Homelessness and Poverty (Report Nos.109)

RESOLVED, That the American Bar Association urges the United States Congress to enact uniform national legislation that, without reducing access to legitimate home mortgage loans for consumers, provides objective standards to define and curb lending practices that are abusive, deceptive or fraudulent, including but not limited to:

(1) making loans secured by the borrower’s principal residence without regard to the borrower’s ability to repay;
(2) inducing borrowers to refinance existing home loans when the new loan does not have a tangible net benefit to the borrower; or
(3) concealing the amount of the true loan obligation or ancillary products.

FURTHER RESOLVED, That the American Bar Association urges national, state, territorial and local bar associations to establish and support bar programs to educate consumers about, and protect them from, lending practices that are abusive, deceptive or fraudulent.
More Americans than ever are realizing the American dream of homeownership. At the same time, an increasing number of homeowners are living the nightmare of overwhelming debt and home foreclosure resulting from fraudulent lending practices. Subprime lending—the extension of high-rate, high-fee loans to people considered to be high-risk borrowers—has grown substantially in recent years. Unfortunately, fraudulent and abusive lending practices have also grown.

—President George W. Bush

Predatory Lending

More Americans are realizing the dream of homeownership. Many are able to realize this dream because of the subprime lending industry. The subprime lending industry plays a vital role by helping borrowers with troubled lending histories secure credit. The industry, however, has also served as a breeding ground by some for abusive lending practices that have resulted in a "wave" of foreclosures, suggesting that many of these lenders target such borrowers who cannot afford to repay such loans. 1 Obviously, these abusive lending practices have brought about increased concern in the subprime lending market. At the same time, it is important to note that not all subprime loans are predatory or abusive. Therefore, a measured approach should be taken to encourage appropriate subprime lending practices while curtailing such abusive lending practices as set forth below. This report concerns those that engage in abusive lending practices.

Abusive lending practices—often referred to as "predatory lending"—include loans with excessive fees, high interest rates,2 and terms that target borrowers who either do not understand or cannot afford them. Such unscrupulous lending practices have devastating effects on individual borrowers—particularly minority and elderly borrowers—and their families, as well as on neighborhoods and cities.


To control the practices used by lenders that charge very high fees and interest rates on home loans, the Federal Reserve lowered the thresholds for what constitutes a high-cost loan, reducing the interest rate trigger to 8 percentage points above comparable Treasury securities, down from 10 percentage points. Sandra Fleishman, Fed Acts to Curb Predatory Lending Practices, WASHINGTON POST, December 13, 2001, at A8.
3 Sandra Fleishman, Sarbanes Reviving Efforts to Crack Down on Predatory Lending, WASHINGTON POST, May 2, 2002, at E2.

Predatory loans ultimately wreak havoc on unsuspecting borrowers. They rob borrowers of the equity in the homes, which — for most Americans — is the majority of their lifetime’s accumulated wealth. In addition, they force borrowers to struggle to pay unaffordable mortgages or risk losing their homes. And, predatory loans often lead to foreclosures.

In a recent joint report on predatory mortgage lending, the United States Department of Housing and Urban Development and the United States Department of the Treasury listed four categories of common abuses in the subprime market:

- lending without regard to the borrower’s ability to repay;
- loan “flipping,” which refers to refinancing an existing home loan when the new loan does not have a tangible net benefit to the borrower, resulting in high fees that strip the equity from the borrower’s home;
- “packing,” which refers to the addition of unnecessary and excessive fees to the loan amount; and
- outright fraud and abuse.

“Making loans secured by the borrower’s principal residence without regard to the borrower’s ability to repay.”

Predatory lenders specifically target borrowers who are equity-rich yet cash poor, by extending unaffordable loans secured by the borrower’s principal residence with the purpose of foreclosure. A number of recent studies and cases illustrate the prevalence of such abusive lending practices which primarily target elderly and minority borrowers.

According to the American Association of Retired Persons (AARP), abusive subprime lenders often target older homeowners who have substantial equity in their homes. The latest American Housing Survey (1999) indicates that over 60 percent of homeowners age 65 or older had at least $50,000 in home equity. As the samples below illustrate, abusive subprime lenders often target these older homeowners and coax them into unaffordable loans, ultimately stripping the equity from their homes, threatening foreclosure, and leaving the elderly homeowners in desperate situations.

For example, a woman named Betty Cooper who is represented by AARP Foundation had the following experience:

Cooper is a 64-year-old D.C. homeowner whose sole source of income
is her pension of $880 per month. In early 1999, a broker, Equitable Mortgage Group, began pursuing her to try to convince her to refinance her mortgage. Telemarketing calls were followed by home visits. She was eventually persuaded to take a mortgage at a promised rate of 6%. After Cooper filled out a loan application, she was visited at home by a representative of Equitable, who actually drove her to the loan closing in March 2000 with the lender, First Government Mortgage. It wasn’t until settlement that she was told that the promised 6% mortgage had risen to 8%. Hidden from her at that time was the fact that the loan was not a fixed term loan, but a “balloon mortgage” (which would require a lump sum payment of nearly $50,000 in 15 years) and the fact that Equitable would receive a remarkable 8% fee on the transaction – well above the industry standard of between zero and three percentage points.

In fact, the situation was worse than Cooper knew because the actual interest rate of the loan was not 8%, but was nearly 9% with an annual percentage rate of more than 10%. Federal law requires that for high cost loans, such as this, accurate information on interest rate and monthly payments be disclosed to a borrower at least three days before the settlement to prevent surprises and to prevent borrowers from feeling pressured to close a deal whose terms make them uncomfortable. First Government did not do this.

As a consequence of these actions, Cooper (who uses a wheelchair) faces the prospect of losing her home.11

Predatory lenders target minority borrowers in the same manner, extending unaffordable loans secured by the borrower’s principal residence. The case of Nancy Hilliard and Angela Birth involves two of the eight plaintiffs in Clyde Margraves, et al. v. Capital City Mortgage Corp., et al.12

Nancy Hilliard and her daughter Angela Birth borrowed $317,769 from Defendants to purchase a church in a predominantly African American area of Prince George’s County, Maryland. The church was owned by Defendants, who had recently foreclosed on the property and evicted the previous owner, another predominantly African American congregation. Defendants had purchased the property at auction for $240,000. Hilliard decided to purchase the church following her husband’s death, to carry on his ministry in his name. She is 54 years old and has a tenth grade education, three children, and no business experience. Initially, Hilliard informed the listing agent that she did not believe the church could afford the property since it had only 35 members and brought in monthly contributions of less than $500. Moreover, Hilliard informed the agent that she herself was unemployed and living on $447 per month in social security; her daughter lived with her and received $800 per month in public assistance. The

11 Predatory and Abusive Lending, ELDER LAW FORUM (AARP Foundation Litigation), Fall 2001, at 4.
listing agent nonetheless assured her that with the $35,000 proceeds from her husband's life insurance policy, she would have "no problem" qualifying for a loan and encouraged her to buy the property for $330,000 — list price.

The listing agent came to Hilliard's home a few days later with papers for her and her daughter to sign regarding the purchase of the church property. He did not identify the lender, nor did he explain what was in the papers. He took $2,000 to "hold" the property and told Hilliard to call him when she received the insurance proceeds.

Only the Hilliard family, the listing agent, and a notary attended the settlement. Although Hilliard and Birth could barely read the documents and did not understand them, the listing agent never suggested that they get advice or assistance with the transaction. Even so, the loan note contains a false representation that Hilliard and Birth had participated in drafting their note and deed of trust and had access to counsel prior to executing the documents. In fact, Hilliard and Birth were led to believe that they were signing for one loan with a $794 monthly payment, when in fact they signed for three notes each with a separate $794 monthly payment, for a combined monthly payment of $2,383. As the combined monthly income of Hilliard, Birth, and the church was only $1,247, Defendants knew or should have known that their income was inadequate to meet the monthly payments. Moreover, for the first time at settlement, the listing agent demanded that Hilliard and Birth pledge their $82,000 home in Landover, Maryland to secure the loan, in addition to the $35,000 from the insurance policy. The agent falsely assured them that Defendants only intended to place a six-month lien on the house.

As intended by Defendants, the loan went into default shortly after the first few payments. After only eight months, Defendants demanded $387,199 as the payoff amount, approximately $70,000 higher than the original $317,199 loan. The loan forced Hilliard and Birth into bankruptcy, and although Defendants have attempted to foreclose on the church and their home, on February 18, 1999, this Court granted a preliminary injunction preventing foreclosure pending resolution of this case. (Order filed Feb. 18, 1999).13

Another reported abuse in the subprime mortgage industry is the targeting of consumers by home improvement contractors who are effectively working as agents of lenders.14 This sophisticated scheme often results in a high interest loan, packed with undisclosed fees and terms, for home improvement work that is ultimately never completed. According to AARP, older homeowners

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13 See Complaint, Capital City Mortgage, supra note 12.
are more likely to live in homes in need of repair, and less likely than younger homeowners to do the repair work themselves, making them prime targets for such a scheme.  

Predatory practices by home improvement contractors and their affiliated lenders are particularly troublesome because the borrowers often start out with no mortgage at all - or a market-rate mortgage - that they are later induced to refinance for the home improvement services. The end result is that the borrower has a high-cost home equity loan with insufficient cash income to repay.  

"Inducing a borrower to refinance an existing home loan when the new loan does not have a tangible net benefit to the borrower."

Predatory lenders often employ the "flipping" mechanism that strips the equity from the borrower's home. "Flipping" is the practice of inducing a consumer to refinance a loan repeatedly, often within a short time frame, charging high points and fees each time. A former employee of a predatory lender who testified before Congress in 1998 explained that flipping is a common practice in the subprime industry. He stated that employees are instructed and expected to flip as many loans as possible. One of his supervisors actually imposed a daily requirement that each employee obtain at least two applications from present borrowers to refinance their loans. In other words, each employee was instructed to flip at least two loans per day.  

A recent case settled by AARP on behalf of its client, Mary Ann Podelco, illustrates the illegal and abusive tactics often used by unscrupulous lenders:

Mary Ann Podelco and her husband were able to purchase their first home late in life. After her husband's death, she used his life insurance proceeds to pay off their mortgage; she owned the home free and clear. Shortly thereafter, Mrs. Podelco began to receive telephone solicitations offering to finance home improvements or to finance a vacation. Mrs. Podelco agreed to a small home improvement loan in May 1995 with Beneficial of West Virginia. Less than two months later, Beneficial persuaded Mrs. Podelco to refinance her loan. The solicitations continued and intensified. Over the next 14 months, Mrs. Podelco was persuaded to refinance her home repeatedly, twice more with Beneficial, once with United Companies, and twice more with loans arranged by Equity One. Each refinancing imposed new costs and fees, charged a high rate of interest and increased the principal owing on the mortgage. Each loan imposed an increasingly unaffordable monthly payment on this widow who received only a small Social Security benefit for herself and a small Social Security disability benefit for herself and a small Social Security disability.

See AARP, supra note 5.


17 See, e.g., Kay Stewart, Widow Sold Her House To Pay Loan She'd Hoped Would Ease Her Debts, LOUISVILLE COURIER-JOURNAL, Feb. 16, 1997, at 16 (lender refinanced borrower's loan four times in nine months).

benefit on behalf of her disabled granddaughter. In sixteen months, from May 1995 to September 1996, this unsophisticated widow was targeted for eight loans by subprime lenders. Her mortgage went from zero to $35,200 and, ultimately, Mrs. Podelco lost her home.16

AARP Foundation attorneys and Mountain State Justice represented Mrs. Podelco in pursuing claims challenging the loan flipping practices of the predatory lenders as unconscionable under West Virginia law. Podelco v. Beneficial West Virginia, Inc. was recently settled. The lenders agreed to pay Mrs. Podelco $55,000 in addition to her attorneys’ fees.20

"Concealing the true loan obligation or ancillary products."

Perhaps the most publicized predatory lending case to date, AARP v. First Alliance Mortgage Company illustrates the sophisticated schemes and fraudulent tactics that unscrupulous lenders employ to take advantage of unsuspecting borrowers. In 1998, AARP alleged that First Alliance’s “grossly manipulative and fraudulent sales practices resulted in homeowners in 18 states signing up for predatory mortgage loans which skimmed 15-20 percent of the equity from their homes.”21 The FTC called the manipulative tactics "psychologically sophisticated," and the entire scheme was characterized by the Washington Post as "chilling."22

The defendants, a subprime lender based in Orange County, California, its parent company, and a Minnesota affiliate, marketed high-cost home equity loans to vulnerable borrowers through misleading statements and aggressive sales tactics that were purposely designed to hide the true meaning and significance of the disclosures mandated by the Truth in Lending Act.23 “The lender was charged with intentionally misleading thousands of its customers into believing they were signing up for low- or no-fee mortgages while in fact some loans had as much as $25,000 in fees tacked away per $100,000 of principal.”24 First Alliance later filed a petition for relief in bankruptcy court. Eventually, First Alliance entered into a settlement agreement with those borrowers whereby First Alliance and its former president agreed to compensate such borrowers by paying $60 million to such borrowers.25

Abusive lenders also "pack" loans with additional "products" such as credit insurance. A former employee of a predatory lender who testified before Congress on March 16, 1998, explained the concept of "packing" as "shoving as much insurance onto the customer as possible without the customer’s knowledge or without the customer’s understanding."26 He went on to say that he was taught by his employer to “always include as many insurance products as possible in the

17 Id.
18 Id.
22 Id.
23 Id.
24 Id.
26 Supra note 18 at 33.
monthly quote so long as I could quote a figure that would be less than the customer's current outstanding debt obligation."

The FTC has a long enforcement history of prosecuting such cases. In 1997, the FTC settled a case against The Money Tree, a Georgia-based consumer finance lender, and its president. The case involved, in part, allegations that the company required consumers to purchase credit-related insurance and other "extras" along with their loans, without disclosing to consumers the true cost of their credit.  

**Current Action against Predatory Lending**

For years consumer and civil rights advocates have voiced their concerns about abusive lending practices targeting minority and elderly borrowers. AARP, the Association of Community Organizations for Reform Now (ACORN), the Center for Community Change, the National Association for the Advancement of Colored People (NAACP), the National League of Cities, and the Leadership Conference on Civil Rights (LCCR), have long campaigned against predatory lending. Lenders have also taken action through the development of education campaigns for borrowers. In fact, 97 percent of larger banks offer mortgage and home ownership counseling programs, and 60 percent sponsor financial literacy programs that target predatory lending practices.  

Freddie Mac, in collaboration with the U.S. Conference of Mayors, launched "Don't Borrow Trouble," a national award-winning consumer awareness campaign that combines public education and counseling services to help homeowners protect themselves from abusive lending tactics.

In 2001, the American Bar Association developed SafeBorrowing.org, an informational website that provides useful resources for borrowers shopping for a mortgage loan in an effort to avoid unfair lending practices. SafeBorrowing.org is a project of the ABA Section of Business Law Committee on Consumer Financial Services Predatory Lending Task Force.

Due to the absence of federal law addressing these issues, approximately 35 cities and state legislatures have either passed or are considering bills aimed at predatory lending. The need for federal legislation becomes ever important for purposes of uniformity. One all-encompassing rule from Washington would be preferable to 50 state laws, or even hundreds of local ones.

**Congressional Action**

On May 1, 2002, Sen. Paul Sarbanes (D-MD), chairman of the Senate Banking Committee, introduced S. 2438, a bill to amend the Truth in Lending Act to protect consumers against

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27 See testimony of Ronald Isaac, supra note 16 at 6.
31 As of March 1, 2012, the following states have state predatory lending laws and regulations: California, Connecticut (pending; stay placed by U.S. District Court), District of Columbia, Georgia, Illinois, Massachusetts, New York, North Carolina, Pennsylvania, Texas, and Utah. See AARP, Predatory Mortgage Lending Training Module, (2002), at 53-45.
predatory practices in connection with high cost mortgage transactions. The measure is designed to restrict abusive lending practices, expand consumer protections, and strengthen enforcement of current law protections against predatory lending by enhancing civil remedies and statutory penalties. Among the groups endorsing the bill are AARP, the NAACP, the National League of Cities and the U.S. Conference of Mayors. Sen. Sarbanes has identified predatory lending as one of the priority issues for his tenure as chair of the Senate Banking Committee.

Action by the Administration

In a proclamation issued in association with National Consumer Protection Week, President Bush addressed the issue of predatory lending. Bush noted the increasing number of homeowners "living the nightmare of overwhelming debt and home foreclosure resulting from fraudulent lending practices." Bush noted efforts by the Federal Trade Commission, the National Association of Consumer Agency Administrators, the U.S. Postal Service, the U.S. Postal Inspection Service, the National Association of Attorneys General, the Department of Justice, and private consumer organizations, to educate consumers and help protect them against unscrupulous lending practices.

The Federal Trade Commission has increased its enforcement activities to halt illegal lending practices engaged in by subprime lenders. The FTC has filed suit on 15 separate occasions involving the subprime industry since 1998. The FTC has also implemented an aggressive consumer education program, publishing a series of free booklets specifically for homeowners and potential home buyers. The Federal Reserve Board expanded its existing regulatory authority to bring additional homeowners under existing consumer protections and to gather more and better data about these practices. The U.S. Department of Treasury and the U.S. Department of Housing and Urban Development initiated a joint task force on predatory lending. In addition, HUD included predatory lending as one of the issues to be addressed in its budget proposal for FY 2003.

34 Supra note 4.
35 Supra note 1.
36 The FTC has implemented an aggressive consumer education program and has published a series of free publications specifically for homeowners and potential home buyers. For example, in 1996, the Commission first produced "High-Rate, High-Fee Loans (Section 32 Mortgages)" to alert homeowners about their rights under HOEPA. In 1998, in conjunction with the filing of the Capital City complaint, the Commission issued two publications to help consumers recognize and avoid home equity scams and abuses: "Avoiding Home Equity Scams" and "Home Equity Loans: Borrowers Beware." In January 1999, the Commission, along with ten other federal agencies, including the Federal Reserve Board, produced "Looking for the BEST Mortgage - Shop, Compare, Negotiate!" to help consumers shop for home loans. During National Consumer Protection Week in February 1999, which highlighted credit fraud and abusive lending practices, the Commission distributed more than 300,000 credit-related publications. As part of "Operation Home Inequity" in July 1999, the Commission, along with other federal agencies, published a new consumer alert about home-equity lending, "Shopping for a Home Equity Loan." Most recently, National Consumer Protection Week 2001 focused on educating consumers about abusive lending practices.
Conclusion

The issue of predatory lending is one of national concern. Comprehensive federal legislation and regulation is needed to ensure that abusive lending practices cease, and that the subprime lending industry functions in an appropriate manner. Considering that the current problems associated with predatory lending involve the victimization of underserved populations such as elderly and minority borrowers, it is especially important for the American Bar Association to lend support to protect consumers against predatory lending practices and call for strengthened civil remedies available to consumers under existing law. Such action would support the ABA’s motto of, “Defending Liberty, Pursuing Justice.”

Respectfully submitted,

William H. Hoch, Chair
Commission on Homelessness & Poverty

August 2002
1. **Summary of Recommendation(s)**

   This recommendation recognizes the importance of protecting consumers against predatory practices in connection with high cost mortgage transactions, and urges federal, state, territorial and local governments and other appropriate entities to enact legislation, develop initiatives and take action to curb abusive, deceptive or fraudulent lending practices. This recommendation also urges federal, state, local and territorial bar associations to establish and support initiatives to educate and protect borrowers from abusive lending practices, and prevent lenders from employing the aforementioned abusive practices.

2. **Approval by Submitting Entity**

   Approved by the Commission on Homelessness and Poverty on May 4, 2002.
   Approved by the Senior Lawyers Division on May 3, 2002.
   Approved by the Steering Committee on the Unmet Legal Needs of Children on May 9, 2002.

3. **Has this or a similar recommendation been submitted to the House or Board previously?**

   No.

4. **What existing Association policies are relevant to this recommendation and how would they be affected by its adoption?**

   The proposed recommendation does not affect existing Association policies.

5. **What urgency exists which requires action at this meeting of the House?**

   Issues related to predatory lending are currently being addressed by the Administration and the 107th Congress. It is likely that the next session of Congress will also see the introduction of similar legislation. Action at this meeting of the House will allow the Association to participate in the ongoing and subsequent debates on the issue of predatory lending in Congress and the Administration.

6. **Status of Legislation. (If applicable.)**

   There is currently legislation pending in both the Senate and the House that addresses predatory lending – the Predatory Lending Consumer Protection Act of 2002 (S. 2438), the Predatory Mortgage Lending Practices Reduction Act (H.R. 3807), the Protecting Our Communities from Predatory Lending Practices Act (H.R. 3607), the Save Our Homes Act (H.R. 2531), the Equal Credit
Enhancement and Neighborhood Protection Act of 2001 (H.R. 1053); the
Community Reinvestment Modernization Act of 2001 (H.R. 865); and the
Initiative of 2001 (H.R. 1416). These or similar bills will likely be re-introduced
in the next session of Congress if no action is taken in the current session.

7. **Cost to the Association.** (Both direct and indirect costs.)
n/a

8. **Disclosure of Interest.** (If applicable.)
n/a

9. **Referrals.**
   Circulation of this Report and Recommendation began in early May 2002. This
   Report and Recommendation will be referred to the Chairs and staff of all ABA
   Sections, Divisions, and Committees in late May 2002.

10. **Contact Person.** (Prior to the meeting.)
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11. **Contact Person.** (Who will present the report to the House.)
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12. **Contact Person Regarding Amendments to This Recommendation.**
    There are no known proposed amendments at this time.