Testimony to the Chicago City Council Hearing on Subprime and Predatory Mortgage Lending on Tuesday, March 30, 2004

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Thank you for the invitation to testify at today's hearing. My name is Malcolm Bush, and I am president of Woodstock Institute. Woodstock Institute is a 30-year old, Chicago-based nonprofit organization that works locally and nationally to promote reinvestment and economic development in lower-income and minority communities. Woodstock has been extremely active in the area of subprime and anti-predatory lending, conducting research that illustrates the scope and impact of predatory lending and working to develop and promote local, state, and federal policy that addresses this problem.

I should say at the outset, that we note the distinction between subprime and predatory mortgage lending. Subprime lending is lending to people with impaired credit. The costs are higher than prime lending to mitigate the lending risks. It turns out, however, that a significant percent of borrowers who received subprime loans, in fact, qualified for, but did not receive prime loans. Predatory lending is a term we use to describe very high cost, high fee subprime loans, with unfair conditions and practices, where the costs are out of line with the banks' risks and with reasonable profit expectations.

Let me also note that a Woodstock staff person, Geoffrey Smith is testifying in Washington today at a House subcommittee hearing on subprime lending regarding findings of a recently released research report that shows in Chicago, after controlling for neighborhood economic and demographic conditions, subprime lending leads to foreclosures at twenty or more times the rate that prime lending does. These foreclosures threaten the stability of modest-income communities and cost cities and neighborhoods hundreds of millions of dollars every year in lost tax revenue, increased service burdens, and lowered property values.

In 2000, the city approved an anti-predatory lending ordinance and the state approved legislation in 2003, but there has been activity at the federal level to preempt state and local laws with a national standard. Already, three bank regulators, the OCC, OTS, and NCUA have stated that their institutions are not subject to state laws.

In the OCC's case, this preemption not only applies to national banks, but also their direct operating subsidiaries. (The Illinois law only applies to state chartered institutions but other state laws, prior to the OCC preemption action also applied to national banks operating in those states.) These subsidiaries are some of the largest mortgage lenders in the country and many have been associated with questionable lending practices. The OCC's answer to the many critics of its preemption order was to develop a weak predatory lending standard of its own, that says that banks cannot originate mortgages based strictly on borrower equity or foreclosure value. This

standard, however, misses some of the most egregious predatory practices such as packing exorbitant fees onto mortgage loans, loan flipping, charging high prepayment penalties, and requiring mandatory arbitration. These practices strip equity from homeowners and trap borrowers in abusive loans.

The preemption by federal regulators, however harmful, still allows states to regulate certain entities such as mortgage companies. The lending industry, however, feels “burdened” with compliance to numerous different state standards, and is pushing for a uniform federal lending standard.

The most recent manifestation of this effort is a bill introduced by Rep. Ney (R) of Ohio. Compared to the Illinois’ law, Ney’s bill would:

-Cover fewer loans by raising interest rate and point and fee triggers
-Consider fewer fees under the fee trigger (including yield-spread premiums)
-Have looser restrictions on prepayment penalties
-Have no limits on the financing of points and fees into the loan
-Limit civil remedies and assignee liability
-Preempt all state and local laws

Alternatively, Sen. Sarbanes (D) of Maryland has proposed a federal bill that would generally strengthen protections in Illinois. Compared to the Illinois’ law, Sarbanes’ bill would:

-Maintain the same interest rate and points and fee threshold
-Apply maximum prepayment penalty to fee trigger
-Limit prepayment penalties to 24 months (an in some cases eliminate entirely)
-Limit financing points and fees to the greater of 3 percent of loan or $600
-Maintain assignee liability currently in HOEPA
-Increase potential monetary damages under HOEPA
-Allow for stronger state laws (this may change)

In our view the Sarbanes bill sets a vigorous standard for preventing predatory mortgage lending and has the advantage of allowing for stronger state law. Some critics of the regulation of predatory lending argue that laws and regulations will restrict the appropriate extension of credit to appropriate borrowers. We, on the other hand, believe that the Illinois statute and the Sarbanes bill are finely crafted to reach their targets, and if, by chance a few of those reasonable loans are denied under these laws, that is a small price to pay for stopping the enormous devastation caused by predatory mortgage lending.