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Credit Union Commitment to Fair Lending

The credit union system abhors the predatory lending practices that are being used by some mortgage brokers and mortgage lenders across the country. America's more than 10,000 credit unions - member owned, not-for-profit cooperatives - strive to help their 80 million members create a better economic future for themselves and their families.

America's credit unions support the elimination of lending practices that are intentionally structured in a manner that is deceptive and disadvantageous to borrowers. Too often those in our society who are least able to protect themselves from these deceptive practices are preyed upon first, and harmed the most.

During the summer of 2000, CUNA developed “Mortgage Lending Standards and Ethical Guidelines” designed to help emphasize credit unions’ concern for consumers and further distinguish credit unions as institutions that care more about people than money.

INTRODUCTION

Members of CUNA's State Issues Subcommittee support the prohibition of predatory lending practices that some mortgage brokers and mortgage lenders across the country are using to harm consumers and, in some cases, foreclose on their homes.

The Subcommittee supports eliminating lending practices that are intentionally structured in a manner that is deceptive and disadvantageous to borrowers, without hampering legitimate mortgage lending programs or consumers' access to credit for home purchases.

Over the past year, the members of the Subcommittee have grown concerned that the term "predatory" is becoming synonymous with "subprime". In fact, on a couple of occasions, consumer advocates have stated: "there is no such thing as a good subprime loan".

Members of the subcommittee are alarmed by such statements and believe it is important to distinguish the characteristics of fair subprime loans from predatory loans. Restricting fair subprime lending would result in a significant decrease in available credit to borrowers with blemished credit histories. The subcommittee created the Equitable Subprime Lending Task Force to investigate and report the positive things credit unions are accomplishing through subprime lending programs.

This booklet is the result of the Task Force's work.

WHAT IS PREDATORY LENDING?

Predatory mortgage lending refers to high-rate, high-fee home equity products that are intentionally structured in a manner that is deceptive and disadvantageous to borrowers. Predatory lending often involves non-sustainable loans, and frequently refinances, without regard to the consumer's ability to repay. Predatory lenders often target the elderly, minorities and the disabled who have accumulated a large amount of equity in their homes. These consumers are often on fixed incomes and usually do not have the ability to repay such high-cost loans. Consequently, some consumers find themselves facing foreclosure on homes they have been loyally paying off for years and in which they have achieved high equity.

The media has highlighted a number of horror stories regarding predatory lending which help illustrate how certain lending practices can be misused or abused to deceive unwary borrowers:

- **"Flipping" a loan leads to higher costs:**

An elderly gentleman, who had never learned to read or write, wanted to purchase meat on credit. A home equity lender loaned him the money for the meat. The gentleman did not understand he was mortgaging his home and pledging 50% of his monthly income. Seventeen days later, the lender contacted the gentleman again and convinced him to take out a larger loan, at a higher rate of 19%, to pay off all of his debts. This gentleman was "flipped" again in 42 days and again 26 days later. Each time he was charged a 10% financing fee. This gentleman was "flipped" 11 times in less than 4 years. By the time he was interviewed by the media, he had a $50,000 mortgage on his home, which he had owned free and clear, and $25,000 of this amount was financing fees.

- ABC News, Prime Time Live, April 23, 1997

- **Undisclosed balloon notes can take borrowers by surprise:**

A single mother refinanced her mortgage to receive $30,000. Three months later she was contacted by the lender and informed that she had a balloon note and would owe the lender a lump sum payment of $27,500 in 15 years. This borrower was unaware and unfamiliar with balloon notes. She had no choice but to refinance again. After only three months, she paid more fees, closing costs and a greater interest rate.

- *WAGA- TV Atlanta, Fox 5 News Investigation, May 5, 1998*

- **"Packing" loans can lead to unnecessary loan fees:**

A borrower took out a $43,000 home equity loan. Unbeknownst to the borrower, the mortgage lender "packed" the loan with insurance premiums. For example, the mortgage lender sold the borrower $75,000 worth of credit life insurance, even though the loan was only for $43,000. The cost of the insurance was $5,000 up-front, rolled into the loan and the borrower did not have any living beneficiaries who would benefit from the proceeds of such insurance.

- *WAGA - TV Atlanta, Fox 5 News Investigation, May 4, 1998*

WHAT IS SUBPRIME LENDING?

Subprime lending involves loans to persons who do not qualify for a financial institution's "prime" rate -- because of a poor credit history, or simply the lack of a credit history. A prime rate is usually the lowest rate of interest a financial institution offers to its best customers for short term unsecured loans.

Subprime loans are offered to consumers at a higher rate of interest, which off-sets the higher risk of lending to consumers with poor credit histories. Fair subprime loans are not structured in a deceptive or disadvantageous manner, but rather are a necessary tool giving borrowers with a poor credit history the ability to build (or rebuild) their credit.

The following are examples of credit union subprime lending programs that benefit consumers:

- **Subprime Loans Can Help Consumers Build Credit**

Some subprime loan programs, such as Aberdeen Proving Ground Credit Union's "Credit Builder" program in Aberdeen, Maryland, are designed to help borrowers improve their credit standing. This program offers subprime loans at 2% or 4% above normal rates, depending on collateral, but these higher rates automatically drop when the borrower makes 12 on time payments.

In this program, the borrower is well informed that if he or she has one payment that is over 30 days past due any time during the first year of the loan, then the borrower is locked into the higher rate for the life of the loan. But, if the borrower makes the first 12 payments on time, the loan rate will automatically drop to the prime rate. However, the borrower must continue the timely payments for the life of the loan to retain the lower rate. If, after the first year of on-time payments, the borrower misses a payment, then the rate reverts to the higher rate again for the life of the loan. This loan is structured as an incentive to make on-time payments.

- **The "First Step" Program Turns Consumers into Homeowners with Only 1% Down**

In Seattle Washington, the Washington State Employees Credit Union, all too often, saw single income families struggling to make ends meet while the American dream of home ownership remained beyond their grasp. To help more consumers buy homes, the credit union developed the "First Step" program. This program requires only 1% down, an interest rate of .50% above the standard Fannie Mae 30 year fixed rate, and certification that the borrower has attended a home buyer education seminar by a local agency or group. To qualify for this loan, the borrower's income cannot be above a certain level and the purchase price of the home must be below maximum limits.

The credit union staff work closely with these borrowers offering financial guidance and budgeting assistance to promote success for this program, as well as for the borrowers.

The credit union has allocated $20 million to this program and has been very successful getting people into homes that could not ordinarily qualify for a mortgage anywhere else.

- **Rate Reduction Options Can Turn a Subprime Loan into a Prime Loan**

Antioch Schools Federal Credit Union, located in California, offers its subprime borrowers several ways to reduce their interest rates, while picking up smart credit habits in the process. This "Rate Reduction" program includes:

- ✓ a 1/2 percentage rate reduction for attending one consumer credit counseling class;
- ✓ a 1% rate reduction for attending more than one consumer credit counseling class;
- ✓ a 1% rate reduction for each year of the term of the loan that there are no draws or escalation of debt during that year;
- ✓ And to promote savings, the Antioch Schools credit union will drop a subprime borrower's rate one half percent if the borrower makes a deposit of at least $15 a month to a savings account and keeps it on deposit for a year.

- **Subprime Loans can be Profitable without Gouging Consumers**

Self-Help Credit Union in North Carolina provides subprime lending products to the community. This credit union does not offer conventional mortgages. The rates for their subprime loans are usually one to two points above conventional rates, with a 1% loan origination fee. The credit union adjusts for the increased risk solely through the interest rate, with no opportunity for hidden costs in fees.

When the subprime borrower has made timely payments for a year or two, the borrower often is encouraged to refinance with a conventional lender.

Self-Help Credit Union finds that reasonably priced subprime loans provide much needed access to credit and perform well without charging exorbitant fees.

- **Not a Perfect Borrower? Find A Way To Do The Loan.**

Credit unions are programmed to be creative and develop unique strategies to meet their members' needs. Many credit unions, like Antioch Schools Federal Credit Union (ASFCU) in California, include these strategies in their loan policies.

Loan officers at ASFCU are instructed to find ways to reduce the risk of lending to some subprime borrowers so that the credit union can make the loan. For example, the loan officer may recommend reducing the amount of the loan, or changing the term of the loan. Another suggestion may be for the borrower to obtain a co-signer or to find additional collateral for the loan. Any of these strategies could turn a lender's "no" into a "yes".

The ASFCU also encourages its members to come back to the credit union each year to have their situation re-evaluated. An improved credit history may result in a better loan rate, the elimination of the need for a co-signor or other favorable changes in the loan's terms.

- **Credit Unions Partner with Fannie Mae to Provide "Timely Rewards" Loans**

Fannie Mae has developed a loan program in which credit unions, and other lenders, can participate to provide subprime loans to consumers. Fannie Mae acts as the investor, buying the subprime loans from the credit unions. The credit unions have the necessary funds to continue offering subprime loans to their members.

The Washington State Employees Credit Union (WSECU) has partnered with Fannie Mae in this program. WSECU calls its loan program the "Credit Builder" loan. When a borrower has less than perfect credit, he or she may qualify for the Credit Builder loan. For the almost perfect lender (a level one borrower) the rate is typically one half a percentage point above the credit union's standard 30 year fixed rate.

For borrowers with more problematic credit histories, considered level 2 and level 3 borrowers, rates will be slightly higher, reaching typically 1% to 1.5% above the credit union's standard 30 year fixed rate. However, when a level 2 or 3 borrower exhibits an improved payment history, by making 24 consecutive on time payments, the subprime interest rate will be reduced by one percent.

When level one borrowers exhibit improved credit histories, they are encouraged to refinance at the prime rate.

- **A Subprime Loan will not Always be the Solution for Non-qualifying Borrowers**

Subprime loans are not the solution for every consumer who does not qualify for a conventional loan at the prime rate. Qualifying criteria must also exist for subprime borrowers to ensure that the borrower has the ability to repay the loan.

Credit unions recognize that some consumers should not have mortgage loans until they are sufficiently prepared to take on the commitment of home ownership. Often first time home buyers are not prepared for the unexpected costs incurred from property taxes, home maintenance, home repairs, and furnishing a new home. It is important that any new home owner have adequate savings on hand for unexpected costs and emergencies.

Even if a borrower has a sufficient monthly income to make a mortgage payment, he or she could still be a poor candidate for a mortgage loan. If this borrower has no reserves, has demonstrated no pattern of savings, has no retirement plan nor has invested funds in assets that will appreciate, he or she may have difficulty making monthly mortgage payments while keeping up with the additional expenses incurred with home ownership.

Credit unions support the inclusion of life-of-the-loan financial assistance for subprime borrowers to ensure that they can meet their monthly financial obligations.

A similar argument can be made for refinance loans. Some home owners with substantial equity may have adequate loan-to-value ratios to qualify for a refinance loan but would not benefit from the additional debt. These consumers are often encouraged to refinance their mortgage loans to pay off credit card and other unsecured debts. The short term benefit of lower monthly payments can be enticing, but often is deceptive to consumers who do not understand the full cost of refinancing and the danger of securing unsecured debt.

CREDIT UNIONS COMBAT PREDATORY LENDERS

- **Focusing on Foreclosure Prevention**

Self Help Credit Union in North Carolina believes that increased foreclosure prevention strategies are vital to sustaining homeownership for low-income families who have less savings to buffer unforeseen expenses and loss of income. The credit union is developing foreclosure alternatives to keep people in their homes. Self-Help Credit Union is also helping to establish a non-profit law center to provide legal services to predatory lending victims.

- **Financial Education in High Schools**

One of the most important programs CUNA, the state credit union leagues and credit unions are currently promoting is financial education of our nation's youth. Credit unions believe that by educating our young people in the area of personal finance they will learn to make sound financial decisions and choose <u>not</u> to use high cost or predatory lenders.

CUNA has partnered with the National Endowment for Financial Education (NEFE) to expand financial education among teens throughout America. Through this partnership CUNA and NEFE provide an educational curriculum and materials to high schools across the country to combat financial illiteracy.

In addition to providing the necessary materials, credit unions actively participate in the classrooms. During the 1999-2000 school year credit unions conducted over 5,000 financial education presentations reaching almost 130,000 students nationwide.

Currently, only a handful of states have either a mandate for personal finance education in schools or include personal finance concepts in state assessment tests. These numbers are expected to increase over the next few years and credit unions plan to continue providing the support necessary to meet these educational objectives.

- **Credit Rating Education**

Many consumers do not understand why they have to pay more for credit. They may know that they have missed a payment a few times but they often do not understand the many other factors that effect their credit rating.

Some credit unions try to build credit education into the loan process - sometimes by offering incentives such as the rate reduction program described previously in this booklet. Credit education informs borrowers about the several factors that can effect their credit status, such as:

- ✓ Their level of unsecured debt;
- ✓ The length of time they have been with the same employer;
- ✓ How many times there have been inquiries on their credit rating; and
- ✓ How many times they have made a late payment.

LEGISLATIVE & REGULATORY ACTIVITY

In 1999, the North Carolina state legislature was the first to pass an anti-predatory lending law. Since then, other states, local governments, and Congress, have introduced legislation, regulations and ordinances that would prohibit mortgage lending practices that are intentionally structured to take advantage of borrowers.

State Government: During the 2000 state legislative sessions, at least ten states considered legislation to address predatory lending practices. By 2001 this number had increased to 24 states. Illinois, Massachusetts, and New York have passed regulations that will curb several lending practices associated with high cost loans.

City Governments: The cities of Chicago, *Philadelphia and Denver have all passed ordinances that prohibit city agencies from doing business with financial institutions or businesses that directly or indirectly participate in predatory lending practices.

Additionally, the District of Columbia passed a law to prohibit financial institutions from using predatory lending practices.

**The Pennsylvania state legislature later passed a predatory lending law that pre-empts the city ordinance.*

County Government: DeKalb County, Georgia, passed a county ordinance that prohibits county agencies from doing business with entities that are defined as participating in predatory lending practices.

Federal Government: Several members of Congress have introduced bills to curb predatory lending practices. The Federal Reserve Board recently issued a proposal which will define a larger number of mortgages as "high cost" and consequently subject them to additional disclosure and reporting requirements. Credit unions joined more than 160 consumer groups and advocates in signing a letter to Federal Reserve Chairman Greenspan urging the agency to take action against predatory lending.

GLOSSARY

Balloon payment: A scheduled final payment that is more than twice as large as the average of earlier scheduled monthly payments.

Call provision: A call provision permits the lender, in its sole discretion, to accelerate the indebtedness. A "no call" provision prohibits a call provision but does not apply when the repayment of the loan has been accelerated by default, pursuant to a due-on-sale provision, or pursuant to some other provision of the loan documents unrelated to the payment schedule.

Equity stripping: Offering a home equity loan without regard to the borrower's ability to repay the loan based on monthly income, expenses and employment status. Such loans often result in foreclosure and the loss of accrued equity to the borrower.

Financing insurance premiums: Financing, directly or indirectly, any credit life, credit disability, or credit unemployment insurance, or any other life or health insurance premiums. (Insurance premiums calculated and paid on a monthly basis are not considered to be financed by the lender.)

Flipping: The making of a home loan to a borrower to refinance an existing home loan when the new loan does not have a reasonable, tangible net benefit to the borrower considering all of the circumstances, including the terms of both the new and refinanced loans, the cost of the new loan, and the borrower's circumstances.

HOEPA: *Home Ownership and Equity Protection Act*. This law was passed in 1994 to address the problem of "reverse redlining". "Reverse redlining" is described as targeting residents of certain geographic boundaries, often based on income, race, or ethnicity for credit on unfair terms.

HOEPA amended the *Truth in Lending Act* to define a class of non-purchase, non-construction, closed-end loans with high interest rates or up-front fees as "High Cost Mortgages". The Act seeks to ensure that consumers understand the terms of such loans and are protected from high pressure sales tactics. The law requires creditors making High Cost Mortgages to provide a special, streamlined High Cost Mortgage disclosure three days before consummation of the transaction. The law also prohibits High Cost Mortgages from including certain terms such a prepayment penalties and balloon payments. Finally the law provides increased civil liability for failure to comply with the requirements for High Cost Mortgages and enables a borrower to assert all claims and defenses against an assignee of the High Cost Mortgages that could be asserted against the originator. *Pub. L. 103-325, 108 Stat. 2160.*

Packing: The practice of selling unnecessary and overpriced products or unrelated goods or services in conjunction with a high-cost home loan.

Prepayment penalties: Terms under which a consumer must pay a prepayment penalty for paying all or part of the principal before the date on which the principal is due.