NCLR
NATIONAL COUNCIL OF LA RAZA

ASSESSING THE DAMAGE OF PREDATORY LENDING BY COUNTRYWIDE: THE FALLOUT FOR LATINO FAMILIES

Presented at

"Examining Lending Discrimination Practices and Foreclosure Abuses"

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Submitted by

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Good morning. My name is Eric Rodriguez and I am Vice President of the Office of Research, Advocacy, and Legislation at the National Council of La Raza (NCLR)—the largest national Hispanic[1] civil rights and advocacy organization in the United States. For the last four decades, NCLR has been committed to improving opportunities for the nation's 50.5 million Latinos. To this end, NCLR conducts research, policy analysis, and advocacy on a variety of financial services issues that affect the ability of Latinos to build and maintain assets and wealth. I would like to thank Chairman Patrick Leahy and Ranking Member Chuck Grassley for inviting me to participate in today's hearing.

NCLR works to improve the financial security of Latino families by promoting fair and responsible housing and financial markets that serve Hispanic families well and allow them to build assets that they can share with the next generation. This goal has led us to engage in critical public policy issues such as strengthening fair housing and lending laws, improving access to financial services for low-income families, and promoting sustainable homeownership in the Latino community. In addition, the NCLR Homeownership Network (NHN)—a network of 50 community-based counseling providers—has provided first-time homebuyers with the advice and guidance they need to navigate the mortgage process for more than a decade. NCLR serves 65,000 families annually through this network, and has produced more than 25,000 first-time homebuyers since its inception. By working closely with housing practitioners serving our community, we are able to represent the real-time experiences of Hispanic families and recommend practical policy solutions. We are focused on results for families, which is why we supported the elimination of the Department of Treasury's Home Affordable Modification Program (HAMP) to make room for a more robust solution to the foreclosure crisis.[2]

Reviews of publicly reported mortgage data have long shown that Black and Hispanic borrowers were more likely than their White peers to receive high-cost and high-risk loans even after controlling for key risk factors.[3] NCLR's analysis pointed to the mechanisms built into our national home lending system that made it more likely that Latino borrowers would be steered toward such loans.[4] The Department of Justice (DOJ) settlement with Bank of America regarding the past discriminatory practices of Countrywide uncovers one of the most egregious practices common during the housing bubble years—steering a creditworthy family into a subprime loan even though they were qualified to receive a prime loan. DOJ is to be

[1] The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, Spanish, and other Hispanic descent; they may be of any race.

[2] Janis Bowdler, "Time to Move On: Families Facing Foreclosure Need Better Solutions than HAMP," *NCLR Blog*, http://www.nclr.org/index.php/about_us/news/blog/time_to_move_on_families_facing_foreclosure_need_better_solutions_than_hamp/ (accessed March 5, 2012).

[3] Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on Price of Subprime Mortgages* (Durham, NC: Center for Responsible Lending, 2006), and Debbie Gruenstein Bocian, Wei Li, Carolina Reid, and Roberto G. Quercia, *Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures* (Center for Responsible Lending and UNC Center for Community Capital, 2011).

[4] NCLR has published several reports, public statements, and testimony on this issue, available at www.nclr.org. Key publications include: Janis Bowdler, *Jeopardizing Hispanic Homeownership: Predatory Practices in the Mortgage Market* (Washington, DC: NCLR, 2005); Janis Bowdler, *Challenges to Building Sustainable Homeownership in Latino Communities* (Washington, DC: NCLR, 2007); Graciela Aponte, *Putting an End to Predatory Lending in Minority and Latino Communities* (Washington, DC: NCLR, 2009).

congratulated for this landmark victory for Hispanic and Black borrowers, while Bank of America deserves credit for not standing in the way of justice for the Countrywide clients that have come under its care.

In my testimony today I will review the evidence of lending abuse that makes this settlement so critical and explain how the consequences stretch far beyond its 200,000 victims. I will also offer recommendations on how Congress and the claims administrator can ensure that justice reaches as many families as possible.

Background

Like all Americans, Latino families rely on the equity in their homes to support their retirement, finance their children's education, buoy them in times of financial emergencies, or start a small business. Those fortunate enough to own their homes or land are able to pass this wealth to their children, a practice that has historically fueled the upward mobility of millions into the middle class. Unfortunately, the benefits of homeownership have not been equally available to all. Historical discrimination has contributed to a stubborn disparity in homeownership rates and a legacy of disparity between the assets owned by White families versus those owned by families of color—a figure known as the racial wealth gap. The racial wealth gap—18-to-one for Latinos and 20-to-one for Blacks—currently has been exasperated by deceptive lending practices that stripped homeowners of equity and contributed to record foreclosure rates.[5] Nevertheless, homeownership is still vital to all Americans, and policies should not abandon the concept of climbing up the economic ladder via homeownership.

Predatory lending in communities of color was not a random occurrence. Deceptive lenders targeted our communities while a breakdown in state and federal oversight allowed for these signs to go unnoticed. Below are four of the most prominent reasons that Hispanic families became targets for dishonest lenders and brokers:

- **Latinos have unique mortgage borrower profiles**. Mortgage lenders have become highly dependent on automated underwriting systems whereas Latino and other immigrant borrowers would benefit from a manual underwriting process for a true evaluation of their credit and income profiles. For example, 22% of Latinos, compared to only 4% of Whites, have a thin credit file, or no credit history, which usually results in a zero credit score.[6] Multiple wage earners, additional co-borrowers, and small business and cash income are also common among Latino borrowers. Mainstream and prime lenders had little incentive to process these applications through manual underwriting systems where other reliable underwriting criteria such as rent and utility payment history could have been evaluated. In some cases, lenders referred borrowers to their subprime affiliates that used no-documentation loans to avoid sound underwriting. Others simply avoided such borrowers despite the demand for credit, leaving a vacuum that subprime and predatory lenders were quick to fill.

[5] Rakesh Kochhar, Richard Fry, and Paul Taylor, *Wealth Gaps Rise to Record Highs Between Whites, Blacks, Hispanics: Twenty-to-One* (Washington, DC: Pew Research Center, 2011).
[6] Michael Stegman et al., "Automated Underwriting: Getting to Yes for More Low-Income Applicants," Presented before the 2001 Conference on Housing Opportunity, Research Institute for Housing America Center for Community Capitalism (Chapel Hill: University of North Carolina, April 2001).

- **Profit incentives fueled predatory lending in minority and vulnerable communities**. Commission-based loan officers have less of an incentive to serve low-to-moderate-income borrowers and a greater incentive to steer borrowers to loans that would earn higher profits, which was exactly the case for subprime and high-risk loans. Loan officer and mortgage brokers' compensation was based on the size of the mortgage, interest rate, and points and fees charged. Therefore, lenders had little motivation to assist families financing modestly sized mortgages, who had applications that took extra time, or who received down payment assistance. The evidence bears out this trend: Research shows that nontraditional mortgage products such as Option Adjustable Rate Mortgages (Option ARMs) and interest-only mortgages are disproportionately concentrated among minority borrowers; Latinos are more than twice as likely as Whites to receive an Option ARM. In addition, Latinos and Blacks were much more likely to receive subprime loans that included high interest rates, prepayment penalties, and hybrid or Option ARMs. These disparities were evident even comparing borrowers within the same credit score ranges. For example, among borrowers with a FICO (Fair Isaac Corporation) credit score of over 660, Blacks and Latinos received a high interest rate loan more than three times as often as White borrowers.[7]

- **Commonsense standards for sustainable lending were abandoned.** The long-standing best practices of matching borrowers to sustainable and well-underwritten mortgages were abandoned in exchange for an underwrite-to-distribute model where profits were earned upfront and the long-term performance of a loan was of little concern. Originators and securitizers of mortgages received instantaneous profits and faced little or no risk of loss if the loans defaulted. As underwriting standards continued to decline in order to facilitate an increased volume of loans, more borrowers received loans that responsible lenders should have known they would be unable to repay.[8] Moreover, most lenders—including Fannie Mae, Freddie Mac, and the Federal Housing Administration mortgage insurance program—lifted their requirement that first-time homebuyers or others with less-than-ideal credit profiles receive homebuyer counseling prior to their purchases. Borrowers who attended housing counseling sessions were more likely to avoid predatory loans and much less likely to default on their mortgage payments.[9]

- **Strong federal rules and enforcement were not in place to protect borrowers**. Federal regulators did not act to prevent or prohibit even the worst of the deceptive lending practices despite constant warnings from community advocates. Congress finally passed anti-predatory legislation in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010; however, by then the damage had been done.

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[7] Debbie Gruenstein Bocian, *Lost Ground, 2011.*

[8] Michael H. Krimminger for the Federal Deposit Insurance Corporation, *Understanding the Implications and Consequences of the Proposed Rule on Risk Retention*, 112 Cong., 1st sess., 2011, available at http://www.fdic.gov/news/news/speeches/chairman/spapr1311.html.

[9] Neil S. Mayer, Peter A. Tatian, Kenneth Temkin, and Charles A. Calhoun, *National Foreclosure Mitigation Counseling Program Evaluation: Preliminary Analysis of Program Effects* (Washington, DC: Urban Institute, 2009).

Consequences of Predatory Lending

Unfair and discriminatory lending may have hit communities of color and low-income families particularly hard, but such tactics have widespread consequences for all homeowners. When regulators turned their backs on the predatory practices festering in the subprime and so-called "Alt-A" lending markets, they laid the groundwork for the housing bubble and the collapse of our financial markets. To date, 2.7 million families have lost their homes to foreclosure[10] and nearly $371 billion in equity has been lost through home value declines in communities of color.[11] The disproportionate impact on minority borrowers will make their recovery even more challenging. Approximately one out of four Latino and Black borrowers has lost a home to foreclosure or is at serious risk of foreclosure, compared to nearly 12% of White borrowers.[12] As a result, the wealth of Hispanic households has declined by a startling 66%.[13]

While the financial impact of the foreclosure crisis is staggering, the lasting effects of foreclosures on children and families have only begun to surface. NCLR and the University of North Carolina (UNC) Center for Community Capital conducted interviews with families that had recently experienced a foreclosure in five regions of the country (southeastern Texas, southeastern Michigan, the west coast of Florida, northwestern Georgia, and the Central Valley of California).[14] Following the foreclosure, signs of depression, increased anxiety and tension, and feelings of guilt and resentment were commonplace. Several participants were forced to forego medical care for themselves or their children in failed attempts to keep their home. Multiple moves contributed to family instability. Parents reported that their children's academic performance declined while problematic behavior at school increased. With their safety nets eroded and their credit scores in ruins, the families found themselves in a hole from which it will be difficult to recover. The Nuñez family from northwestern Georgia, an interview participant, summed up their frustration:

> *[W]e invested the money we had [in the house] thinking that the money that we were investing would be for our children to study, hoping that they didn't have to be moving here and there, that they would have a home and be stable. We had dreams and plans. For them to study, go to college. We had plans, with the money that we gave as down payment, that we could use it for them to have a career or study something good. But now, there's no house, there's no money, and there's no dreams. There's only our good intention of doing all that for them.*

Given the demographic shifts of our nation, efforts to hold discriminatory lenders responsible and restore opportunity in minority neighborhoods are a critical step to the nation's economic improvement. Private industry, Fannie Mae, Freddie Mac, federal regulators, and community

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[10] Debbie Gruenstein Bocian, *Lost Ground, 2011*.
[11] Debbie Gruenstein Bocian, Wei Li, and Keith S. Ernst, *Foreclosures by Race and Ethnicity: The Demographics of a Crisis* (Washington DC: Center for Responsible Lending, 2010).
[12] Debbie Gruenstein Bocian, *Lost Ground, 2011*.
[13] Rakesh Kochhar, Richard Fry, and Paul Taylor, *Wealth Gaps Rise to Record Highs Between Whites, Blacks, Hispanics: Twenty-to-One* (Washington, DC: Pew Research Center, 2011).
[14] Janis Bowdler, Roberto Quercia, and David Andrew Smith, *The Foreclosure Generation: The Long-Term Impact of the Housing Crisis on Latino Children and Families* (NCLR and University of North Carolina, Center for Community Capital, 2010).

service providers must work together to create bold solutions to our housing challenges. In addition to tangible, direct support such as loan modifications and principal reduction, public accountability is critical to the healing of the market. The Department of Justice's settlement with Bank of America on behalf of Countrywide is critical in this respect. The breakthrough case sends a strong signal to the market that discriminatory practices will not be tolerated and to families that justice is possible.

Delivering Justice to Harmed Families

The DOJ investigations into Countrywide uncovered widespread discrimination that harmed more than 200,000 Latino and Black borrowers between 2004 and 2008. Approximately 10,000 Countrywide borrowers were steered into risky subprime loans, many of which are likely to have ended in foreclosure, even though the borrowers qualified for a prime loan. Two-thirds of the victims are Latino and one-third are Black borrowers. These abusive practices occurred with Countrywide loans across the country, but more than 30% of the victims were in California, where one out of two foreclosures in the state are against Latino homeowners.[15] This is the largest residential fair-lending settlement in history and provides $335 million to compensate victims.

The settlement was negotiated by DOJ's Fair Lending Unit, which was recently created to improve efforts to combat lending discrimination. The Unit works closely with the banking regulatory agencies, the Federal Trade Commission, and the Department of Housing and Urban Development (HUD), by investigating referrals where the agency suspects there is a pattern or practice of discrimination. In 2010, the division received 49 referrals from partner agencies, more than it had received in a single year in at least 20 years.[16] The improved coordination between federal agencies and heightened vigilance are critical to ensuring that fair housing and lending laws are honored and enforced as the majority of fair housing violations do not get reported. Victims often do not know their rights have been violated, many do not know where to report violations, and others fear the consequences of reporting. HUD estimates that only 1% of fair housing violations committed are ever reported, but even this number is conservative. Yet over four million fair housing violations are committed every year against members of protected classes under the Fair Housing Act.[17]

Given the importance of this settlement, it is critical that DOJ—and Congress as its overseer—make every effort to locate homeowners harmed by Countrywide. The settlement has two categories of victims: prime borrowers that were charged thousands of dollars in excessive fees and those unfairly and unnecessarily steered from prime to subprime loans. The first set of borrowers should be easier to locate. However, homeowners that were steered and therefore experienced a foreclosure will be difficult to find and may be hesitant to respond to unsolicited outreach.

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[15] Debbie Gruenstein Bocian, Peter Smith, Ginna Green and Paul Leonard, *Dreams Deferred: Impacts and Characteristics of the California Foreclosure Crisis* (Durham, NC: Center for Responsible Lending, 2010).

[16] Tracy Russo, "Fair Lending," *The Justice Blog*, September 1, 2011, http://blogs.usdoj.gov/blog/archives/1537 (accessed February 2, 2012).

[17] National Fair Housing Alliance, *The Big Picture: How Fair Housing Organizations Challenge Systemic and Institutionalized Discrimination, 2011 Fair Housing Trends Report* (Washington, DC: National Fair Housing Alliance, 2011).

To ensure that as many victims receive their due justice as possible, NCLR makes the following recommendations to the Department of Justice, the settlement claims administrator, and Congress:

- **Streamline and maximize outreach efforts**. A number of efforts are underway to deliver relief or compensation to millions of families affected by discriminatory lending, servicer abuse, and wrongful foreclosure. Unclear or confusing outreach efforts will only make room for scammers to insert themselves into the process and exploit families once again. The federal agencies charged with administering compensation to victims must streamline their approach and integrate applications for the two major federal foreclosure prevention programs—HAMP and Home Affordable Refinance Program (HARP). Moreover, their efforts will be maximized by including public service announcements (PSAs) and paid advertisements featuring recognized and trusted officials from the administration, a toll-free phone line with Spanish-language capability that can provide information about each of the initiatives, coordinating with the nonprofit sector, and a system to monitor and enforce rules that prevent scams.

- **Partner with qualified community-based organizations**. The power, reach, and capacity of the nonprofit sector has been consistently overlooked and underused in the rollout of federal foreclosure initiatives. Not surprisingly, borrower contact, satisfaction, and success have been lackluster in many cases. HUD-approved housing counseling agencies have worked with more than 11 million households since 2006. Objective, trusted counseling organizations support borrower contact efforts and work with local news outlets to place PSAs and paid advertisements to draw out victims. In addition, the claims administrator can contract with qualified nonprofits to reach unresponsive households. NCLR employs this model with Bank of America, Wells Fargo, and Ocwen, and has been successful at connecting hard-to-serve clients to the loss mitigation process. We also urge Congress and the administration to fully fund the HUD Housing Counseling Program at $88 million.

- **Ensure sustainable homeownership opportunities for victims of lending discrimination**. Congress and the administration must require servicers to provide settlement victims still in their homes an expedited review to determine their eligibility for a loan modification and principal reduction. For those who have already lost their homes, the road back to homeownership may be a long one. In addition to cash compensation, the settlement should provide for a financial advisor or housing counselor to work with families to begin repairing their financial circumstances. The three credit bureaus should consider credit amnesty policies for victims of lending discrimination. Ultimately, if and when these families are ready to purchase another home, affordable financing should be made available through Fannie, Freddie, or FHA.

Conclusion

The Department of Justice's investigation of Countrywide should serve as a blueprint for further enforcement of our fair lending laws. The evidence uncovered during this probe into Countrywide dealings serves as affirmation of the analysis offered by civil rights organizations for the past decade regarding the unequal homeownership opportunities available to communities of color. Moreover, it is now clear that the unequal treatment of certain borrowers can lead to widespread harm for nearly all homeowners. Our housing market and economy will be stronger when all lenders play by the rules and every borrower has a fair shot at homeownership.