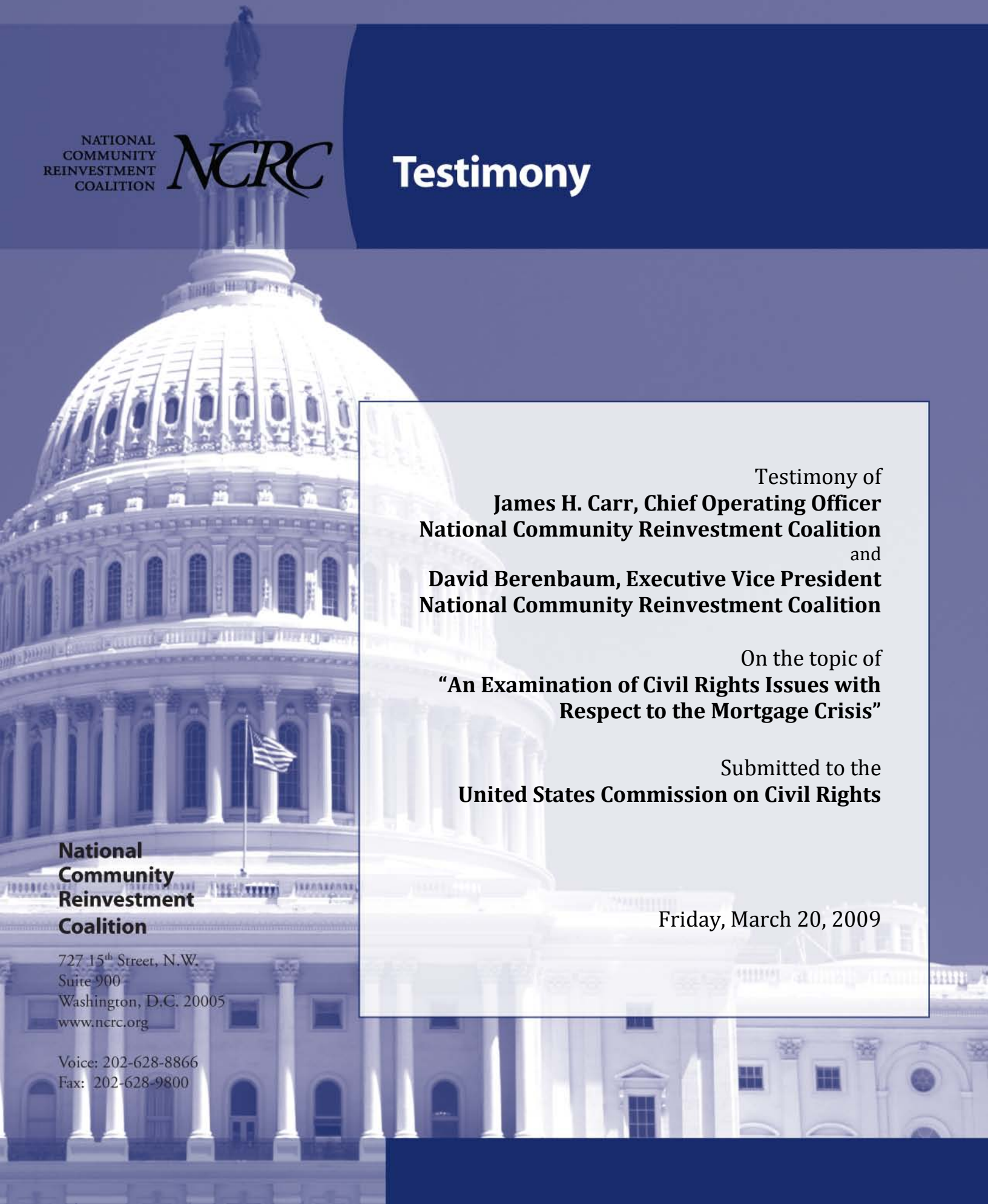


NATIONAL COMMUNITY REINVESTMENT COALITION

NCRC

Testimony

Testimony of
James H. Carr, Chief Operating Officer
National Community Reinvestment Coalition
and
David Berenbaum, Executive Vice President
National Community Reinvestment Coalition

On the topic of
"An Examination of Civil Rights Issues with Respect to the Mortgage Crisis"

Submitted to the
United States Commission on Civil Rights

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National Community Reinvestment Coalition

727 15th Street, N.W.
Suite 900
Washington, D.C. 20005
www.ncrc.org

Voice: 202-628-8866
Fax: 202-628-9800

Introduction

This written statement is submitted on behalf of James H. Carr, chief operating officer at the National Community Reinvestment Coalition (NCRC), and David Berenbaum, executive vice president at NCRC, in advance of their testimony before the United States Commission on Civil Rights hearing on "An Examination of Civil Rights Issues with Respect to the Mortgage Crisis." 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.

The US economy is unraveling at a pace not seen in decades. The more than 650,000 jobs lost last month has contributed to a growing concern that the unemployment rate could rise to 10 percent or higher before the economy rebounds. At the center of the economy's instability is a foreclosure crisis that has claimed 3.5 million homes in the last year alone, and threatens the loss of an additional 8 to 10 million homes to foreclosure over the next five years. The loss of wealth associated with the collapse of the housing market is staggering. More than $5 trillion in housing equity has virtually evaporated since the foreclosure crisis began. Major stock indexes have also been cut in half, further contributing to decreased consumer confidence, substantially reduced spending, lower productivity, rising unemployment and additional foreclosures.

The magnitude of the economic decline has led many observers to conclude that the current crisis is an "equal opportunity financial nightmare." But, reality paints a different picture. While few have been able to escape the financial pain completely, African Americans, Latinos, Native Americans and many Asian sub-populations are bearing the brunt of this national epidemic. Even before the crisis, the unemployment rate for African Americans was nearly double that for non-Hispanic white workers. Today, as the national unemployment rate rests at 8.1 percent, African Americans and Latinos are mired in double-digit job losses—the unemployment rate for African Americans is just under 14 percent, Latinos more than 11 percent, and non-Hispanic whites a little over 7 percent. For young black males, the rate is 25 percent and climbing. Before the current crisis, African Americans and Latinos held on average a mere $10 and $12 of net worth respectively for every $100 of savings for the typical non-Hispanic white household. The disproportionate impact of the foreclosure crisis on African Americans and Hispanics forms a

wider expansion of the racial and ethnic wealth gap. African Americans and Latinos were the disproportionate targets for the unfair, deceptive and reckless lending practices that triggered the foreclosure collapse and imploded the credit markets. The situation is so dire within the African-American community that United for a Fair Economy, a Boston-based policy group, estimates that African Americans could experience the greatest loss of wealth since Reconstruction.

I. Predatory Lending and the Mortgage Crisis

Predatory and abusive lending is the driving force behind the mortgage crisis and recession. Financial institutions hold troubled assets (in the form of problematic loans) that are increasingly becoming seriously delinquent and/or headed into default. Since the late 1990s, NCRC research, testimony, and policy papers warned that predatory lending was disproportionately targeted to minority communities in violation of fair housing and fair lending laws. While predatory lending had plagued protected classes for a long period of time, it eventually spread like a cancer and infected middle-income and non-minority communities, particularly in more recent years.[1]

Steering borrowers into unfair and deceptive products is the hallmark of the foreclosure crisis, and has resulted in significant amounts of lost wealth in minority communities and neighborhoods with large concentrations of elderly residents. NCRC's 2004 report "Broken Credit System" analyzes ten large metropolitan areas: Atlanta, Baltimore, Cleveland, Detroit, Houston, Los Angeles, Milwaukee, New York, St. Louis, and Washington, DC. NCRC obtained creditworthiness data on a one-time basis from a large credit bureau, which showed that the number of subprime loans increased as the amount of neighborhood residents in higher credit risk categories increased. After controlling for risk and housing market conditions, however, the race and age composition of the neighborhood had an independent and strong effect, increasing the amount of high-cost subprime lending. In particular:

- The level of refinance subprime lending increased as the percentage of African Americans in a neighborhood increased in nine of the ten metropolitan areas. The

[1] Dan Immergluck, The Accumulation of Foreclosed Properties: Trajectories of Metropolitan REO Inventories during the 2007-2008 Mortgage Crisis, Federal Reserve Bank of Atlanta, Community Affairs Discussion Paper, No. 02-08, December 15, 2008, accessed via http://www.frbatlanta.org/filelegacydocs/dp_0208.pdf

level of home-purchase subprime lending increased as the percentage of African Americans in a neighborhood increased in six metropolitan areas.

- The impact of the age of borrowers was strong in refinance lending. In seven metropolitan areas, subprime refinance lending increased solely when the number of residents over the age of 65 increased in a neighborhood.

NCRC also observed that racial differences in lending increased as income levels increased. In the 2008 study "Income is No Shield Against Racial Difference in Lending" NCRC found that middle- and upper-income minorities were more likely, relative to their middle- and upper-income white counterparts, to receive high-cost loans than low- and moderate-income minorities are, relative to low- and moderate-income whites. Middle- and upper-income African Americans were twice or more likely as middle- and upper-income whites to receive high-cost loans in 71.4 percent of the metropolitan areas examined in this report, while low- and moderate-income African Americans were twice or more likely as low- and moderate-income whites to receive high-cost loans in just 47.3 percent of the metropolitan areas examined. Lending disparities that correlate with higher income levels can also be observed when comparing Hispanics with whites and minority to non-minority census tracts.[2]

Funded by a US Department of Housing and Urban Development (HUD) FHIP grant, NCRC's National Neighbor's program conducted extensive testing of mortgage brokers in the subprime market during 2005 and 2006. The testing consisted of more than 100 fair lending tests of more

[2] NCRC's findings are consistent with a wide variety of research on subprime lending. Paul Calem of the Federal Reserve, and Kevin Gillen and Susan Wachter of the Wharton School also use credit scoring data to conduct econometric analysis scrutinizing the influence of credit scores, demographic characteristics, and economic conditions on the level of subprime lending. Their study found that after controlling for creditworthiness and housing market conditions, the level of subprime refinance and home purchase loans increased in a statistically significant fashion as the portion of African-Americans increased on a census tract level in Philadelphia and Chicago. The Center for Responsible Lending (CRL) also used the 2004 HMDA data with pricing information to reach the same troubling conclusions that racial disparities remain after controlling for creditworthiness. A more recent CRL study suggests that brokers are particularly likely to steer borrowers into subprime loans. See Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. Available via pcalem@frb.gov. also Paul S. Calem, Jonathan E. Hershaff, and Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, in Fannie Mae Foundation's Housing Policy Debate, Volume 15, Issue 3, 2004 pp. 603-622. Also, Center for Responsible Lending, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages,* see http://www.responsiblelending.org/issues/mortgage/reports/page.jsp?itemID=29371010. Also see Steered Wrong: Brokers, Borrowers, and Subprime Loans, April 2008, http://www.responsiblelending.org/pdfs/steered-wrong-brokers-borrowers-and-subprime-loans.pdf.

than 60 brokers in six major metropolitan areas throughout the United States including Atlanta, Baltimore, Chicago, Los Angeles, St. Louis, and Washington, DC. The testing was conducted on the basis of race and national origin. The testing uncovered a 46 percent rate of disparate treatment based on race. In the cases in which protected testers received good-faith estimates, their broker fees totaled an average of 2.7 percent of their loan amounts, while fees were only 1.8 percent of whites' loan amounts. Moreover, brokers discussed fees with 66.7 percent of white testers, but only 37 percent of protected testers. Brokers were also more evasive with protected testers when they discussed fees, telling them 55.2 percent of the time that fees would be rolled into the loan, or that they would be low, when asked. White testers only received this treatment 36.5 percent of the time when fees were discussed.[3]

Lending discrimination in the form of steering high-cost loans to borrowers qualified for market rate loans results in equity stripping and has contributed to inequalities in wealth.[4] Suppose 15 percent or 300 families in a predominantly minority census tract with 2,000 households receive subprime loans although they were creditworthy for prime loans (15 percent of families that are inappropriately steered into subprime loans is a realistic figure based on existing research). Further, assume that these families pay $50,000 more over the life of the loan than they should (the $50,000 figure is conservative). In total, the 300 families in the minority census tract have paid lenders $15 million more than they would have if they had received prime loans for which they could have qualified. The $15 million in purchasing power could have supported stores in the neighborhood, economic development in the neighborhood, or other wealth-building endeavors for the families and neighborhood. For even one neighborhood, the magnitude of wealth loss due to pricing disparities and/or discrimination is stark. Across the country, the wealth loss is staggering.

[3] NCRC Subprime Fair Lending Testing, Phase Two, National Mortgage Broker Mystery Shopping Project, memo on file at NCRC.

[4] Using a mortgage calculator from Bankrate.com, a $140,000 30-year mortgage with a prime rate of 6.25% costs about $862 a month or about $310,320 over the life of the loan. In contrast, a 30-year subprime loan with an interest rate of 8.25% costs $1,052 a month or approximately $378,637 over the life of the loan. The difference in total costs between the 6.25% and 8.25% loan is $68,317. Finally, a 30-year subprime loan at 9.25% costs $1,152 per month and $414,630 over the life of the loan. The difference in total costs between a 6.25% and 9.25% loan is $104,310. For a family that is creditworthy for a prime loan but receives a subprime loan, the total loss in equity can easily be between $50,000 and $100,000. This amount represents resources that could have been used to send children to college or start a small business.

Larger payments to lenders is one, but not the only, destructive outcome of steering. Wealth losses associated with foreclosure is another devastating outcome of steering. Subprime loans, particularly, adjustable rate mortgage (ARM) subprime loans have significantly higher default and delinquency rates that prime loans. According to a recent Mortgage Bankers Association survey, the foreclosure start rates for prime fixed rate, prime ARM, and subprime ARM loans were .34 percent, 1.77 percent, and 6.47 percent respectively.[5] The Federal Reserve Board has estimated that 28 percent of ARM subprime loans were seriously delinquent by May 2008, or five times the mid-2005 level.[6] Many of these subprime ARM loans are delinquent and/or in foreclosure because they were not underwritten carefully and contain several risk factors (39 percent have low or no income documentation, 74 percent of them have prepayment penalties, and their median debt-to-income ratio was a high 41 percent).[7]

When minority borrowers and communities receive a concentration of these types of loans, they experience enormous losses of wealth and high levels of foreclosures. United for a Fair Economy multiplies foreclosure estimates provided by the Center for Responsible Lending by subprime loan shares calculated by NCRC to estimate that people of color can expect to lose between $164 billion to $213 billion of dollars over an eight-year period.[8] This estimate of wealth loss understates the total wealth loss since it only considers subprime lending and does not include option ARM and other non-traditional prime lending.

Strong prohibitions against steering are justified to prevent dramatic equity loss in minority neighborhoods. Another motivation is preventing the spread of abusive lending that harms communities and financial institutions. The present crisis started with predatory lending targeted in minority neighborhoods. If the regulatory agencies had acted swiftly and aggressively against this abusive lending by enforcing anti-discrimination laws, it is possible that abusive lending

[5] Mortgage Bankers Association, Delinquencies Increase, Foreclosure Starts Flat in Latest MBA National Delinquency Survey, December 5, 2008, http://www.mbaa.org/NewsandMedia/PressCenter/66626.htm..
[6] Federal Reserve final HOEPA rule, p. 44524, via http://edocket.access.gpo.gov/2008/pdf/E8-16500.pdf, . Also, the OCC and OTS Mortgage Metrics Report of the Third Quarter 2008 reports that 13.5 percent, 7.1 percent, and 1.7 percent of subprime, ALT-A, and prime loans, respectively, were seriously delinquent, see http://www. http://www.occ.gov/ftp/release/2008-150a.pdf.
[7] December 2008 data fromLoanPerformance ABS Loan Level Data Set via Federal Reserve Bank of New York web page, http://www.newyorkfed.org/regional/subprime.html.
[8] United for a Fair Economy, Foreclosed: State of the Dream 2008, January 15, 2008, available viahttp://www.faireconomy.org/issues/racial_wealth_divide/foreclosed_state_of_the_dream_2008_0

could have been substantially curtailed before it wreaked havoc in minority communities and spread to predominantly white communities.

II. CRA and the Mortgage Crisis

The sharp economic decline and distress in the mortgage market resulting from the foreclosure crisis can be traced to outdated consumer protection laws and failed regulatory oversight. Loopholes in the law and inadequate regulatory enforcement allowed abusive and problematic lending to flourish. The foreclosures that arose from predatory lending have not only severely undermined the financial stability of working families and communities but also are now weakening the credit markets and diminishing overall economic activity and performance. Massive foreclosures are spurring a self-reinforcing cycle of defaults, declines in home values, and rising unemployment. Widespread unemployment is accelerating the economic crisis, as evidenced in a recent report published by Credit Suisse. The study projects 9 million foreclosures over the next four years, assuming an 8 percent unemployment rate. The federal government reported late last week that nationwide unemployment now stands at 8.1 percent, the highest rate in more than 25 years.[9] Loose underwriting combined with rising unemployment has contributed to new record rate of 11 percent of loans in foreclosure (or at least one payment past due according to a recently released report by the Mortgage Bankers Association).[10]

The foreclosure crisis has destroyed significant amounts of national and family wealth. Since the onset of the crisis, home prices have declined by at least 25 percent, with approximately 10 percent more in declines projected over the next few years. Home price declines destabilize credit markets, diminish family wealth, decrease consumer confidence, and further drive unemployment.[11] In 2008, $3.3 trillion in home equity was erased.[12]

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[9] Credit Suisse. "*Foreclosure Update: over 8 million foreclosures expected*." December 4, 2008. For unemployment figures, see Michael A. Fletcher, *Administration Officials Showcase Package's Impact* in the Washington Post, Saturday, March 7, 2009.

[10] Mortgage Bankers Association, Delinquencies Continue to Climb in Latest MBA National Delinquency Survey, March 5, 2009, http://www.mortgagebankers.org/NewsandMedia/PressCenter/68008.htm.

[11] Christie, Les, Foreclosures dominate home sales CNNMoney.com February 3, 2009

[12] S&P Case-Shiller Home Price National Index

Inadequate regulatory oversight and outdated consumer protection laws underscore the need for strong anti-predatory lending legislation and Community Reinvestment Act (CRA) modernization. CRA is one of the most important laws for building wealth and revitalizing neighborhoods. CRA provides incentives for safe and sound lending and should be more broadly applied throughout the financial services industry. Had CRA been applied more broadly to non-bank financial institutions and independent mortgage providers, it is arguable that the foreclosure crisis would not have occurred. Current anti-predatory lending law is weak and lacks adequate enforcement at the federal level. In response to this, NCRC plans to work with the 111th Congress to enact comprehensive anti-predatory lending legislation and preserve and expand CRA.

CRA is the antidote to the current crisis in the housing and credit markets. Passed in 1977, CRA requires banks to meet the credit needs of all communities, including low- and moderate-income areas. Congress enacted CRA in response to "redlining" (denial of loans and services) by lending institutions in low- and moderate-income communities. While Congress intended that CRA rectify redlining by promoting credit and banking services in low- and moderate-income communities, Congress required that lending be conducted "consistent with the safe and sound operation" of banks.

CRA has leveraged substantial amounts of loans and investments in low- and moderate-income communities, and has had a broader impact on the overall economy through job creation, affordable housing, and small business development.

The following examples demonstrate the responsible lending and investing leveraged by CRA:

- The Harvard study "The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System" demonstrates that without CRA, home-purchase lending to low- and moderate-income borrowers and communities would have decreased by 336,000 loans from 1993 through 2000.[13] The study also reveals that bank lending to such borrowers is higher in geographical areas where federal agencies grade banks on CRA exams than in localities where banks lend but are not subject to

[13] The Joint Center for Housing Studies at Harvard University, *The 25th Anniversary of the Community Reinvestment Act: Access to Capitol in an Evolving Financial Services System*, March 2002

CRA exams. (Banks generally are not subject to CRA in locations in which they do not have branches but still engage in lending through brokers).

- Research conducted by the Treasury Department reveals that CRA-covered lenders increased their home-mortgage loans to low- and moderate-income areas and borrowers by 39 percent from 1993 to 1998, which is more than twice the increase (of 17 percent) to middle- and upper-income borrowers and areas.[14]

- CRA community development lending for shopping centers and other economic development projects supports mortgage lending and housing developments by providing jobs for neighborhood residents and by increasing neighborhood purchasing power and incomes. Using publicly available CRA data from the Financial Institutions Examination database, NCRC calculates that the annual dollar amount of community development loans more than tripled during an 11-year period (from $17.7 billion in 1996 to $63.8 billion in 2007).

- NCRC also found that banks made 14.8 million small business loans totaling more than $581 billion in LMI neighborhoods from 1996 through 2007.

CRA-covered depository institutions made substantially fewer high-cost loans and piggyback[15] loans than lenders not covered by CRA. High-cost and/or piggyback loans have been found to be riskier with higher default rates than the traditional prime loans of CRA-covered depository institutions.

- The 2006 Federal Reserve Board's study "Higher Priced Home Lending and the 2005 HMDA Data" finds that 34.3 percent of home-purchase loans issued by non-CRA-covered lenders in 2005 were high-cost loans. In contrast, only 5 percent of the home purchase loans issued by depository institutions and closely scrutinized on CRA exams were high-cost.[16]

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[14] Robert Litan, Nicolas Retsinas, Eric Belsky and Susan White Haag, *The Community Reinvestment Act After Financial Modernization: A Baseline Report*, produced for the United States Department of the Treasury, April 2000

[15] Piggyback loans are those with a simultaneous first and second mortgage.

[16] Robert Avery, Kenneth Brevoort, and Glenn B. Canner, *Higher Priced Home Lending and the 2005 HMDA Data*, Federal Reserve Bulletin, September 2006.

- These findings were also supported by Traiger & Hinckley LLP, a fair lending compliance law firm that observed that 84.3 percent of the high-cost home purchase loans in the 15 most populous metropolitan areas were issued by non-CRA-covered lenders, while the remaining 15.7 percent were issued by banks and their affiliates.[17]

- Independent mortgage companies were a significant source of piggyback credit according to the Federal Reserve. From 2004 to 2006, independent mortgage companies extended between 55 percent and 63 percent of the high-cost piggyback loans. During the same time, depository institutions accounted for about one- fifth to more than one-fourth of the high-cost piggyback loans.[18]

- Sandra Braunstein, Director of the Division of Consumer and Community Affairs of the Federal Reserve System, testified February 24, 2009, before the Financial Institutions and Consumer Credit Subcommittee of the House Committee on Financial Services and affirmed, "I can state very definitively from the research we have done, that the Community Reinvestment Act is not one of the causes of the current crisis." Braunstein continued, "We have run data on CRA lending and where loans are located, and we found that only six percent of all higher cost loans were made by CRA covered institutions in neighborhoods targeted, which would be low to moderate income (sic) neighborhoods targeted by CRA. So I can tell you if that's where you're going, that CRA was not the cause of this loan crisis."[19]

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[17] Traiger and Hinckley, LLP, *The Community Reinvestment Act: A Welcome Anomaly to the Foreclosure Crisis,* January 7, 2008 and the addendum to the report, January 14, 2008.
[18] Avery, Brevoort, and Canner, *The 2007 HMDA Data*, draft article. See http://www.federalreserve.gov/pubs/bulletin/2008/pdf/hmda07draft.pdf
[19] Also see, Governor Elizabeth A. Duke At the Revisiting the CRA Policy Discussion, Washington, D.C., February 24, 2009 CRA: A Framework for the Future, http://www.federalreserve.gov/newsevents/speech/duke20090224a.htm and Federal Reserve Staff Analysis of the Relationship between the CRA and the Subprime Crisis http://www.federalreserve.gov/newsevents/speech/duke20090224a.htm

- CRA encourages foreclosure prevention by awarding points on CRA exams for counseling and modifying high-cost loans into affordable loans.[20] CRA penalizes banks and thrifts for making and/or purchasing illegal and abusive loans.[21]

III. Wall Street's Culpability in Creating the Predatory Lending and Fair Lending Crisis

An inadequately regulated marketplace financed large amounts of problematic subprime and non-traditional loans over the last several years, with no regard for the long-term implications for borrowers with unsustainable debt. More recently, unscrupulous lenders have migrated to the Federal Housing Administration (FHA) program, which is now experiencing a rapid increase in defaults. If regulatory enforcement is not immediately tightened, the unsafe and reckless lending practices of the past will recycle into different loan products, prolonging the crisis and hampering recovery.

Eugene Ludwig, former Comptroller of the Currency, and Eric Stein, senior vice president at the Center for Responsible Lending, assert that insatiable demand from Wall Street prompted lending institutions to dramatically increase risky lending. Ludwig states, "Investors' appetite for subprime mortgage securitizations was huge, and Wall Street responded by providing more of the products, greatly increasing the demand for originations of subprime loans."[22] Both Ludwig and Stein document that fees and profits associated with subprime lending was higher than those for prime lending for institutions across the financial industry, ranging from brokers earning yield spread premiums, to lending institutions, and to Wall Street investment banks.[23]

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[20] Federal Register, Vol. 74, No. 3, January 6, 2009, Community Reinvestment Act; Interagency Question and Answers Regarding Reinvestment, p. 498

[21] For example, the FDIC failed CIT Bank on a May 2008 CRA exam for purchasing abusive loans that featured low or no income-documentation, qualifying borrowers on the teaser rate, and prepayment penalties. See http://www2.fdic.gov/crapes/2008/35575_080512.PDF. Also, the FDIC failed Republic Bank and Trust on a May 2008 CRA exam, citing Equal Credit Opportunity Act (ECOA) violation associated with the bank's Rapid Anticipation Loan program.

[22] Eugene A. Ludwig, James Kamihachi, and Laura Toh, *The CRA: Past Successes and Future Opportunities in Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act*, A Joint Publication of the Federal Reserve Banks of Boston and San Francisco, p. 96, via http://www.frbsf.org/publications/community/cra/index.html

[23] Testimony of Eric Stein, Center for Responsible Lending, Before the U.S. Senate Committee on Banking, Housing and Urban Affairs, "Turmoil in the U.S. Credit Markets: The Genesis of the Current Economic Crisis, October 16, 2008, pp. 17-18. and also see p. 97 of Ludwig, et al.

Credit rating agencies also had incentives to deal in mortgage-backed securities (MBS), as credit rating agencies were paid by the issuers of these securities. The credit rating agencies inflated ratings and facilitated the sale of hundreds of billions of MBS containing problematic loans that defaulted in large numbers.

Ludwig suggests that the final breaking point creating a highly leveraged Wall Street occurred when investment bankers used MBS to create highly leveraged bets in the form of complex credit derivatives. Credit derivatives were not subject to margin requirements, meaning that investors could pay for these securities with short-term loans. As a result of massive amounts of trading and speculating with inadequately capitalized loss reserves, Wall Street firms and investors could not absorb the losses that came from massive defaults of risky loans and sudden declines in home prices.[24]

The heightened pace of financing problematic lending occurred because institutions escaped penalties for making and financing abusive and risky loans. Research suggests that too much of a good or service will be developed when a producer does not internalize (through penalties, fines, or losses of profit) the harmful aspects of the product. In this case, brokers and lending institutions sold problematic loans to Wall Street banks and investors; and investors did not require brokers or lending institutions to bear any significant amount of future losses should the loans become delinquent or default. Investors, likewise, calculated that the new financial instruments including credit derivatives and MBS with finely-tuned tranches sufficiently diversified risk so that no one investor would suffer unsustainable losses. The difficulty was that the financial industry did not anticipate large-scale home value declines, which resulted in significant defaults and foreclosures of problematic loans. Instead, the financial industry was operating on the assumption that home values would continue to rise, making it possible for borrowers to refinance out of unsustainable loans.

Federal Reserve Chairman Ben Bernanke stated in Congressional testimony, “The originate-to-distribute model (selling loans to the secondary market instead of holding them in portfolio)

[24] Ludwig et al., p. 97.

seems to have contributed to a loosening of underwriting standards in 2005 and 2006."[25] Industry statistics suggest a loosening of underwriting standards over time. For example, the Mortgage Bankers Association reports that 39 percent of loans were interest-only or option Adjustable Rate Mortgage (ARM) in 2006, while only 2 percent of the loans issued in 2000 exhibited these risky features.[26] In addition, Federal Reserve statistics reveal that the portion of subprime ARM loans with low or no documentation of borrower income rose from 20 percent to 40 percent in 2006. In recent years, more than 75 percent of the loans in subprime MBS pools were particularly high-risk ARM loans of the 2/28 or 3/27 variety (the first number being the number of years in which the loan has a fixed rate and second number indicating the number of years in which the loan rate adjusts). The Congressional Oversight Panel, in a March 6, 2009, report also documents an increasing market share of subprime and ARM products with related increasing delinquencies, particularly between 2004 and 2007.[27]

Since a wide variety of financial institutions were involved in the financing of problematic loans, a mortgage reform law and its accompanying regulations must be comprehensive, vigorous, and cover the entire industry. Coverage must not only extend to the entities commonly discussed such as brokers, lending institutions, appraisers, and servicers but must also include Wall Street investment banks and the so-called "shadow market," including hedge funds and credit derivatives. The current lack of financial penalties for excessively risky activities must end. Congress must create comprehensive protections and establish a fiduciary responsibility for brokers and lending institutions for adhering to the comprehensive protections. In addition, Congress must also apply assignee liability to investors and other secondary market firms. Assignee liability requires investors and other firms to adequately compensate borrowers for violations of prohibitions against unfair and deceptive lending.

[25] Ben S. Bernanke, "Subprime Mortgage Lending and Mitigating Foreclosures," Testimony before the Committee of Financial Services, U.S. House of Representatives, Washington DC, September 20, 2007.
[26] Interest only loans permit the borrower to pay only the monthly amount due for interest during a specified time period. For an option ARM loan, the borrower has various payment options. For example, the borrower can pay the entire monthly payment due for interest and principal or can elect to not even pay the amount due to cover monthly interest. Many borrowers opted to pay the lowest amount each month, not suspecting that this would result in large increases in future payments.
[27] Congressional Oversight Panel, the Foreclosure Crisis: Working Towards a Solution, March 6, 2009, pp. 18-22, via http://cop.senate.gov/documents/cop-030609-report.pdf

Credit Ratings Agencies

Credit rating agencies reaped millions of dollars in fees for providing inflated ratings to residential MBS and collateralized debt obligations. These practices contributed to the funding of hundreds of billions of dollars of loans that were not underwritten for long-term sustainable homeownership. The President's Working Group on Financial Markets in March 2008 cited "the erosion of market discipline" by credit ratings agencies and "flaws in credit rating agencies' assessments" as being among the underlying cause of financial market collapse. More recently, the Congressional Oversight Panel asserted that credit rating agencies perhaps played the "decisive" role in endangering the financial system.[28]

NCRC has filed complaints with HUD against Fitch, Inc., Moody's Investors Service, and Standard and Poor's. NCRC alleges that these agencies substantially contributed to the housing and foreclosure crisis in African-American and Latino communities by making public misrepresentations about the soundness and reliability of subprime securities' ratings. The rating agencies fueled imprudent high-cost mortgage lending disproportionately targeted to minority communities, which contributed to high-default and foreclosure rates in violation of the *Fair Housing Act*.

In order to prevent credit rating agencies from enabling reckless lending in the future, NCRC recommends that Congress pass legislation that changes the method by which ratings agencies are compensated. At the very least, Congress should require that ratings agencies clearly disclose how they are compensated. Currently, ratings agencies have a strong incentive to inflate ratings because they receive fees from sellers of MBS. The Congressional Oversight Panel recommends that, instead, ratings agencies could be compensated by creating pools financed by fees of all issuers so that an agency is not paid directly by an issuer for rating a security. The Congressional Oversight Panel also recommends that Congress provide clearer and stronger

[28] Congressional Oversight Panel, Special Report on Regulatory Reform: Modernizing the American Financial Regulatory System – Recommendations for Improving Oversight, Protecting Consumers, and Ensuring Stability, January 2009, p. 40. http://cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf

oversight of ratings agencies by creating a Credit Rating Review Board that would oversee ratings and generally monitor the ratings agencies.[29]

IV. Recommendations

Enact Comprehensive Anti-Predatory Lending Legislation

The current foreclosure crisis would not have occurred had Congress passed a comprehensive anti-predatory lending law in the late 1990s or the earlier part of the 21st century. A comprehensive anti-predatory lending law would apply consumer protections to several types of financial institutions including banks, brokers, mortgage companies, appraisers, servicers, investment banks, securitizers, credit rating agencies, hedge funds, and other financial companies. A central element of an anti-predatory lending law would be a strong prohibition against steering high-cost loans to borrowers who qualify for lower-cost loans. In addition, an anti-predatory lending law must have a robust requirement ensuring that lenders have assessed a borrower's ability to repay the loan, based on the maximum rate instead of the teaser rate in the case of adjustable rate loans. No or low-income documentation lending must be banned. Prepayment penalties and yield-spread premium payments to brokers must also be banned on subprime and non-traditional prime loans. Other practices including intimidating or influencing appraisers and servicer abuses, such as forced placement in insurance, should also be prohibited. Investors, lenders, and securitizers must be held liable when loans violate the mandates in anti-predatory lending legislation.

A requirement imposed on servicers to engage in reasonable efforts to modify distressed loans on the verge of default and/or foreclosure must be part of a comprehensive anti-predatory lending bill. Rep. Barney Frank, Chairman of the House Committee on Financial Services, stated at NCRC's annual conference last week that he is working with Rep. Maxine Waters to create this type of requirement. Finally, comprehensive anti-predatory lending legislation must not preempt state law that is consistent and stronger than federal law. Moreover, federal agencies must not interfere with state officials when state officials enforce either state or federal law. Currently,

[29] Congressional Oversight Panel Report of January 2009, see pages 43-44.

the Office of the Comptroller of the Currency has prevented state officials from enforcing federal law in the case of nationally-chartered banks.

Currently, the House Committee on Financial Services is drafting a comprehensive anti-predatory lending bill, and the Senate Banking Committee will also likely consider an anti-predatory lending bill this spring or summer.

Support the *CRA Modernization Act of 2009* (H.R. 1479)

H.R. 1479 would strengthen the existing *Community Reinvestment Act* (CRA) as applied to banks. It would require CRA exams in the great majority of geographical areas banks serve. As mentioned previously, CRA examines banks in areas where they have branches but not in other areas where they lend through brokers. Under the bill, CRA exams would explicitly consider lending and services to minorities in addition to low- and moderate-income communities. The bill would require the reporting of race and gender of borrowers of small business loans and would require data collection of deposit and savings accounts. The ratings system of CRA exams would be enhanced by the bill. The federal regulatory agencies would also be required to hold more meetings and public hearings when banks merge and when banks seek to close branches. Finally, the bill would apply CRA to a variety of non-bank institutions including independent mortgage companies, mortgage company affiliates of banks, mainstream credit unions, insurance companies, and securities firms.

Enhance the Quality of *Home Mortgage Disclosure Act* (HMDA) Data

Congress and the Federal Reserve Board (which implements the HMDA regulations) should enhance HMDA data so that regular and comprehensive studies can rigorously scrutinize fairness in lending by considering a wide variety of borrower and loan characteristics, such as borrower creditworthiness and debt-to-income ratios.

The *CRA Modernization Act of 2009* (H.R. 1479) includes the following:

- Fee and pricing information for all loans, not just high-cost loans
- Specific loan terms, such as whether the loan was fixed and/or adjustable rate

- Information on the length of time in which the initial rate was in effect
- Credit score information
- Loan-to-value and debt-to-income ratios

A new database on loan performance, which would include information on whether loans were current, delinquent, in foreclosure, or were modified, would be linked to HMDA data. H.R. 1479 includes HMDA-like data in for insurance companies and securities firms so that the general public, community organizations, and federal agencies can assess the availability of their products to borrowers and communities by race, gender, and income levels.

Create a Cabinet-Level Civil Rights Enforcement Agency

NCRC recommends the establishment of a new cabinet-level agency focused on civil rights enforcement. This agency would report directly to the President of the United States and would be responsible for measuring, monitoring, and eliminating discrimination from the public and private sectors and promote financial inclusion and racial and cultural equality, opportunity, and diversity through coordinated government efforts. As proposed, the new civil rights enforcement agency would not replace the civil rights responsibilities of other federal and state agencies, but would develop a strategic plan to work in partnership with all federal departments and agencies to coordinate civil rights enforcement. And when departments or agencies fail to carry out civil rights enforcement mandates, the new agency would step in to enforce their mandates. This new agency would also create public service campaigns and multicultural marketing materials to educate racially diverse working communities on the growing need to promote fairness and equal access to socio-economic opportunity.

Alternatively, NCRC recommends substantially enhanced funding and authority of this Commission to support a "virtual army" of local fair lending enforcement agencies across America to measure, monitor, and report on continuing acts of discrimination. The National Fair Housing Alliance conservatively estimates more than 4 million acts of housing discrimination each year. As such, funding should be at a level that would adequately address the scale and scope of this continuing and insidious behavior.

Establish a Federal Interagency Fair Housing Planning Policy for All Federal Programs and Recipients of Federal Funds

Currently, all states and localities that receive funding from the Community Development Block Grant must have Fair Housing Planning activities that are updated every five years. These plans should act as a model for a national plan, be vigorously enforced, and be updated every three years to reflect changes in the market climate. In addition, all federal agencies that have any fair housing responsibilities should conduct an analysis of potential agency impediments and craft a plan to overcome such impediments (to be coordinated with the new cabinet-level agency), while ensuring that their public- and private-sector partners are working to further fair housing initiatives.

Make Fair Housing and Fair Lending Enforcement More Transparent and Effective

Federal agencies should report to Congress annually on the number of fair housing and fair lending investigations, types of investigations, and outcomes of these investigations. Annual reporting should include information on fair lending compliance exams conducted in conjunction with CRA exams and HUD's processing of fair lending complaints.

HUD, the US Department of Justice, and State Fair Housing Assistance Program agencies must investigate, mediate, and charge more complaints, including pattern-and-practice, architectural accessibility, and fair lending matters. Regulatory capacity to investigate national fair lending systemic investigations must be also increased including investing in training, staff resources, and interagency collaboration.

Conclusion

The issue of discrimination has been traditionally argued solely on the basis of fairness, equality, and justice. While those are important grounds, there is increasingly another critical reason to level the playing field by race and ethnicity.

Globalization represents for America competitive challenges the nation has never previously experienced. Growing concern over the considerable loss of jobs in the US economy continues to undermine investor confidence, here and abroad, and diminish this country's ability to attract

investors from around the world back to the US markets. Within the next 35 years, half of the US population will consist of people of color. This has particular implications for the American economy overall since people of color represent the fastest growing share of the nation's population that are the least well-housed, have diminished access to the labor and financial markets, and are disproportionately isolated from quality education and health care, and earn relatively low levels of wealth.

During the 2009 State of the Black Union, author Les Brown asserted that "knowledge is the new currency." President Obama, in a speech delivered March 10 before the National Hispanic Chamber of Commerce, stated "The source of America's prosperity has never been merely how ably we accumulate wealth, but how well we educate our people." In an increasingly competitive global economy, the President's words have never been more salient for underscoring the importance of America's ability to compete in an international marketplace. President Obama went on to add that "…despite resources that are unmatched anywhere in the world, we've let our grades slip, our schools crumble, our teacher quality fall short, and other nations outpace us…and year after year, a stubborn gap persists between how well white students are doing compared to their African American and Latino classmates."

This paradigm shift represents the need to educate our citizens in order for them to effectively compete. This paradigm shift also signals that the old paradigm of discrimination and inequality must fall. We must continue the open dialogue on race that began last year and fully understand the historical implications for our nation's future. Succeeding in a new globally competitive world is not an option…we must. And we will, because we are a great people. And America will, because it is composed of a great people rich in diversity. Your efforts to eradicate the last vestiges of discrimination and inequality are essential to that success.