

The National Credit Reporting Association, Inc.
Position and Views on
Predatory and Sub-Prime Mortgage Lending
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Within the past year, the subject of predatory mortgage lending has become more visible than ever, culminating in hearings conducted by the U.S. Senate on July 26th and 27th. NCRA's position is and has always been that such discriminatory practices are unethical, illegal, and should be dealt with firmly.

What is unclear is whether the percentage of cases is actually increasing or, if by heightened consumer education and awareness combined with increased funding of sub-prime loans by Wall Street, more cases are being discovered. What is clear is that, due to recent changes in loan origination and underwriting procedures, a growing segment of consumers are finding themselves with interest rates and settlement fees that are considerably higher than prime rate. We would like to address, what we believe to be, the factors that are currently facilitating these unscrupulous lending practices.

The Problem

Higher than normal profits and commissions are, to no one's surprise, the motivating factor behind predatory mortgage lending. "Loan flipping," "equity stripping," "yield spread premiums," and countless other practices are the highly visible methods of predatory practices. Though less visible, another widespread example of predatory mortgage lending is the downgrading a consumer who should qualify for a prime rate loan into the sub-prime market. NCRA would prefer to focus attention on the enabling factors that allow some lenders to steer or downgrade potential borrowers from a deserved prime rate to a significantly higher priced sub-prime loan. The two enabling factors that have helped some unethical lenders to promote questionable "high rate" lending practices are risk score based pricing and automated underwriting programs. These two factors are interrelated and are designed with consumer benefits in mind. While NCRA does not doubt the noble intentions of both programs, and in fact believes that both programs have provided many benefits to some consumers, lenders have gained far greater benefits. It would be completely remiss to ignore the significant shortcomings in the programs that can be easily corrected.

American Banker magazine reports that abusive credit practices cost U.S. borrowers \$9.1 billion per year, according to the Coalition for Responsible Lending. Martin Eakes, spokesperson for the group noted "The most important lending issue today is no longer denial of credit, but the terms of credit...Sub-prime loans with predatory terms are far more likely to end in foreclosure than conventional loans." According to the Department of Housing and Urban Development (HUD), sub-prime refinance lending increased almost 1000% from 1993-1998. This time frame correlates very closely with the introduction, development, and increased usage of automated underwriting programs sponsored by Fannie Mae and Freddie Mac. These programs rely heavily upon risk scoring models, which were originally introduced to the industry as a guideline for underwriters of lending institutions to use in their loan approval process. In reality, required risk scores now define most loan programs, and many underwriters adhere strictly to the scoring guidelines, fearful of losing the conventional loan backing by Fannie or Freddie if they override a denial or rate increase by the automated underwriting systems. This leads to applicants who miss the qualifying score, even by as little as one or two points, being pushed into a sub-prime loan at a higher interest rate or with higher origination charges. If these files were analyzed properly, and the consumer provided the opportunity to evaluate their credit report, there would be a significant percentage of inaccuracies found in the consumer credit files. The risk scores generated from these inaccurate files cost many applicants the points needed to qualify for market rates. NCRA members have seen hundreds of these inaccuracies that were not allowed to be properly addressed and corrected, costing the consumer thousands of dollars in added interest over the course of the loan.

NCRA believes that the three national credit repositories do an admirable job of maintaining credit files for a country of some 300 million residents. However, many inaccuracies exist in these files, as has been acknowledged by both GSE's and HUD. Many are due to inaccurate or outdated reporting on the part of the creditors, collection

agencies, and public record search firms who populate the files. Since inaccuracies can greatly lower credit risk scores, and scores dictate lenders' interest rates, applicants who have "borderline" scores are unfairly punished and many are being forced into sub-prime lending by flaws in the current use of automated underwriting systems.

The Solution

Risk scoring and automated underwriting programs have revolutionized the speed and documentation process of mortgage approvals since their inception. As recently as five years ago, an applicant with a steady job and income, low debt ratios, and good credit had far too many procedures to go through, considering approval was imminent. This type of borrower is not targeted by predatory lending practices and NCRA strongly supports the approval through these systems, encouraging a smoother and quicker process for deserving applicants. The outright rejections, the "refers" or "cautions" resulting in higher rate loans, and the consumer disclosures from the automated systems are the areas that are being manipulated by some lenders.

Two steps could correct the approval process and help to keep many applicants out of sub-prime loans:

1. Require a mandatory copy of the entire credit report, used to underwrite the loan, to be furnished to every borrower quoted above prime rate and the opportunity for reverifications if inaccuracies are found. Currently, in the event of adverse action, the Equal Credit Opportunity Act, Regulation B, allows four seemingly cryptic, generic reasons for denial or rate increase to be provided to the borrower with no possibility to review the credit report evaluated by the lender. By viewing their entire credit profiles, including credit scores, applicants would be able to spot errors and inconsistencies in need of correction to achieve an accurate loan rate based on true risk status. Upon notification of such errors, lenders could employ the credit reporting agencies that furnished the original report to re-verify and update problem areas for re-evaluation. Lender involvement would expedite this process so that most files could be re-verified within days.
2. Require automated or manual re-evaluations with the corrected credit report. Underwriters should be required, in the case of inaccurate or missing information on the original credit report, to re-underwrite the loan based on changes and corrections completed by a credit reporting agency. While Fannie Mae and Freddie Mac contend that this safeguard is already in place, the previously stated HUD findings that sub-prime lending has increased by 1000% between 1993 and 1998 does not seem to support their position.

Considering there was no use of risk scoring or automated underwriting in 1993, and that all loans contained risk scores by 1998 with a great majority being evaluated by automated underwriting systems, these two factors have clearly impacted sub-prime lending in a negative fashion. Because a process is automated does not mean that it is better. Focusing on changes that helped a particular class of borrower may have inadvertently hurt another class. Allowing simple improvements in access to the information in a borrower's own file and some manual intervention in the case of rejected and high cost loans, are two actions that could greatly reduce many of the questionable sub-prime lending practices that have become rampant in the recent increase of predatory lending practices.

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