative obligation to ascertain and be responsive to the credit needs of their entire service area, including low-and moderate-income families, consistent with safe and sound lending.

So there is nothing in the call for flexibility that requires irresponsibility. Now, lenders, knowing that they weren't going to keep a loan in their portfolio and they were going to immediately sell it and turn it around, that clearly contributed to the problem, but it is not because of the flexibility.

And I also want to point out—semi-related—that the Employee Free Choice Act does not deny any worker the secret ballot. It provides workers with the opportunity to exercise a choice as to whether or not they want to have a secret ballot or a card check.

Representative Brady. That is not how my workers see it, but I appreciate the point. I do think one thing we have noticed in this foreclosure crisis is that everyone offends the good intentions in policy that they set out to accomplish.

How those were interpreted, used, regulated, invested, ultimately borrowed from a wide range of borrowers, both from some out of need, from some for a hope of actually owning a home, some for making a quick buck—although I am not pointing to any single one; there were a whole lot of host of different issues that we have to deal with.

And again, I really think this is a good panel. We appreciate you, Chairman.

Mr. Carr. Could I respond to that? Could I respond to that question about the study, because I think that study was a watershed.

That was actually at a high point in them actually trying to promote affordable, sustainable homeownership.

The study didn't say become more reckless; it said be more careful in looking at the details of these consumers who, historically, have been outside of the system, so that you can bring them in. And that is not what broke down the system. Using alternative sources of income is not what happened. It was using no source of income, called no-doc mortgages.

It was not giving them a fixed-rate mortgage that was a percentage point higher; it was giving them a—it was putting them into an adjustable loan that had payment shock that was about 50 to 80 percent and in some cases 100 percent higher. It was qualifying a person at a teaser rate rather than the actual adjusted rates that——

Representative Brady. Although you have to admit, Federal Reserve Board followed up that study with specific guidance to banks—said, loosen, you know, the income ability to repay, the standard 28, 36 figure. It said, you know, loosen up how you get the down payment, closing costs, and loosen up using income like unemployment benefits. Again, I am not saying that caused a cascade of all of this——

Mr. Carr [continuing]. Exactly. But they don't use income at all.

Representative Brady [continuing]. What is that?

Mr. Carr. My point is that they didn't say, underwrite consumers for the adjustable starting teaser rate and not for the cost of a loan. They did not say, use pre-payment penalties that would lock a consumer in. But once they were in the system and they actually perform well after the first year or year and a half, and they realize, "Wow. This homeownership stuff works. I can get into a low-rate, fixed-rate mortgage." They couldn't because they were penalized and held into that mortgage.

They didn't say, charge them $12,000 to $17,000 more——

Representative Brady. But I do point out, there really were significant changes as a result of that study that had an impact down the road, whether intentional or not. Thank you.

Chair Maloney. Mr. Hinchey.

Representative Hinchey. Thank you very much, Madam Chairman.

And thank you very much for your very excellent testimony and the very candid responses that you have given to the questions that have been asked of you.

This is a very complicated situation, and it is something that really needs to be dealt with. We have seen a manipulation of the lending practices in this country now going back for almost a decade.

And to a large extent, they originated with the repeal of the Glass-Steagall Act, which was a very conscious repeal that was engaged in and caused by people who wanted to engage in predatory lending and the manipulation of the lending system, going back to the circumstances that caused the depression of the 1920s, what enabled them to make a huge amount of money, and they didn't care what the outcome was going to be. That is the circumstances that we are dealing with.

It strikes me as a kind of modern version of the con jobs of the 1930s. You go around establishing confidence in people, and then after you establish the confidence you manipulate them and take away as much money from them as possible. That is what we have seen, and we need to deal with this effectively. This Congress and this administration needs to deal with it effectively.

A lot of things have come forward now that are attempting to deal with it, but there are a host of other things that really need further dealing with. One of the aspects of the past that interests me, frankly, was that January 7th, 2004 act of the Office of the Comptroller of the Currency, which issued a final rule identifying types of state laws that are preempted for national banks, including mortgage lender broker licensing laws, escrow account laws, credit score disclosure laws, and anti-predatory lending laws.

That was just a brilliant move by the part of the OCC back in the Bush administration, and I am sure that they were advised to do that by a lot of the people who wanted to engage in these practices that we have seen that have caused so much of the damage.

So we are seeing efforts now that are attempting to engage these problems, and I hope I am not too right about this, but in my opinion what is being suggested is not nearly enough. It is going to go some part of the way; it is going to deal with some aspects of the problem. But it is not going to deal with it all the way.

So I am wondering if you might suggest to us what might be done with the Consumer Financial Product Safety Commission Act of 2009, which is the big bill which is upcoming and is supposed to deal with this problem. What should the Congress think about adding, consider adding? What should we do to strengthen that?

And what should we do to really deal with some of the underlying problems here, which were set up intentionally to manipulate this national economic financial system, bring about predatory lending and the whole host of things that have caused these deep economic problems?

And what can we do to deal with those, and not just deal with them in the context of the circumstances that are existing now, but what are we going to do to try to—to make sure to prevent this kind of thing from happening again in another 10 years? Maybe you might have some suggestions, so let me start with Mr. Squires and ask him.

Mr. Squires. Not being familiar with the statute that you are talking about, I would say that if there isn't a private right of action, there ought to be. You ought to make it easy for fair housing organizations, consumer advocates, private attorneys around the country to use the statute to take action on their own.

We see with the Fair Housing Act, for example, HUD can only do so much, Justice can only do so much. Most of the major pathbreaking decisions that we have gotten from the courts have been as a result of private lawsuits leading to decisions or settlements.

So I think that you want to try to energize as many different organizations around the country so you are not relying simply on a federal regulatory agency to enforce the law.

Mr. Carr [continuing]. Yes. I would offer just some broad comments. I think one of the most powerful things that can be done is collect information on the abuses that are occurring in the system. Without taking any action to eliminate abuses, just shining a spotlight on where the disparities in lending are happening and how and making it clear to the American public would go a long way, I think, to addressing a lot of problems, because just like at this hearing today, there are many who disagree with, for example, the—you know, where the disparities come from in the lending market. And we shouldn't be debating, you know, the facts; we should be debating how do we resolve them.

A second thing I would say is, I would really encourage looking at the full panoply of institutions that serve consumers across the spectrum and asking, do they have the responsibility and do they have a perspective on how most to achieve financial mobility and economic—upward economic movement?

One of the things that I find striking is these conversations between safety and soundness on one side and consumer protection on the other. We should know now very clearly that safety and soundness means promoting the economic mobility of consumers, and if that is not happening, the system is neither safe nor sound.

Ms. Raskin. Yes, well I certainly concur with you that the causes of this are much broader than the proposed solutions appear to be. And when I look at this crisis I see, as you do, problems not just with the repeal of Glass-Steagall, which, after all, validated the growth and complexity of these institutions which are now too big to fail and which have devoted so much of our federal taxpayer dollars to help bail out, but also the absence of any meaningful antitrust enforcement as well as a general deregulatory impulse that has—that has sort of gripped the regulators in the last couple decades.

To speak primarily to the question of the consumer protection proposal and suggestions for making it work, I would offer the following: First of all, I think that we want to make sure that we keep it from being captured. We think about how you create an agency—a federal agency—in this environment that is not captured by the industry that it is supposed to be regulating.

Secondly, I think we want to look and make sure that we can keep it from being slow and reactive. In other words, what can we build into this agency that will keep it nimble and keep, in essence, what we do at the state level, which is the ability to respond very quickly and nimbly and in a tailored way to new developments as they emerge, because as this whole panel has pointed out, the predatory practices completely morph and change at a very constant, rapid-fire kind of way, and the last thing we want is a federal agency that is supposed to be overlooking these practices responding too slowly and too late.

And finally, I would say that this protection agency should be studied with an eye towards understanding why other consumer protection agencies at the federal level have failed, have not been as strong as they could have, and what lessons have been learned from the other federal agencies that are supposed to be doing consumer protection.

Representative Hinchey. Thank you very much.

Mr. Strupp.

Mr. Strupp. I am going to focus on your original, or initial, comments about preemption——

Representative Cummings. And be brief.

Mr. Strupp [continuing]. And I will be brief. Thank you, Congressman.

I am a member of the Bar in the state of Virginia and in the District of Columbia. If I choose to practice law in New York, I have to get a New York license. I think this agency will set—should set minimum standards, but if I am a lender, and I choose to go into another state and it may have higher standards, I should adhere to that state's higher standards. I think that that is an important structure for this agency.

Representative Cummings. Thank you very much.

Mr. Campbell.

Representative Campbell. Thank you, Mr. Chairman.

And thank you all. First question: There is a proposal out there for a federal requirement of a single-page disclosure that would be very simple, very clear, that would have to outline if there is a change in payments what the maximum payment could be, et cetera, et cetera. Good idea, bad idea?

Ms. Raskin. I think it is a great idea. If it can happen, if people can sit down and come up with a single form of disclosure that makes sense to people, I am all for it. It has bedeviled people in the past, but it is something that is worthwhile.

Representative Campbell. Okay. I see nodding, I think, general agreement.

Mr. Carr. I would agree.

Representative Campbell. Okay. Fannie and Freddie—we haven't talked about them much. Do you all see Fannie and Freddie as having contributed to the problem, as having contributed to a solution, or as having been neutral in all the ills that we are currently experiencing?

Mr. Carr. Well, as a former employee of Fannie Mae who was paid for many years to develop affordable loan products that were sustainable and to talk about and try to get predatory lending out of the market, I can say that Fannie Mae was a major player in trying to right what was happening wrong.

In fact, going all the way back to 2001, I published two studies while still a Fannie Mae Foundation employee. I published an entire journal, called "Predatory Lending," looking at every aspect of the mortgage market, again, funded by Fannie Mae.

Going all the way back to 1999, 1998, 1997, I was giving lots of speeches around these issues. The problem is that those subprime loans were allowed to percolate through the markets, and ultimately it affected the entire mortgage finance system, and ultimately the finance system itself.

But Fannie Mae was not a major player in the subprime mortgage market. And even to the extent that it did buy subprime mortgages, it did not contain the predatory features that in fact were the cause of the collapse of the market.

Representative Campbell. Other thoughts from the panel? No other comments around that?

Okay. One last question that I have, then. We talked about changes in the bankruptcy laws, and there is something—I have opposed that, and there is something that I just don't get and don't understand, and perhaps you can explain your position.

Home loans are secured loans, and if under a bankruptcy loan, basically that security—the ability to tap that security can go away in bankruptcy, then doesn't that make—as a lender, doesn't that make you then say, "All right, this is effectively a personal loan, which will"—and when you talk about underwriting standards and so forth and, you know, somebody wants to make a $200,000, $300,000, $400,000 personal loan that a very—a great number of people who currently are able to qualify for loans won't under that scenario? I mean, what am I missing?

Mr. Carr. I think the key to the bankruptcy reform—the real key—was to actually get loans retroactively, loans that had already been originated, to allow people going to foreclosure to have those loans modified. And to the extent——

Representative Campbell. And not going forward?

Mr. Carr [continuing]. Not going forward, no. Because hopefully going forward we will be making loans that people won't need to go to bankruptcy court to maintain.

Representative Campbell. Okay. So—you see it only as a solution to deal with the current crisis—and going forward that you would not be able to discharge that debt in bankruptcy and keep the security?

Mr. Carr. Not for newly-originated loans.

Representative Campbell. Okay.

Mr. Carr. I am saying this would be a problem trying to clean out this exceptional problem that already exists and for which no other solution has been found. And what is helpful about this proposal, bankruptcy reform allows the cost to be borne by the individuals who were the two parties to the process—the borrower and the lender.

Representative Campbell. I get that. And actually I think that is a reasonable point and I appreciate it. The only concern I would have—and then I will yield back my time—but the only concern I would have is that there is one thing going on in the marketplaces right now, that the rules of the game change in the middle of the game, and so still—if you did that now you would, in fact, be changing the rules of the game in the middle of the game.

Now, you can argue that there is justification for doing that, that some people cheated, and I get that and I understand it. But the question becomes, there are a lot of people who didn't cheat, and do they say, "Well, wait a minute, you know, I don't know how to play this game in the future because now the rules might change after we enter the game." So it is just a concern.

I yield back my time. Thank you.

Mr. Carr. Yes. I think that that, you know, that the institutions that are arguing that giving a homeowner access to bankruptcy court that is equivalent with something they could get for their luxury yacht in a time of national crisis is completely frivolous.

The federal government is standing on the hook for about $12.8 trillion. If that is not a national disaster—and the taxpayers at the end of the day will have paid more than $1 trillion of subsidies.

So to open the window on a temporary law that will allow the cost to come out of the people who were actually investors in what was a lot of fraudulent mortgage product rather than shoving all of those costs on the backs of the American taxpayer I think makes reasonable sense. And I think it is important to recognize that all of us are paying, not just homeowners—all of us, because that foreclosure crisis is destroying the U.S. economy, and the crisis in foreclosures is getting worse.

Representative Snyder. Thank you, Mr. Chairman. This is a Maryland-related hearing today, and I am from Arkansas.

I think I want to direct my question to you, Ms. Raskin. This is my 13th year, but I suspect since about 12½ years I have been hearing from the local affiliate of Acorn back home about the potential problem with predatory lending. You had mentioned in your written statement that some banking commissioners have been warning about these problems for some years, and I think there were other people that were, too.

Last night I got an e-mail from—in response to our questions from the Acorn group back home, and this is one of the things that they said, part of their e-mail: "About 2005 we began seeing lots of first-time homebuyers who were getting 80–20 loans—two loans, one for 80 percent and the other for the 20 percent down payment. All of these loans had ARMs and most were loans that had a 2-year fixed rate before the ARM kicked in.

"Almost everyone received a loan through a mortgage broker. Most loans had a sizeable yield spread premium, the backend compensation that goes to the broker. The overwhelming majority of the people we have been seeing live in zip codes 72204 and 72209. Those zips have the highest number of foreclosure filings in Pulaski County, Arkansas, as well.

"Almost everyone says they were never given any alternative products. Many reported being pressured into signing the paperwork. Of the 50 or 60 people we have had in counseling over the last year, no one fully understood the terms of the loan, no one was aware of the yield spread premium or even what it was, everyone was told that they could refinance during the 2-year period. When the ARM kicked in, the loan became more and more difficult to handle," end of quote.

Is that about the kind of problem that you all have been seeing in Maryland, as well as Arkansas?

Ms. Raskin. Yes. That pretty much sums it up. And I would venture to say that that description holds true in a lot of states in our country.

Representative Snyder. Right. I wanted to ask, I am the father of four boys under the age of four, which means anything I learn now I learn from either the "Jungle Book" or "Mary Poppins," and, you know, the staid old bankers in "Mary Poppins" that look like they have been very content with their 4 percent earning, or whatever. I want to ask about the ethic of banking in general and financial services.

We look at this predatory lending as an outlier, but in fact, when you look at some of the practices of mainstream banking, it doesn't seem so much like an outlier.

Computer programs that, you know, if I go down and take $100 out of my account on Friday afternoon—sorry, take $10 out of my account on Friday afternoon and Monday morning early I take $100 out, it will be processed in my bank account so that $100 comes out first with the goal being to drive me into more over-charge fees. Our mainstream banks who put out credit cards are doing all this nefarious stuff that the Congress and the fed finally had to act.

I put—two mornings ago deposited $13,000 in my bank account on June 23rd and received back my deposit slip that said half of it will not be credited till July 2nd. And I am pleased with that one because, apparently, my bank is saving gas money by sending the checks by Pony Express to the other state and then bring the cash back by Pony Express. It is the only way I can account for like, 11 days, to see if a check cleared or not.

So what is happening? You have been in the industry a while from a different perspective, Ms. Raskin, from the policy for spending. What has happened to the banking and financial services industry that we can't really trust anyone? I mean, you really can't trust anyone in the banking industry that at some level they don't have predatory practices? What has happened to the ethic of financial services?

And to my personal friends who are bankers back home, you all are excluded from my question.

Ms. Raskin. Well, I mean, excellent observations, and it has been fascinating, really, to watch the evolution of banking over—really over the last couple decades. And I think——

Representative Snyder. Worse than fascinating—it has been just, I mean, horrible.

Ms. Raskin [continuing]. Right. But what we are talking about—what we have been talking about, you know, prior to your question, has been mostly predatory behavior on the mortgage side, not that that includes the whole universe of predatory behavior.

But if you look at the small community banks, the Main Street banks, as you have talked about them, they generally were not—and obviously I can't speak with absolute quantitative precision here—but they were not the institutions that were heavily engaged in subprime lending.

The subprime problem and the predatory behaviors associated with part of the subprime problem were associated really with the fact of the mortgage broker industry being inserted into the chain of relationships that used to be just a banker-borrower kind of relationship, and then the corresponding securitization of loans and lending that financed this incredible new retail kind of operation.

So when we look at mainstream banking we clearly look for the practices that you describe. I mean, we very much are sensitive to overdrafts, overdraft charges, the accumulation of fees that don't seem to bear any relationship to cost, and those are clearly things that need to be examined and kept an eye on.

I would like to think that this doesn't represent a fundamental erosion of a community banking ethic. I tend to think, from the community banks that I see in my state, that that ethic remains strong, that the notion of charging excessive fees or acting in a predatory way is not the norm and is not the way that banks really want to move in terms of being sustainable engines of growth for our local economies.

Representative Snyder. I agree with you on the community banks, and maybe that "too big to fail" is synonymous with "too big to be ethical" also. Thank you.

Representative Hinchey. Let me just ask you one more question: The original House bill on bankruptcy modification—would allow bankruptcy courts to modify mortgages on primary residences. These loans are the only asset that a consumer has that can't be changed in bankruptcy court—second homes, whatever it might be.

All of this can be modified. This doesn't mean that the value of the house, of course, doesn't matter in the context of the bankruptcy. But given the fact that the Senate version of the bankruptcy bill—is weak, let me ask you what you think we can do to give mortgage companies the incentive to modify these mortgages properly without forcing homeowners in the context to go bankrupt?

Mr. Carr. I think the big problem is that we are already paying their bills, and so they are not incented to agree to bankruptcy or anything else because they know that they are too big to fail and we are going to subsidize, and the taxpayers are doing, and unfortunately I think our approach to propping up the financial system with an unlimited draw on the U.S. Treasury is what is hurting us in every type of loan modification, bankruptcy, and everything else.

I mean, just the idea that the financial institutions are allowed to lobby while holding taxpayer funds, to lobby against the interest of the American taxpayer is, in and of itself, it is just a bizarre circumstance, and that needs to change in order to move forward in a positive way.

Mr. Squires. And I would endorse that, and I think part of the problem is we have seen so many examples just in the last couple of years of where we are prepared to bail out these entities.

There has always been this thought in the back that places like, you know, Fannie and Freddie had this implied relationship with the federal government and they would be protected, but now we have seen very concrete evidence that, you know, except for Lehman Brothers, we are prepared to step in and help out almost any entity, and so we have gone in the opposite direction and we have provided disincentives to institutions to sit down and work out these modifications.

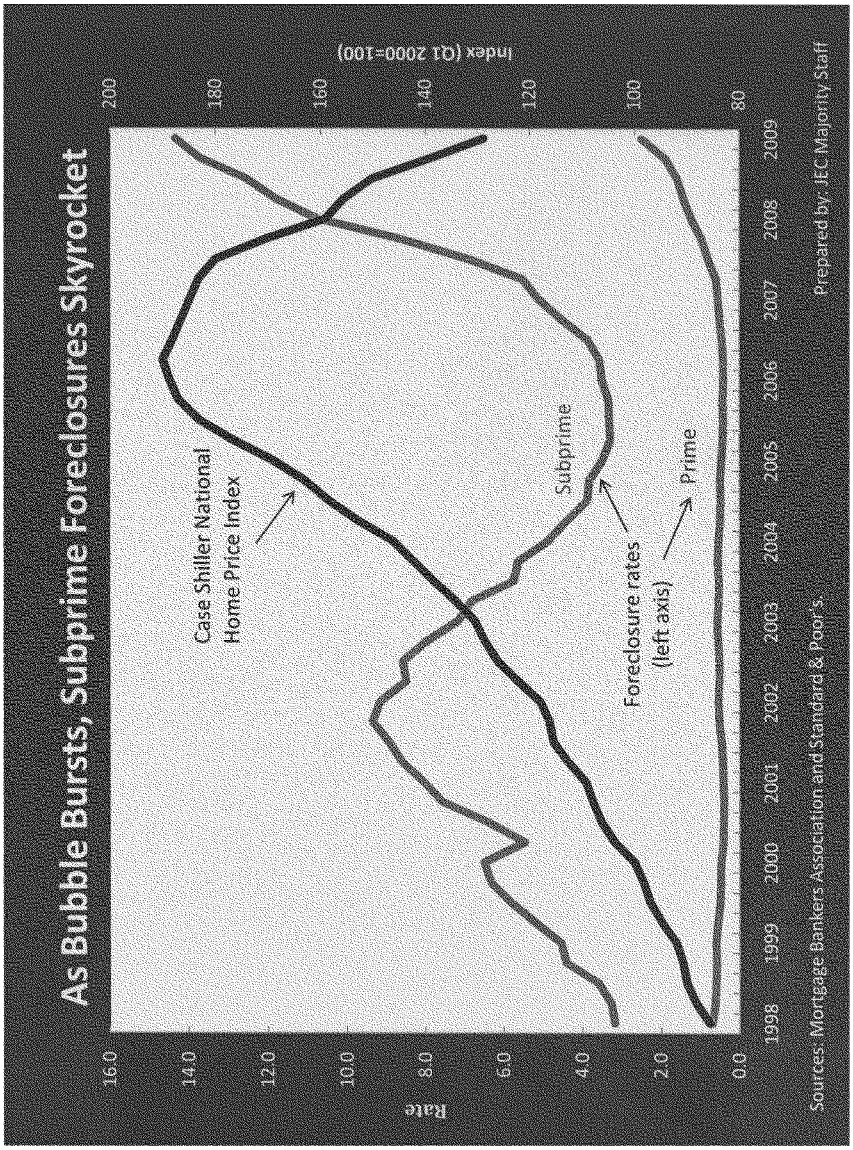
Mr. Strupp. I think the incentive is to mandate it and make them in noncompliance with the law if they don't, because I think that the problem is that the loan modification process we currently have is largely voluntary, and so the incentive should be, this is the law, this is what the lenders or the note-holders must do.

Representative Hinchey. Well, once again, let me express my gratitude and appreciation to you for being here and for the things that you have said, which are very helpful, and again, the candid responses that you have provided to the questions, and my appreciation for Mr. Cummings, who had to leave to go back to the floor, for inviting many of you to be here.

Thanks very much. We deeply appreciate it.

[Whereupon, at 12:45 p.m., the committee was adjourned.]

SUBMISSIONS FOR THE RECORD



As Bubble Bursts, Subprime Foreclosures Skyrocket
Rate
16.0
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
Index (Q1 2000=100)
200
180
160
140
120
100
80
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
Case Shiller National Home Price Index
Subprime
Prime
Foreclosure rates (left axis)
Sources: Mortgage Bankers Association and Standard & Poor's.
Prepared by: JEC Majority Staff

PREPARED STATEMENT OF REPRESENTATIVE CAROLYN B. MALONEY, CHAIR, JOINT ECONOMIC COMMITTEE

Good morning. I would like to welcome our distinguished panel of witnesses who are here to examine the economic impact of reverse redlining, where minority borrowers and senior citizens have been targeted to receive unnecessarily expensive mortgages.

I thank Congressman Cummings and his staff for their help bringing in witnesses from Baltimore, Maryland, one of several states and localities that is investigating or have recently brought suit against lenders over practices that may have violated fair lending or civil rights laws by deliberately steering minorities and the elderly into more costly subprime loans.

Two years ago, problems in the subprime mortgage markets touched off an economic crisis that is still unfolding. Today, almost 1 in 6 subprime mortgages are in foreclosure compared to 1 in 40 prime mortgages in the United States.

As subprime foreclosures have risen over the past two years, minority homeownership rates have fallen at a much faster pace than for non-minority home owners.

The pain of rising foreclosures is being felt in communities all across the country, as the ripple of mounting losses spreads to borrowers, lenders, governments, and neighbors. In some areas, once thriving neighborhoods have been transformed into boarded-up ghost towns. Concentrated foreclosures have spillover effects on neighboring properties, increasing crime and vandalism, and lowering surrounding property values.

A fundamental problem is that the financial incentives of mortgage companies and mortgage brokers are not aligned with the best interest of their borrowers.

Higher commissions for higher interest loans, creates the incentive for mortgage brokers to sell the most expensive products to those who can least afford them. Low or no documentation loans, which rely on stated income rather than W-2 forms, provide an avenue for lenders to evade state law by making loans appear affordable, even when they are not.

Evidence continues to come to light that many of the subprime borrowers who had paystubs to prove their employment—and may have qualified for prime loans—were steered into more costly no doc loans by some lenders.

In my home state of New York, Brooklyn and Queens have the highest concentrations of low and no documentation subprime loans compared to other parts of the state. There is a particularly high concentration of these loans in Astoria, which I represent.

Congress and the President have taken steps to strengthen the economy, keep families in their homes, expand affordable mortgage opportunities for families, and rein in abusive lending. But more must be done to stop bad loans from being made in the first place.

We need to return to sensible principles that require lenders to assess borrowers' ability to pay over the whole life of the loan. But we also need to strike a balance between making sure borrowers can repay the loans they get and helping borrowers who can repay a loan get one.

I have high hopes that the President's proposed Consumer Financial Protection Agency will play a key role in strengthening consumer protections against predatory practices in the future.

The Administration's proposal to eliminate the current preemption of state laws regarding antipredatory lending for national banks, thrifts, and federal credit unions will allow states to adopt and enforce stricter laws for institutions of all types, regardless of charter.

Stopping abusive lending practices that have contributed to the current foreclosure crisis and returning to healthy, fair lending principles will provide a sound basis for economic growth and recovery.

I look forward to the testimony of our witnesses.

PREPARED STATEMENT OF REPRESENTATIVE KEVIN BRADY, SENIOR HOUSE REPUBLICAN

I am pleased to join in welcoming the panel of witnesses testifying before the Committee this morning.

Racial discrimination in lending is immoral. It is also illegal under the *Equal Credit Opportunity Act*. Recent studies suggest that discrimination is generally limited to minority applicants with low incomes or poor credit and employment histories. Moreover, discrimination occurs primarily in the price of credit rather than in its availability. This practice is known as "reverse redlining." Nevertheless, distinguishing between racial discrimination, misguided efforts to shoehorn marginal borrowers into subprime mortgage loans to buy homes as prices escalated, and simple greed by unethical lenders is not easy.

From 1995 to 2007, the federal government encouraged mortgage lenders to loosen underwriting standards and offer exotic alternatives to fully amortizing, fixed rate, thirty-year mortgage loans to increase the rate of home ownership among low-income and minority families.

Mortgage lenders obliged, knowing that they did not have responsibility for the performance of mortgage loans they had extended once these loans were sold to issuers for securitization.

The deterioration of underwriting standards and the development of subprime mortgage loans combined with an overly accommodative monetary policy to inflate a huge housing bubble.

As in past bubbles, both borrowers and lenders became increasingly reckless. In some cases, individuals misled lenders to secure subprime mortgage loans to speculate in housing.

In other cases, lenders took advantage of unsophisticated families by placing them in subprime mortgage loans that they did not understand and could not afford. In either case, the results were the same—many families found themselves underwater, and a tidal wave of defaults and foreclosures followed—once the housing bubble burst. This has been especially difficult for low-income and minority families.

Individuals must be fully aware of mortgage terms and the financial burden that they are assuming before closing. Improving financial education would help families to understand mortgages and other financial products and to avoid credit problems in the future.

In conclusion, exploiting the complexity of mortgage contracts to fleece borrowers is not an acceptable business practice. Full disclosure and transparency should be part of the solution. Loan originators and issuers of mortgage-backed securities should also be required to retain "skin in the game" to discourage (1) lenders from knowingly extending mortgage loans that are unlikely to be repaid, and (2) issuers from placing such loans in mortgage-backed securities. Finally, excessive debt burdens, although all too common, make it very hard for families to get ahead over the long run. Better financial education could help people to avoid at least the most financially burdensome kinds of loans available.

PREPARED STATEMENT OF REPRESENTATIVE ELIJAH E. CUMMINGS

Madam Chair,

Thank you for holding this critical hearing to examine the targeted predatory lending practices that have ravaged our communities and our economy.

I requested this hearing following the *New York Times* report on June 7th detailing new developments in the lawsuit filed by my hometown of Baltimore, against Wells Fargo.

The article described affidavits that were recently filed by the City of Baltimore that included staggering claims about Wells Fargo employees steering African-American citizens toward high-cost loan products to boost company profits and reward employees with monetary bonuses and trips.

The affidavits also claim that the true opinion of the Wells Fargo firm toward their clients was reflected in their use of racist epithets to describe African Americans.

The city's contention is that the discriminatory lending practices pursued by Wells Fargo promoted high-cost loan instruments which led to foreclosures far in excess of what the rate of foreclosure might otherwise have been.

That in turn has led to declines in property values in many neighborhoods as well as increased crime, increased costs for city services, and lost tax revenues, all on the back of an increasingly burdened city.

With home values still falling, and the national unemployment rate now exceeding 9 percent, there has been a seemingly unending flood of foreclosures that has taken, and continues to take an immeasurable toll on all of our communities, and on the overall economy.

Obviously, the proliferation of subprime and other alternative loan products in communities across this nation contributed significantly to the foreclosure crisis.

So in order to progress toward a complete economic recovery we need to understand exactly what got us where we are today—and that means that we need to understand both the specific financial transactions and regulatory failures as well as, frankly, the assumptions and attitudes that led firms to target certain groups for some of their most questionable transactions.

The subprime loans, which were created to increase homeownership in low and middle income sectors, turned into vehicles for enriching lenders, brokers, and investors.

We also know, from research done by Mr. Carr and the National Community Reinvestment Coalition, that there is a racial and ethnic disparity in the distribution of these high-cost loans.

They found that low- to moderate-income African Americans were *at least twice as likely* as low- to moderate-income whites to receive high-cost loans in 47.3 percent of areas they examined. The disparity continued into the higher income brackets as well.

Dr. Squires has written very eloquently that, "clearly not all subprime loans are predatory, but virtually all predatory loans are in the subprime market."

That is why it so important for us to ensure the protection of all homebuyers, and President Obama has taken a decisive first step in this direction with the proposed Consumer Financial Protection Agency.

As I say so often, I live in the inner, inner city of Baltimore. And the people on my block are my neighbors, *and* my constituents, *and* my friends. They are struggling, and they need help now.

I am determined to do everything I can for them, from hiring dedicated staff for constituent mortgages to getting people a seat at the table with their lender—as we did recently putting 1000 borrowers together with 19 lenders at our foreclosure prevention workshop.

The witnesses before us have also done their part. I commend all of them for their work protecting the interests of home borrowers and communities.

I am particularly pleased to have Commissioner Raskin with us. She remains vigilant in exercising all the rights she has under Maryland law—and her efforts have led to the enactment of new mortgage fraud protections by the General Assembly.

Again, I want to thank the Chair for holding this hearing and I look forward to the coming discussion.

TESTIMONY OF JAMES H. CARR, CHIEF OPERATING OFFICER, NATIONAL COMMUNITY REINVESTMENT COALITION

Good morning. My name is James H. Carr and I am the Chief Operating Officer for the National Community Reinvestment Coalition. On behalf of our coalition, I am honored to speak with you today.

NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families. NCRC is also pleased to be a member of a new coalition of more than 200 consumer, civic, and civil rights organizations—Americans for Financial Reform—that are working together to restore integrity and accountability to the US financial system.

THE FORECLOSURE AND ECONOMIC CRISES

Members of the Committee, recent reports of green shoots and signs of an economic recovery offer hope to the American public that the worst may have past. But when one reads the fine print and footnotes on the optimistic headlines, the positive news is less than encouraging. This is particularly true within the financial services industry.

The reason for the continuing and protracted economic downturn is that the problem that precipitated the collapse of the credit markets and erosion of the economy, namely the foreclosure crisis, continues to worsen. Already this year, more than a million homes have been lost to foreclosure and five million more homes are at risk of over the next three years (assuming Making Home Affordable achieves the full success expected by the Administration).

ORIGINS OF THE FORECLOSURE CRISIS

Many blame the foreclosure crisis on a claim that financial institutions that sought to improve homeownership among low- and moderate-income households. A variation of this argument is that the Community Reinvestment Act forced banks to lend in a reckless and irresponsible manner.

Both of these assertions have no basis in fact or logic. According to the Federal Reserve Board, only 6 percent of high-cost subprime loans to low- and moderate-income households were covered by CRA regulation. And, the Center for Responsible

Lending finds that less than 10 percent of subprime loans were for first-time homeownership.

Failure to regulate adequately the US mortgage markets allowed deceptive, reckless, and irresponsible lending to grow unchecked until eventually it overwhelmed the financial system.

Almost every institutional actor in home mortgage finance process played a role, including brokers, lenders, appraisers, Wall Street bond rating agencies, and investment banks.

NOT AN EQUAL OPPORTUNITY CRISIS

While few have been able to escape the financial pain completely, African Americans, Latinos, and Native Americans are bearing the brunt of this current economic disaster.

Although the national unemployment rate is an uncomfortable 9.4 percent, that rate for African Americans is 15 percent, and for Latinos, unemployment is approaching 13 percent. The unemployment rate for non-Hispanic whites remains under 9 percent.

Because African Americans and Latinos have so few savings, they are poorly positioned to survive a lengthy bout of unemployment. As a result, potentially millions of African Americans and Latino middle-class households could find themselves falling out of the middle by the time the economy recovers.

Moreover, African Americans and Latinos were targeted disproportionately for deceptive high cost loans. According to a study by the US Department of Housing and Urban Development, subprime loans are five times more likely in African American communities than in white neighborhoods, and homeowners in high-income black areas are twice as likely as borrowers in lower-income white communities to have subprime loans.

The result is that blacks and Latinos are over-represented in the foreclosure statistics. African Americans, for example, have experienced a full three-percentage point drop in their homeownership rate since the crisis began.

Further, research by the National Community Reinvestment Coalition found that predatory lenders aimed their toxic products particularly at women of color. And, because African-American children are more likely to reside in female-headed households, black children are also disproportionately harmed as a result of the foreclosure crisis and its attendant stresses.

If a family lost their home to foreclosure and could not find a suitable apartment in the neighborhood from which they were evicted, children may be forced to leave their school, social networks, and familiar community surroundings, all of which can hinder their educational performance and long-term socioeconomic wellbeing.

In a separate NCRC study (The Broken Credit System, 2004), we found that after controlling for risk and housing market conditions, the portion of subprime refinance lending increased solely when the number of residents over the age of 65 increased in a neighborhood. If a borrower were a person of color, female, and a senior, she was the "perfect catch" for a predatory lender.

These levels of disparity have little to do with differences in the credit quality of the borrowers. Fannie Mae has estimated that 50 percent of consumers with subprime loans could have qualified for prime loans. In fact, in 2006, more than 60 percent of subprime borrowers had credit scores sufficient for them to have received a prime loan.

Failure to provide adequate consumer and civil rights protections explain the exceptional damage from the foreclosure crisis now being felt overwhelmingly in communities of color.

FIXING THE PROBLEMS

In response to the magnitude and complexity of the current crisis, a three-fold response is essential.

1. Stem the Rising Tide of Foreclosures

Although the new "Making Home Affordable" program is the most comprehensive plan to date to address the foreclosure crisis, its success is measured in the thousands while the foreclosure crisis grows by the millions. The result: more is needed.

A "new" vintage Great Depression-era Homeowners Loan Corporation (HOLC) is warranted. The new entity would more aggressively pursue loan modifications using exceptional governmental powers to purchase high-risk loans at reasonable discounts in order to accomplish millions of loan modifications, in a relatively short span of time, and at a limited cost to taxpayers.

The new HOLC could also take possession of properties and structure foreclosure moratoria based on workers' unemployment benefits. In the event of foreclosure, this new entity could also allow families to remain in their homes under rental agreements.

2. Rebuild Communities Harmed by the Crisis

Government action also should help communities rebuild. Economic recovery funding should be focused on communities with a convergence of three factors:

1. Areas with the highest levels of unemployment
2. Areas with the greatest concentrations of foreclosures
3. Areas with historically under-funded, inferior, or poorly maintained infrastructure

3. Enact Comprehensive Anti-Predatory Lending Legislation

Comprehensive anti-predatory lending legislation should be immediately enacted. It should apply consumer financial protections to all of the institutional players in the mortgage market. In addition to purging previous predatory lending practices, the establishment of a financial consumer protection agency should be enacted. Already, in the midst of this crisis, new predatory practices are emerging.

CONCLUSION

In the words of Nobel Prize-winning economist Joseph Stiglitz, the financial system discovered there was money at the bottom of the wealth pyramid and it did everything it could to ensure that it did not remain there. Stated otherwise, the business model for many financial institutions was to strip consumers of their wealth rather than build and improve their financial security.

Ironically, most solutions to date have focused on rewarding the financial firms (and their executives) that created this crisis. But in spite of more than $12.8 trillions of financial support in the form of loans, investment, and guarantees, this approach is not working because consumers continue to struggle in a virtual sea of deceptive mortgage debt and a financial system that remains unaccountable to the American public.

Now is the time to shift the focus away from Wall Street and on Main Street by addressing, in a broader manner, the growing foreclosure crisis and its contagion effects on national home prices and the overall economy. This includes introducing a more robust foreclosure mitigation program, focusing recovery dollars on the communities most negatively impacted by the crisis, and enacting strong consumer protections against deceptive and reckless lending practices.

PREPARED STATEMENT OF GREGORY D. SQUIRES, PROFESSOR OF SOCIOLOGY AND PUBLIC POLICY AND PUBLIC ADMINISTRATION, GEORGE WASHINGTON UNIVERSITY

SEGREGATION AS A DRIVER OF SUBPRIME LENDING AND THE ENSUING ECONOMIC FALLOUT

Few issues have posed the range and severity of challenges to the nation as have recent developments in financial services. I want to thank the Joint Economic Committee for conducting this hearing, for taking on these difficult challenges, and for inviting me to participate.

Dramatic changes have taken place in the nation's mortgage lending markets in recent years. Passage of the Community Reinvestment Act (CRA) in 1977, enforcement of the federal Fair Housing Act (FHA), and compliance with a range of local, state, and national fair lending rules have increased access to credit for many households and communities long denied conventional financial services. But within the past decade the rise in subprime and predatory lending has put many families and neighborhoods in financial jeopardy as default and foreclosure rates are skyrocketing, particularly in minority and low-income areas. Fingers are pointed in several directions: greed on the part of families trying to buy homes they could not afford, lax underwriting by originators, inaccurate appraisals, fraudulent practices by investment bankers, inattention by regulators, and more. Community groups, elected officials, bank regulators and mortgage lenders themselves are debating over how the nation should respond.

Lost amidst recent debates is the central role that surging economic inequality and persistent racial segregation have played. The concentration of income and wealth at the top coupled with the concentration of poverty and persisting levels of segregation and hypersegregation have nurtured significant increases in subprime and predatory lending among vulnerable communities. Reforming the regulation of financial services is a necessary but insufficient step for ameliorating the crises created by recent lending practices. Broader, macro-economic policies that directly address various trajectories of economic inequality and dynamics of discrimination and segregation must complement progressive banking and bank regulatory reforms if emerging challenges are to be met.[1] This comment examines the impact of inequality on subprime and predatory lending and offers a range of policy responses to the emerging problems confronting metropolitan areas across the country.

Surging Inequality

By virtually any measure economic inequality has increased in recent decades. Between 1967 and 2007, the share of income in the U.S. going to the top quintile of all households increased from 43.6% to 49.7%, while the share going to the bottom fifth dropped from 4.0% to 3.4%.[2]

Since the mid 1970s, compensation for the 100 highest paid chief executive officers increased from $1.3 million, or thirty-nine times the pay of the average worker, to $37.5 million, or more than 1,000 times the pay of a typical worker.[3] In 2004, those in the top one percent enjoyed a 12.5% increase in their incomes compared to 1.5% for the remaining 99%.[4]

Wealth, of course, has long been much more unequally distributed than income, and that inequality has increased over time. Between 1983 and 2001, the share of wealth going to the top five percent grew from 56.1% to 59.2%. While African Americans and Hispanics earn approximately two-thirds of what whites earn, wealth holding for the typical non-white family are approximately one-tenth that of the typical white family.[5]

City residents have been falling behind their suburban counterparts, and non-white neighborhoods have been falling behind white communities. In 1960, per capita income in cities was 105% that of suburbanites, but in 2000, urban residents were earning just 84% of those in the suburbs.[6] The median census tract income for the typical black household in 1990 was $27,808 compared to $45,486 for whites, a gap of $17,679. A similar pattern holds for Hispanics.[7]

Between 1970 and 2000, the number of high poverty census tracts (those where 40 percent or more of the population is poor) grew from 1177 to 2510, and the number of people living in those tracts grew from 4.1 million to 7.9 million.[8] The isolation of rich and poor families is also reflected by the declining number of middle income communities.[9] Between 1970 and 2000, the number of middle income neighborhoods (census tracts where the median family income is between 80% and 120% of the median family income for the metropolitan area) dropped from 58% to 41% of all metropolitan area neighborhoods.[10] And whereas more than half of lower-income families lived in middle income neighborhoods in 1970, only 37% of such families did so in 2000.[11] The share of low-income families in low-income areas grew from 36% to 48%.[12]

Even longer standing patterns of racial segregation persist. Nationwide, the black/white index of dissimilarity declined from .73 to .64 between 1980 and 2000.[13]

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[1] Gregory D. Squires, *Urban Development and Unequal Access to Housing Finance Services*, New York Law School Law Review 53(2): 255–268 (2008/9).

[2] Carmen Walt-Denavas, Bernadette D. Proctor, and Jessica C. Smith, U.S. Census Bureau, Current Population Reports, P60-235, /Income, Poverty, And Health Insurance Coverage In The United States: 2007/, Table A-3. Selected Measures Of Household Income Dispersion: 1967–2007, U.S. Government Printing Office, Washington, DC, 2008.

[3] Paul Krugman, *For Richer*, N.Y. Times Mag., Oct. 20, 2002, at 62, 64.

[4] Paul Krugman, Editorial, *Left Behind Economics*, N.Y. Times, July 14, 2006, at A19.

[5] Thomas M. Shapiro, *The Hidden Cost of Being African American* 48–49 (2006); see also Nat'l Cmty Reinvestment Coal. & Woodstock Instit., *A Lifetime of Assets* (2006).

[6] *Interwoven Destinies: Cities and the Nation* 25 (Henry G. Cisneros Ed. 1993); John R. Logan, Lewis Mumford Ctr. for Comparative Urban and Regional Research, Univ. at Albany, *The Suburban Advantage: New Census Data Show Unyielding City-Suburb Economic Gap, and Surprising Shifts in Some Places* (2002).

[7] John R. Logan, Lewis Mumford Ctr. for Comparative Urban Regional Research, Univ. at Albany, *Separate and Unequal: The Neighborhood Gap for Blacks and Hispanics in Metropolitan America* tbl. 1 (2002).

[8] Compare Paul A. Jargowsky, *Poverty and Place: Ghettos, Barrios, and the American City* 34 (1998) (Reporting 1970 Figures), with Paul A. Jargowsky, Brookings Inst., *Stunning Progress, Hidden Problems: The Dramatic Decline of Concentrated Poverty in the 1990s* 20 (2003).

[9] Jason C. Booza, Jackie Cutsinger & George Galster, Brookings Inst., *Where Did They Go? The Decline of Middle-Income Neighborhoods in Metropolitan America* 1 (2006).

[10] *Id.*

[11] *Id.*

[12] *Id.* at 7.

[13] John Iceland, Daniel H. Weinberg & Erika Steinmetz, U.S. Census Bureau, Racial and Ethnic Residential Segregation in the United States: 1980–2000 tbl. 1 (2002). This index varies from

Scores above .60 are widely viewed as reflecting high levels of segregation. But in the large metropolitan areas where the black population is most concentrated, segregation levels persist at high levels reaching at or near .80 in New York, Chicago, Detroit, Milwaukee, and many other urban communities. Lower levels exist primarily in western and southwestern communities with small black populations. For Hispanics and Asians, segregation levels are much lower, approximately .4 and .5, but they have remained at that level or actually increased slightly between 1980 and 2000.[14]

Inequality and Subprime Lending

A wealth of research has documented the concentration of subprime loans in low-income and minority communities.[15] HMDA reports reveal, for example, that for 2006, when subprime lending was at its peak, for first lean conventional home purchase loans 46 percent of borrowers in low-income areas compared to 16 percent in upper income areas received a high-priced loan. Among borrowers in predominantly non-white communities 49 percent received such loans compared to 18 percent in predominantly white areas. In that year 53 percent of African Americans, 46 percent of Hispanics, and 22 percent of whites received high-priced loans. Subsequent research revealed that even after controlling on credit rating, income, and other financial characteristics, racial disparities persist.[16]

Such patterns are no accident. The City of Baltimore recently sued Wells Fargo Bank for racially discriminatory predatory lending patterns in that community leading to high foreclosure rates and the heavy costs associated with those foreclosures. Plaintiffs found, for example, that the foreclosure rate for Wells Fargo loans was twice the city-wide average in African American communities while the rate in white neighborhoods was half the city-wide average (Mayor and City Council of Baltimore v. Wells Fargo Bank, U.S. District Court for the District of Maryland, Baltimore Division Case Number 1:2008v00062, January 8, 2008). Subsequent investigation revealed that Wells Fargo loan officers were provided financial incentives to steer borrowers from lower-cost prime loans to higher-cost subprime loans, referring to them as “ghetto loans” and to the borrowers as “mud people.”[17]

And racial segregation has an effect above and beyond that of race alone. Table 1 shows that the share of loans that are high-priced is considerably higher in highly segregated than in less segregated communities. The average share of such loans in the nation’s ten most segregated communities is 31 percent compared to 20 percent in the ten least segregated.

Table 1—Top 10 Most and Least Segregated Metro Areas and Percent of High-Cost Loans

10 Most Segregated Metropolitan Regions	Black Segregation Index	High-Cost Loans (%)
Detroit-Warren-Livonia, MI	84	34
Milwaukee-Waukesha-West Allis, WI	81	29
Chicago-Naperville-Joliet, IL-IN-WI	78	31
Cleveland-Elyria-Mentor, OH	77	28
Flint, MI	76	37
Muskegon-Norton Shores, MI	76	38
Buffalo-Niagara Falls, NY	76	25
Niles-Benton Harbor, MI	73	30
St. Louis, MO-IL	73	31
Cincinnati-Middletown, OH-KY-IN	73	25

0 to 1, where a score of 0 would indicate that each neighborhood had the same racial composition of the metropolitan area as a whole and a score of 1 would represent total segregation meaning every neighborhood was either all African American or all white. *Id.* at 5. For a more complete discussion of the index of dissimilarity, see Jeffrey M. Timberlake & John Iceland, *Change in Racial and Ethnic Residential Inequality in American Cities, 1970–2000*, 6 City & Community 335–65 (2007).

[14] Iceland, Weinberg & Steinmetz, supra note 14, at tbls. 3 & 5; see also John E. Farley & Gregory D. Squires, *Fences and Neighbors: Segregation in 21st Century America*, 4 Contexts 33, 34–35 (2005).

[15] Gregory D. Squires, Derek S. Hyra, and Robert N. Renner, *Segregation and the Subprime Lending Crisis*, Paper Presented at the Federal Reserve Board’s Community Affairs Research Conference, (April 16, 2009).

[16] P. Calem, K. Gillen, and S. Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, Journal of Real Estate Finance and Economics 29: 393–410 (2004).

[17] Michael Powell, *Bank Accused of Pushing Mortgage Deals on Blacks*, The New York Times, (June 7, 2009): A–15.

Table 1—Top 10 Most and Least Segregated Metro Areas and Percent of High-Cost Loans—Continued

10 Most Segregated Metropolitan Regions	Black Segregation Index	High-Cost Loans (%)
Average	77	31

10 Least Segregated Metropolitan Regions	Black Segregation Index	High-Cost Loans (%)
Coeur d'Alene, ID	16	24
Hinesville-Fort Stewart, GA	18	39
Santa Fe, NM	21	17
Prescott, AZ	21	21
Bellingham, WA	22	16
Boulder, CO	23	10
Jacksonville, NC	24	22
Blacksburg-Christiansburg-Radford, VA	24	20
Santa Cruz-Watsonville, CA	24	14
Missoula, MT	24	15
Average	22	20

Source: Gregory D. Squires, Derek S. Hyra, and Robert N. Renner, Segregation and the Subprime Lending Crisis, paper presented at the Federal Reserve Board's Community Affairs Research Conference, (April 16, 2009).

Far more significant, however, is that racial and ethnic segregation remain statistically significant predictors of the level of high-priced loans even after controlling for credit rating, poverty level, percent minority, and education (see Tables 2 and 3). These data show, for example, that a ten percent increase in black/white segregation (measured by the index of dissimilarity) is associated with an increase of 1.4 percent in high-cost lending. Every ten percent increase in Hispanic/white segregation is associated with an increase of 0.6 percent in high-cost lending.

Table 2—Black Segregation

Variables	Coefficients	Standard Errors
Percent in Poverty	−0.00	0.67
Percent Minority	0.13 *	0.02
Median Home Value	−0.11 *	0.03
Black Segregation	0.14 *	0.02
Percent Low Credit Score	0.23 *	0.06
Percent with BA or Higher	−0.48 *	0.04

N = 354, R-Squared = 0.6943, * $p < .01$.

Table 3—Model II: Hispanic Segregation

Variables	Coefficients	Standard Errors
Percent in Poverty	−0.05	0.07
Percent Minority	0.12 *	0.02
Median Home Value	−0.14 *	0.03
Hispanic Segregation	0.06 *	0.02
Percent Low Credit Score	0.25 *	0.07
Percent with BA or Higher	−0.48 *	0.04

N = 354, R-Squared = 0.6312, * $p < .01$

Policy Responses

Many proposals have been offered to change the way banks do business and the way they are regulated. Clearly, such reforms are necessary. But if the problems generated by subprime and predatory lending along with the foreclosures and other economic costs that followed require new policies to change lending practices of financial institutions and regulatory actions of enforcement agencies, the broader context of inequality and segregation must also be addressed.

Several politically feasible tools are available to respond to the overall surge in inequality. For example, the federal minimum wage should be indexed to take into consideration the cost of living so that the recent increase that was approved in May 2007 does not continue to lose buying power as it has since the moment it went into effect in July 2007.[18] Living wage ordinances, which mandate even higher wages, generally $8 to $10 per hour, frequently with fringe benefits, have been enacted in more than 100 jurisdictions with these rules applying to government contractors and recipients of economic development subsidies.[19] More jurisdictions should follow this lead. The Earned Income Tax Credit could be expanded to lift more working families out of poverty.[20] Enacting the Employee Free Choice Act, which allows workers to form a union when more than 50% of workers sign a card indicating their desire to do so in lieu of secret elections, would strengthen the role of unions in the U.S. and their positive impact on wage inequality.[21] A more provocative proposal, the Income Equity Act, has been offered by former Minnesota Representative Martin Sabo that would deny corporations tax deductions on any executive compensation exceeding twenty-five times the pay of the firm's lowest paid workers.[22]

Expansion of several housing and land use policies would also reduce inequality. Inclusionary zoning laws that require developers to set aside a specific share of housing units to meet affordable housing objectives have been implemented in dozens of cities.[23] Tax-based revenue sharing, whereby a portion of the increasing property tax revenues in prosperous neighborhoods is used to invest in housing and other community development initiatives in distressed areas, has been implemented in Minnesota.[24] Mobility programs have enabled thousands of families to leave ghettos and barrios for more prosperous outlying urban and suburban communities where they found safer neighborhoods, better schools, and better job prospects.[25]

Housing policies of the past have been linked with the concentration of minorities, particularly African Americans, in extremely segregated and impoverished communities.[26] Today, much of the distressed public housing that once segregated minorities in inner city neighborhoods is being razed.[27] Residents of these demolished buildings are receiving housing vouchers, a rent subsidy, to obtain private market rental units. Evidence suggests that voucher holders are ending up in other highly segregated communities.[28] To prevent the continuing concentration of poverty and racial disadvantage, the U.S. Department of Housing and Urban Development's Housing Choice Voucher program must be reformed to provide greater opportunities for recipients to find units in less segregated and impoverished neighborhoods.

The Low Income Housing Tax Credit (LIHTC) program and inclusionary zoning laws are two other mechanisms for increasing the number of affordable rental units in non-poverty neighborhoods for voucher recipients. Traditionally, housing developments in low-income communities are given preferences for LIHTCs. This cir-

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[18] *See generally* John Atlas & Peter Dreier, *Waging Victory*, Am. Prospect., Nov. 10, 2006, http://www.prospect.org/cs/articles?article=waging__victory; Neal Peirce, *Congress' Minimum Wage Vote: Prelude to a Better Politics?*, Stateline.org, Jan. 25, 2007, http://www.stateline.org/live/details/story?contentID=174954.

[19] Peter Dreier, *Community Organizing For What? Progressive Politics and Movement Building in America.*, In Transforming the City: Community Organizing and the Challenge of Political Change 237 (Marion Orr ed., 2007).

[20] *See* Lawrence Mishel, Jared Bernstein & Sylvia Allegretto, *The State of Working America*, 2004/2005 13 (2005).

[21] *See* Thomas Kochan & Beth Shulman, Econ. Policy Inst., *A New Social Contract: Restoring Dignity and Balance to the Economy* 14, 15–16 (2007).

[22] Peirce, *supra* note 46.

[23] Rusk, *supra* note 45 (arguing that state legislatures must set new "rules of the game" requiring housing policies to ensure that all new developments have their fair share of low- and moderate-income housing).

[24] Myron Orfield, *American Metropolitics: The New Suburban Reality* (2002).

[25] John Goering & Judith D. Feins, *Choosing a Better Life?: Evaluating the Moving to Opportunity Social Experiment* (2003); Alexander Polikoff, *Waiting for Gautreaux: A Story of Segregation, Housing, and the Black Ghetto* (2006); Leonard S. Rubinowitz & James E. Rosenbaum, *Crossing the Class and Color Lines: From Public Housing to White Suburbia* (2000).

[26] James H. Carr and Nandinee K. Kutty, *Segregation: The Rising Costs for America*, New York: Routledge, (2008). Douglas S. Massey and Nancy Denton, *American Apartheid: Segregation and the Making of the Underclass*, Cambridge, MA: Harvard University Press (1993). Douglas S. Massey and Shawn M. Kanaiaupuni, *Public Housing and the Concentration of Poverty*, Social Science Quarterly 74(1): 109–122, (1993).

[27] Edward Goetz, *Clearing the Way: Deconcentrating the Poor in Urban America*, Washington, D.C.: The Urban Institute Press (2003). Derek S. Hyra, *The New Urban Renewal: The Economic Transformation of Harlem and Bronzeville*, Chicago: University of Chicago Press (2008).

[28] Paul Fischer, *Where Are Public Housing Families Going? An Update*, Chicago: Woods Fund of Chicago (2003). John M. Hartung and Jeffrey R. Henig, *Housing Vouchers and Certificates as a Vehicle for Deconcentrating the Poor*, Urban Affairs Review 32(3): 403–419 (1997).

cumstance may indirectly increase or sustain prior levels of segregation by placing low-income residents and units in an already low-income community. To open up housing opportunities for low-income families, affordable housing developments in middle- and upper-income communities should be given priority for LIHTCs. Inclusionary zoning laws can also increase the stock of affordable housing in low-poverty areas. These local laws require new developments to set aside a certain percentage of units for affordable housing. The federal government could provide financial incentives for municipalities to adopt zoning laws that promote the construction and redevelopment of affordable units.

Housing market discrimination clearly contributes to segregation. To more effectively enforce fair housing laws already in place, the proposed Housing Fairness Act of 2009 (H.R. 476) should be enacted. This bill would increase funding for the Fair Housing Initiatives Program to $52 million and would fund a $20 million nationwide paired testing program providing for 5,000 tests, approximately 50 in each of the nation's 100 largest metropolitan areas. In paired-testing investigations, equally qualified white and non-white auditors posing as homebuyers or renters approach housing providers, such as real estate and rental agents, mortgage lenders, and insurance agents, and inquire about the availability of the same or similar housing units or housing related services like home insurance or mortgage loans. Any differences in treatment they receive likely reflect discrimination since these auditors or testers are assigned identical qualifications and interests. Such investigations have routinely revealed discrimination in approximately one out of every five initial visits to real estate or rental agents. Discrimination in insurance and mortgage lending has also been documented using similar investigative techniques.[29] If the real estate, mortgage and insurance industries knew these investigations were occurring more frequently, incidents of discrimination and levels of segregation might be reduced.

In addition to these general economic reforms and housing proposals, there are specific changes in the regulation of financial services that should be included in any reorganization of that regulatory function. For example, prepayment penalties and introductory teaser rates should be limited in all mortgage lending including the prime and subprime markets. Prepayment penalties make it more difficult for those that get behind in their payments to refinance or sell their homes. Even though these penalties provide banks with risk protection against early payment, it increases the likelihood that borrowers will default. Teaser rates (for example, 2/28 and 3/27 adjustable rate mortgages) frequently lead to late payments, defaults, and foreclosure.[30] Only when carefully underwritten and when there is a clear economic benefit for the borrower should these types of loans be permitted. These simple product restrictions might reduce the extent of subprime loans, defaults, and foreclosures throughout the country. The National Mortgage Reform and Anti Predatory Lending Act (H.R. 1728) would reduce substantially the provision of inappropriate products in the mortgage market.

State and local governments that receive federal funding for housing and community development are required to "affirmatively further fair housing" in the utilization of those funds. Recipients of TARP, bailout, or any other federal financial support should be required to pursue this objective as well.

To ensure that these regulations and restrictions are followed, federal oversight is needed over the independent mortgage companies, the unregulated entities who originated the bulk of subprime mortgages and the affiliated institutions that are involved in the trading of mortgage-backed securities.[31] Currently, the CRA applies only to depository institutions but passage of the CRA Modernization Act of 2009 (H.R. 1749) would bring unregulated mortgage lenders under its purview. Having greater oversight over independent mortgage companies, might help decrease the number of high-cost loans.

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[29] Shanna Smith and Cathy Cloud, *Documenting Discrimination by Homeowners Insurance Companies Through Testing.* In Gregory D. Squires (Ed), Insurance Redlining: Disinvestment, Reinvestment, and the Evolving Role of Financial Institutions, Washington, D.C.: The Urban Institute Press (1997). Margery T. Turner and Felicity Skidmore, *Mortgage Lending Discrimination: A Review of Existing Evidence*, Washington, D.C.: The Urban Institute (1999). Margery Turner, Fred Freiberg, Erin Godfrey, Carla Herbig, Diane Levy, and Robin Smith, *All Other Things Being Equal: A Paired Testing Study of Mortgage Lending Institutions*, Washington, D.C.: The Urban Institute (2002).

[30] Robert G. Quercia, Michael A. Stegman, and Walter R. Davis, *The Impact of Predatory Loan Terms on Subprime Foreclosures: The Special Case of Prepayment Penalties and Balloon Payments*, Housing Policy Debate 18(2): 311–346 (2007).

[31] Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, *The 2006 HMDA Data*, Federal Reserve Bulletin 93: 73–109 (2007).

It has been argued that the CRA and related fair lending laws contributed to the foreclosure and related problems. But as the Federal Reserve Board and others have documented, this is simply not the case. CRA lenders made approximately 6% of all high-cost loans to low-income markets. Altogether just 5% of loans made by CRA lenders were high-cost compared to 34% for non-CRA lenders. In fact, the Fed and others have found that the CRA is responsible for significant increases in the level of good loans in traditionally underserved markets.[32]

A promising step in this direction is the President's proposal for the creation of a Consumer Financial Protection Agency.[33] If given the tools to write and enforce strong regulations, this independent agency should prove far more effective in protecting the rights of consumers under the CRA and other consumer protection laws.

Conclusion

The housing and related economic crises that disproportionately impact poor and minority communities, but which are clearly now threatening many middle income families as well, are inextricably linked to specific financial industry practices as well as broader forces of inequality and uneven development. The policies and practices that have generated these patterns are no great secret. Neither are at least some of the remedies.

Prepared Statement of Sarah Bloom Raskin, Commissioner of Financial Regulation, State of Maryland

Chairman Maloney, Vice Chairman Schumer, Congressman Cummings and members of the Committee, thank you for inviting me to testify at today's hearing. As the chief financial regulator for the state of Maryland, I am pleased to share information about our state's efforts to respond to the subprime lending crisis as it has manifested itself in Maryland. I also serve as the Chair of the Legislative Committee of the Conference of State Bank Supervisors.

Protecting Maryland residents from predatory mortgage lending has been a priority of mine since I took office as the Maryland Commissioner of Financial Regulation two years ago.

As you all know, the home foreclosure crisis has profoundly affected not only homeowners but also taxpayers, cities, and states. I have heard from Maryland citizens who can hardly believe the enormous sums of taxpayer dollars flowing into the large money-center financial institutions to keep them afloat. In return for their trillion-dollar investment, these same citizens demand accountability, and, just as importantly, they demand that something be done to stem the swelling tide of home foreclosures in their communities.

As the Commissioner of Financial Regulation, it is my obligation to pursue, within the boundaries of my authority, those who engaged in violations of all our laws, including our anti-predatory lending laws. State regulators have a long history as the first-line of protection for consumers. It was the states that first sounded the alarm against predatory lending and brought landmark enforcements against some of the biggest subprime lenders.

Indeed, state banking commissioners have aggressively pursued enforcement actions against predatory lending practices since the 1990s. And just last week, Maryland and 13 other states entered into a $9 million settlement with one of the ten largest wholesale mortgage lenders in the country. On Tuesday, Maryland issued a cease and desist order against a company that brokers usurious pay-day loans to Maryland residents.

My testimony is divided into two parts. First, I will discuss a couple of the enforcement actions that my office has pursued against participants who have violated our financial laws and regulations designed to protect consumers. Second, I will identify some of the key impediments to effective legislation and enforcement of fraud and other consumer protection laws and regulations by state banking commissioners.

Maryland is not a newcomer to the arena of predatory lending or its impact. Our state is ravaged by the fallout from irresponsible lending—too many loans that never should have been made—poorly underwritten, if at all, with features and loan

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[32] Governor Randall S. Kroszner, *The Community Reinvestment Act and the Recent Mortgage Crisis*, Speech Delivered to Confronting Concentrated Poverty Policy Forum, Board of Governors of The Federal Reserve System, Washington, D.C. (December 3, 2008). New York Times, *Mortgages and Minorities* Editorial, (December 9, 2008). Gregory D. Squires, *Scapegoating Blacks for the Economic Crisis*, Poverty & Race 17(6): 3,4 (2008).

[33] U.S. Department of the Treasure, *Financial Regulatory Reform*, Washington, D.C.: U.S. Department of the Treasury (2009).

terms that make it clear that the chance for success was limited. And all too often, these loans have had a disproportionate impact on minority communities. The Urban Institute published a study last month of subprime lending in 100 metropolitan areas. The study controlled for income levels and concluded that the neighborhoods hardest hit by the subprime crisis have been those where minority residents predominate.[1]

The fallout is evident in foreclosures throughout our state, particularly Baltimore City and Prince George's County. Under a new law reforming the foreclosure process in our state, secured parties must send a Notice of Intent to Foreclose to homeowners at least 45 days prior to docketing the foreclosure. My office receives copies of these notices—and unfortunately they come in by the boxload. In the past twelve months, over 100,000 Notices of Intent to Foreclose have been sent to Maryland borrowers and to our office. Each day, we struggle to input the information into our database and to send outreach to the borrower regarding options for assistance and warnings about foreclosure scams.

With state attorneys general and other state regulators, Maryland has sought to cooperatively pursue unfair and deceptive practices in the mortgage market. Through several settlements, state regulators have returned nearly one billion dollars to consumers. In 2002, a settlement with Household Financial resulted in $484 million paid in restitution; that investigation targeted many of the practices that bring us to this room today. A settlement with Ameriquest Mortgage Company four years later resulted in $295 million paid in restitution; for those of us at the state level, the Ameriquest investigation marks the moment when we began to see the underwriting practices of mortgage lenders erode at a disturbingly accelerated pace.

While these cases have received most of the recognition, success is sometimes better measured by those actions that never receive media attention. In 2007 alone, states took almost 6,000 enforcement actions against mortgage lenders and brokers. But these cases do not include the unrecorded investigations and referrals for criminally punishable fraud and other crimes.

We have also moved through regulatory and legislative action. We have implemented regulatory changes through my office——

- Establishing a standard of good faith and fair dealing for mortgage lenders, brokers, servicers, and originators;
- Requiring that mortgage refinances provide the borrower with a net tangible benefit; and
- Setting forth new marketing standards and risk management standards for nontraditional mortgage loans

Our state has also implemented statutory changes. These include requiring lenders to verify the borrower's ability to repay a mortgage loan at the fully indexed rate, prohibiting prepayment penalties in connection with residential mortgage loans, increasing surety bond requirements for mortgage lenders, enhancing mortgage originator licensing requirements in a way that conforms to the federal SAFE Mortgage Licensing Act, reforming the foreclosure process, and creating a process to track mortgage lenders and originators throughout the life of a mortgage loan by requiring that this information be recorded with the instrument securing the loan.

These are important steps. Unfortunately, Wells Fargo, as a national bank, is not subject to these laws and regulations.

At the same time, Maryland was one of 14 states that most recently entered into a major settlement with Taylor, Bean & Whitaker Mortgage Corporation earlier this week. Taylor Bean is one of the 10 largest wholesale mortgage lenders in the country. They are also a major mortgage servicer—the 7th largest licensed servicer in Maryland. This agreement follows a coordinated examination conducted jointly by 14 states to evaluate compliance with laws and regulations pertaining to the origination of nontraditional mortgage loans made in 2006. These non-traditional products, also known as "exotic" loans represent the riskiest and most dangerous products on the mortgage market—"interest-only" mortgages, "payment option" adjustable-rate mortgages and stated income loans. In so many communities, these tools represent ground zero for the mortgage crisis.

Concern over these practices led Taylor Bean to stop offering nontraditional mortgages in early 2007 and to make other changes to its internal control processes. As part of this settlement, Taylor Bean agreed to implement a loan modification program in accordance with the Making Home Affordable Program, to implement a comprehensive compliance program and to retain a third party to review compliance with state laws for these products to determine if refunds are appropriate. Maryland

[1] Source: Urban Institute, *The Impacts of Foreclosures on Families and Communities*. Thomas Kingsley, Robin Smith and David Price. May 2009.

conducted an initial review on its own that has already resulted in over $50,000 in refunds to our borrowers. Finally, Taylor Bean is paying $9 million as part of the settlement including $4.5 million to help fund the new Nationwide Mortgage Licensing System.

This coordinated, multi-state examination and its results underscore the efforts and progress that the states have made in addressing problems within the non-bank mortgage segment. These efforts, combined with an increased use of technology to support the examination process, are a critical step forward in protecting consumers and further professionalizing the mortgage industry.

Despite these enforcement and legislative successes, state actions have been hamstrung by the dual forces of preemption of state authority and lack of federal oversight. The authority of state banking commissioners to craft and to enforce consumer protection laws of general applicability was challenged at precisely the time it was most needed—when the amount of subprime lending exploded and riskier and riskier mortgage products came into the marketplace.

The laws passed by state legislatures to protect citizens and the enforcement actions taken by state regulators should have alerted federal authorities to the extent of the problems in the mortgage market and should have spurred a dialogue between state and federal authorities about the best way to address the problem. Unfortunately, this did not occur. Had the federal regulators not adopted preemptive policies, I suggest we would have fewer home foreclosures and may have avoided the need to prop up our largest financial institutions. It is worth noting that many of the institutions whose names were attached to the mortgage preemptive initiative in general, including two who served as plaintiffs in an action against my predecessor in Maryland for trying to invoke a state law regarding pre-payment penalties—National City and First Franklin—were all brought down by the mortgage crisis.

What is clear is that the nation's largest and most influential financial institutions have been major contributing factors in our regulatory system's failure to respond to this crisis. At the state level, we sometimes perceived an environment at the federal level skewed toward facilitating the business models and viability of our largest institutions, rather than promoting the strength of the consumer or our diverse economy.

At the same time that preemption of state consumer protection powers gained ground, federal agencies failed to fill the gap in regulation with uniform marketwide standards that ensured lenders did not engage in fraudulent, deceptive or unfair lending practices and to respond to the crisis. Congressman Cummings has seen this close up in the effort to gather information on mortgage modifications. My office gathers modification data and, following concern regarding modifications that were not substantive, we required servicers to report the impact of modification on the borrowers' monthly payment last summer. When the results showed that 50+% of modifications did not lower the borrower's monthly payment, it was clear to us that this topic should be aired. Unfortunately, the federal authorities resisted. They dutifully reported that modifications were redefaulting at high rates, but resisted drilling into the nature of those modifications. Thankfully, Congressional action led by Congressman Cummings helped change things, and earlier this year, the OCC began collecting similar data regarding monthly payment.

Our federalist system of government is premised on the notion that federal and state regulation can co-exist and are in fact complementary. Moreover, even if sufficient federal regulations had been promulgated, they are only effective to the extent that the federal regulator is interested in enforcing them.

The void created by preemption in the face of a failure of federal oversight added a number of impediments for state banking commissioners in crafting legislation and in pursuing enforcement actions against predatory lenders. While it is too late to remove some of these impediments, there are some obstacles that can be eliminated to restore to state bank commissioners the ability to successfully regulate lending in the future.

One key point I would like to make is that Congress should eliminate the preemption of consumer protections enacted by the states. I urge Congress to promptly eliminate federal preemption of the application of the state consumer protection laws to national banks. The magic of federalism is that if one level of government falls asleep at the wheel or has too much to drink at the party, another can drive everybody home safely. But when you preempt our best laws, you take away the keys to the car and our license to drive.

Together with our nation's 50 banking commissioners, and with the Conference of State Bank Supervisors, I am supportive of provisions contained within President Obama's recently proposed financial regulatory reform plan that would grant state authorities the ability to promulgate statutes and regulations that would apply to all financial firms operating in our states, to examine for compliance of these statutes and rules, and to take enforcement actions against those entities that were found to be out of compliance with these statutes and rules.

The Administration's proposal to create a consumer financial product agency is interesting. This agency could require a federal minimum of consumer protections for particular products. Such a standard would declare a national norm but also would allow states to address new predatory practices as they evolve. This dynamic would create a floor for all lenders but still permit states to protect their citizens through more robust legislation and regulation.

Such ability to expand upon a basic federal standard is essential to the development of effective responses to new mortgage abuses as they emerge. Today, we see another mortgage storm brewing in the area of loss-mitigation consulting. Historically, we confronted fraudulent foreclosure transactions where title was conveyed as part of a scheme to strip homeowners of their equity. Today, with no equity left to strip, the ripoffs have become fee-based with so-called consultants charging high up-front fees to vulnerable consumers to help them get a loan modification. Too often, these efforts result in both wasted money and wasted time. Up front fees are restricted in Maryland and our office has recovered more than $80,000 for consumers to date. We have worked through the State Foreclosure Prevention Working Group to raise the issue with the Administration and to warn those overseeing the President's Housing Program of the potential for these practices to cause further financial instability. Congress can ban upfront fees at the federal level, or at least ensure that states have the flexibility to enforce their own laws against such "loss-mitigation consultants" who seem to be more in the business of loss aggravation.

To sum up, some bank commissioners have been predicting the current lending crisis for years, but few listened. Banks, lenders and mortgage brokers lobbied aggressively to prevent any regulation at either the state or federal level. There are lessons to be learned. First, the movement to erode state authority to enforce state and federal consumer protection laws must cease. Attempts to exclude state banking regulators from enforcing consumer protection laws have significantly contributed to the distress our residents have endured as a result of these difficult economic times. Thank you for the opportunity to testify before the Committee today.

PREPARED STATEMENT OF ROBERT J. STRUPP, DIRECTOR OF RESEARCH AND POLICY, COMMUNITY LAW CENTER

Good Morning Congresswoman Maloney, Senator Schumer, and members of the Joint Economic Committee. My name is Robert J. Strupp and I am the Director of Research and Policy at the Community Law Center based in Baltimore. I am honored to testify today concerning the impact of predatory lending and reverse redlining on low-income, minority, and senior borrowers and communities.

For over 22 years, the Community Law Center has been a leading voice in Baltimore for preventing and eradicating blight and returning vacant and abandoned property to productive use. The Community Law Center also seeks solutions to the predatory and deceptive real estate transactions that have caused foreclosures and that have led to many of the housing challenges facing communities throughout Maryland

Discriminatory practices in residential real estate are a well-documented blemish on our Country's history. It was not until 1962 that President Kennedy issued Executive Order # 11063 making Federal Housing Administration (FHA) and VA loans available to all Americans, without regard to race, color, creed, or national origin. Tragically, some homebuilders responded by no longer offering FHA and VA loans. Indeed, 5 years later, thirteen homebuilders—including three in Baltimore—were identified as violating the President's directive (See Michael L. Mark, *But Not Next Door*, Baltimore Neighborhoods, Inc, 2002, p. 20).

In 2000, at the behest of Senators Barbara Mikulski and Senator Paul Sarbanes, the United States Department of Housing and Urban Development (HUD) established the Baltimore City Flipping and Predatory Lending Task Force as a "laboratory" to develop creative solutions to the problems arising in Baltimore and nationwide from abuses in the FHA mortgage program, which was designed to help low-income families attain homeownership. The Community Law Center served as the staff for this Task Force. The Task Force was created to combat a number of residential real estate tactics that were hurting Baltimore's most vulnerable residents and neighborhoods. Relying on false and unsupportable appraisals, lenders originated FHA insured loans in amounts greatly exceeding the property's true value. Unsuspecting, trusting families aspiring to the American dream of homeownership were lured into purchasing shoddy, over-mortgaged properties that were too costly to repair and too overvalued to sell. As a result of these predatory practices, neighborhoods in the 1990s experienced rising foreclosures, bankruptcies, vacancies, and neighborhood disintegration. The gravity of the foreclosure situation at the time is perhaps best demonstrated by the decision of the FICA to declare a moratorium on FHA foreclosures.

The Baltimore Task Force included representatives of HUD, FHA, Baltimore City Housing agencies, Fannie Mae, governmental officials, law enforcement agencies, housing counselors, consumer advocates, community leaders, and some of the regulated industries, including lenders and the real estate licensees.

As law enforcement heightened, responses to the mortgage fraud epidemic increased, and FHA loan requirements became more stringent, the abusive use of highly risky and exotic loan products to promote homeownership began to emerge.

The American obsession with homeownership at least since the administration of President Hoover. President Hoover initiated the Own Your Own Home Program, citing that "nothing [is] worse than increased tenancy and landlordism." Unfortunately, as homeownership grew, so did foreclosures: from 2% of commercial bank mortgages in 1922 to 11% by 1927. Following the Great Depression, the federal government established numerous initiatives to repair the mortgage markets and encourage homeownership. It created FHA to insure home loans and initiated the Federal National Mortgage Association (Fannie Mae) to purchase mortgages made by local banks. The federal government's regulation of the mortgage industry was born.

Homeownership requires sustainable, qualified borrowers. During the decade of the 1950s the FHA default rate increased fivefold. VA loans doubled during the same period. At the same time, the foreclosure rate on conventional mortgages remained nearly constant because non-government lenders maintained strict underwriting standards.

In 1968, responding to the turmoil in our cities, FHA was empowered by Congress to insure loans that required down payments as low as $250. The unintended consequence was blockbusting; unscrupulous investors began to buy homes in changing neighborhoods, scaring homeowners to sell quick, and then these homes would be resold to low-income and minority families at inflated prices. By the early 1970s the consequences of these practices hit home, resulting in large numbers of mortgage defaults, a 500 count federal indictment involving 7,500 FHA insured homes in New York City neighborhoods, and previously stable neighborhoods collapsing as once optimistic homeowners, now in over their heads, walked away, leaving their homes to arsonists and other criminals.

The press for homeownership opportunities continued in the 1980s when Congress passed legislation requiring Fannie Mae and Freddie Mac to buy mortgages designed for low- and moderate-income households. The intent was noble: find a way to grow sustainable homeownership among American minorities. These efforts, however, failed to regard the borrower's underlying economic ability to sustain the mortgage and obligations of homeownership. Despite the fact that by the end of the 1990s homeownership reached 66% of all households, homeownership for low- and moderate-income households and young families was declining. The most creditworthy, were now homebuyers, leaving the biggest opportunity for mortgage expansion to be the field of lower-income families and refinancing. A Maryland mortgage lender predicted in a trade article that "low income borrowers are going to be our leading customers going into the 21st century."

Homeownership has been described as wealth building, a "forced savings plan," and is recognized as the largest purchase most Americans will ever make. Not only is homeownership important economically; it is important psychologically. A Baltimore study revealed that low-income homeowners had significantly higher levels of life satisfaction than similarly situated renters. (William M. Rohe & Michael A. Stegman, *The Effects of Homeownership on the Self-Esteem, Perceived Control, and Life Satisfaction of Low-Income People*, Journal of the American Planning Association 60, 1994 pp173–184). No doubt, personal satisfaction with one's life leads to more stable households and communities.

Encouraging increased homeownership opportunities is not irresponsible, but it is wrong to equate legitimate, flexible lending standards with irresponsible underwriting. Low- and moderate-income communities need and ought to be given opportunities to access affordable credit. As we have learned, the loan products provided to borrowers were not affordable. Rather, they were money makers for the lending industry, so much so that premiums were paid based on the risk of the loan. The riskier the loan, the more a mortgage broker was paid, and the more Wall Street paid the originating bank. This feeding frenzy continued until, much like an overstuffed animal, the entire system exploded.

What went wrong was the misuse of loan products not designed for fixed-income low- and moderate-income families, but intended for higher-compensated, self-employed borrowers with fluctuating incomes. Nevertheless, lenders were encouraged to utilize certain "tricks of the trade," such as the use of the NINA ("no income, no asset") loans. These loans are commonly referred to as "liar loans." As we know, in 2007, Freddie Mac stopped purchasing these loans. Although it is widely believed that borrowers deliberately took advantage of these products to be untruthful on their loan applications, the reality is that, time and again, it was the mortgage brokers and loan officers who inflated the borrower's income to qualify borrowers for loans they could not afford and to redirect them to the higher risk, more lucrative, and more expensive loans. Loan applications were frequently taken over the telephone and borrowers often did not see the documents until the closing. When borrowers spoke up, they were often told "not to worry," the information did not need to be verified. Many borrowers never even saw the misstatements until much later because they were rushed through the closing process without an opportunity to review, let alone comprehend, the documents. Today, as a result of these practices and the proliferation of predatory and subprime lending, numerous cities confront abandoned, foreclosed, and unmaintained properties. For example, Baltimore and other municipalities have filed law suits against lenders for the economic devastation caused by lending practices and lack of property maintenance. As a result of foreclosures and the ensuing vacant houses, cities like Baltimore are losing tax revenue due to plummeting home values, but must continue to provide essential services. In addition, the rise in vacant properties increases the costs for rodent control, attracts squatters and drug dealers, and contributes to the overall decline of the community.

So, were minorities "targeted"? Was this reverse red-lining? Research conducted by the *Chicago Reporter* showed that African-Americans earning more than $100,000 a year were more than twice as likely to receive a high-cost loan than a white homeowner earning less than $35,000.

The New York Times reported in-depth on the impact of foreclosures in the Baltimore community of Belair-Edison. The Community Law Center researches the real estate transactions in this community and provides findings to the local housing counselors to reach out to at-risk homeowners, This partnership has enabled Belair-Edison residents the opportunity to successfully obtain sustainable loan modifications and avoid foreclosure.

The *Times* article highlighted a study conducted by The Reinvestment Fund, showing that over a 4-year period (2003–2007), nearly half of the houses foreclosed on were owned by women. The National Association of Realtors reported that 40% of all home sales in 2006 were to single female buyers. The National Community Reinvestment Coalition (NCRC) determined that nearly half of these 2006 female purchases utilized subprime mortgages.

The Consumer Federation of America reported that women were 32% more likely to receive a subprime loan than men, even though male/female credit scores are comparable. The Consumer Federation of America also determined that, among high income borrowers, African-American women were five times more likely to receive subprime loans than white men. There has been considerable research conducted by NCRC, the Federal Reserve, and others to support the conclusion that minorities received a disproportionate number of subprime loans, even after controlling for creditworthiness (i.e., see Paul S. Calem, Kevin Gillen & Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, 29 Journal of Real Estate Fin. & Econ. 393 (2004); Paul S. Calem, Jonathan E. Hershaff & Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, 15 Housing Policy Debate 603 (2004)).

The mortgage crisis is felt by the senior population as well. Equity is often a senior's largest if not only asset for retirement. The devaluation of home prices severely impacts this population, delays retirement, impacts employment opportunities for the next generation, and thwarts the ability of seniors to use reverse mortgage products to supplement fixed-income elderly homeowners. According to AARP research, 28% of all delinquencies and foreclosures at the end of 2007 were on loans held by older Americans. Older African Americans and Hispanics had higher foreclosure rates than older whites. Another frightening trend highlighted by Harvard's Joint Center for Housing Studies is that today more older Americans are carrying a mortgage. Twenty years ago, 34% of Americans over 50 had a mortgage. Today, according to the study, 53% of older Americans have a mortgage. Combined with the fact that millions of elderly homeowners devote more than 50% of their income to pay for housing, this presents a troubling picture. Research indicates that some of the most financially vulnerable members of our society, such as the elderly and poor, are being hit particularly hard by the housing crisis.

Returning to Baltimore, since 2000, over 30,000 homes went into foreclosure, roughly 13% of all city households. As noted, these foreclosures have caused the city lost tax revenue, lower home values, increased crime and added expenditure for essential services and property maintenance—including rodent control and the need to board up and secure these homes from squatters and other misuse. In January 2008, Baltimore filed a complaint against Wells Fargo Bank seeking damages for the economic injuries brought upon the city's minority neighborhoods as a result of Wells Fargo's deceptive lending practices.

Where do we go now? The FHA response a decade ago in Baltimore is worth a closer look. A national foreclosure moratorium may be the bold but necessary next step in resolving the foreclosure crisis. Although foreclosures are said to have dipped slightly in May, one in every 398 households with loans received a foreclosure filing. Filings, which include notices of default and auctions, were reported on 321,480 properties last month.

Congress alluded to a national foreclosure moratorium in the Helping Families Save Their Homes Act of 2009, Title IV § 401(a): "It is the sense of the Congress that mortgage holders, institutions, and mortgage servicers should not initiate a foreclosure proceeding or a foreclosure sale on any homeowner until . . . foreclosure mitigation provisions have been implemented and determined to be operational . . . " This provision is unfortunately not binding, but it points to Congress's recognition that a national foreclosure moratorium would give borrowers time to research and apply to loan modification programs and give lenders time to build the capacity necessary to handle the increased volume of loan modification requests.

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