

**TESTIMONY OF ATTORNEY GENERAL TOM REILLY
IN SUPPORT OF HIGH COST MORTGAGE LOAN REGULATIONS**

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Introduction and Background

Commissioner Curry

Good afternoon. My name is Pamela Kogut and I am an Assistant Attorney General in the Consumer Protection and Antitrust Division in the Office of Attorney General Tom Reilly. The Attorney General has requested that I come before you today to present his views on your proposed amendments to existing regulations and the adoption of new regulations in the area of high cost mortgage loans. The Attorney General commends Commissioner Curry and the members of his staff for proposing new measures to protect consumers from predatory mortgage lending practices, which have unfortunately become an expensive problem for Massachusetts consumers.

It has become clear in the last several years, that predatory mortgage lenders have proliferated nationally and consumers have suffered severe harm because of these practices. It appears that during periods of growth in the real estate market, where property values skyrocket and homeowners see the equity in their property increase, abusive lending practices emerge. Consumers who are hardest hit are those who are income poor or on fixed incomes but who have built up significant amounts of equity in their homes.

Over the years, the Attorney General's Office and the Division of Banks have worked closely to combat abusive lending practices in the Commonwealth. Still, Massachusetts consumers have been subjected to predatory lending practices. These practices are very costly to individuals -- and some consumers have had to pay the highest cost, which is that they have lost their homes.

Enforcement Actions Brought By the Massachusetts Attorney General's Office

The Massachusetts Attorney General's Office has brought enforcement actions recently that illustrate abusive lending practices that we have seen:

1) United Companies Lending Corporation. In a case we brought against United Companies Lending Corporation, a Louisiana company that did business nationally including in Massachusetts, we found the following problem practices:

- United Companies routinely charged Massachusetts borrowers 10 points.
- In addition to the excessive points charges, United Companies charged Massachusetts borrowers mortgage broker fees that often amounted to another 4% of the mortgage loan amount. In many cases, the broker fees were not disclosed to the borrowers.
- The United Companies borrowers were typically seeking to borrow a relatively small sum of money to do home improvement work or to consolidate debts. United Companies required the borrowers to refinance their original mortgage loans rather than providing second mortgage loans or other forms of credit. The result was that consumers paid very high costs to borrow relatively small amounts of money.

(Our litigation got a favorable result: United Companies was ordered to provide restitution to consumers consisting of excessive points and mortgage broker fees paid -- the total amount of restitution paid to Massachusetts consumers exceeded \$860,000 -- and United Companies agreed to a permanent injunction. Still the litigation took us nearly two years to complete, and although United Companies provided restitution, it would have been preferable for consumers not to have entered into such transactions in the first place. Also, United Companies filed for bankruptcy protection soon after most of the restitution had been paid; consumers will end up receiving less than 100% of the remedies ordered to be paid to them. And it is worth noting that if United Companies had filed for bankruptcy protection earlier, Massachusetts consumers would presumably have fared even less well.)

2) First Alliance Mortgage Company. In a case that we brought against First Alliance Mortgage Company that is still pending, we have found the following problems, which have been outlined in court filings that we have made:

- First Alliance Mortgage Company routinely made points charges that exceeded 20% of the loan amount. In fact, of the 300 loans that First Alliance Mortgage Company made to Massachusetts borrowers, 35.57% contain points charges in excess of 20 (in two cases, borrowers paid more than 30 points); 73.15% contain points charges in excess of 10; 96.64% contain points charges in excess of five; and only 3.36% contain points charges that are less than five.
- Further, of these 300 Massachusetts mortgage loans made, 20% were made to borrowers who had good credit histories and who could have obtained conventional loans with competitive terms. (According to the loan files, First Alliance Mortgage Company made mortgage loans to the following numbers of consumers in the following credit rating categories: A or A-: 59; B or B-: 115; C or C-: 115; and D: 8.)
- 187 of the 300 First Alliance Mortgage Company loans (more than half of them) had adjustable rates of interest. The interest rates on these loans increased every six months. The index used was a LIBOR plus a large margin. (The margin most often used was

7.99, but it varied.) This is significant, and appears to be an increasing problem: many consumers do not understand that the initial rate of interest they pay to mortgage lenders is really a teaser rate. Many consumers expect that their mortgage rates are tied to a national standard and when they learn that prime rates are low, they expect that their interest rates will decrease.

- 28 of the borrowers apparently experienced "flipping" -- 28 of the borrowers got more than one First Alliance Mortgage Company loan in a relatively short amount of time. And they paid the same level of points again. (A couple in their 60s for instance paid \$15,757 in points for a loan with First Alliance Mortgage Company, which amounted to 20.96 points, and paid \$15,778.61, or what amounted to 15.32 points, to First Alliance Mortgage Company to refinance their loan a second time just one year later. In other words, this couple paid more than \$30,000 in points in one year to First Alliance Mortgage Company.)
- Each of the First Alliance Mortgage Company loans contains a prepayment penalty provision in the notes.

Our case with First Alliance Mortgage Company is still pending. The company filed for bankruptcy protection on March 23, 2000, and that bankruptcy filing has slowed down our enforcement efforts. Meanwhile, as we continue to litigate these claims, consumers bear the heavy costs of these loans.

The Proposed Regulations

The regulations proposed by Commissioner Curry will help to prevent abusive practices from occurring. If these regulations had been in place a few years ago, for instance, the lending practices described above would most likely not have occurred, and hundreds of Massachusetts consumers would have avoided harm.

Turning now to the particular proposals, we offer the following comments:

1) Coverage of the Regulations, 209 CMR 32.32(1): We believe that it is important to increase the coverage of the high cost mortgage loan regulations by lowering the annual percentage rate and points triggers, and support all of the changes proposed in this section. We particularly support (a) lowering the points trigger from eight points to five; and (b) requiring lenders to calculate the annual percentage rate trigger by using the interest rates that would be effective after the teaser rate expires. We note that we would not create an exception for "bona fide loan discount points," as is described below. (The proposed regulation now provides that when calculating the total number of points payable in connection with a loan for purposes of determining whether these regulations are triggered, bona fide loan discount points may be excluded.)

2) Definitions, 209 CMR 32.32 (2): "Bona fide loan discount points" is a newly defined term, and defines these points as those which in fact reduce the interest rate or time-price differential applicable to the loan. From a law enforcement perspective, it will be impossible to tell from the face of loan documents whether the points paid by a borrower include bona fide loan discount points, and will therefore make law enforcement efforts more difficult. This exemption will make unclear an otherwise clear rule, and for this reason, we strongly recommend eliminating it.

3) Disclosures, 209 CMR 32.32(3): We strongly support the new disclosures that would be required by section (e) of this regulation, which will require lenders to provide two new disclosures, and particularly believe that the one required by section (e)(1) is a good idea: in at least 12 point type above the signature line on loan applications, lenders would be required to state that the loan "is not necessarily the least expensive loan available to you."

4) Limitations, 209 CMR 32.32(4): We support the changes proposed by this section, including those to extend the minimum term for balloon notes from 5 to 7 years, and those that further limit the charging of prepayment penalties. We would be inclined to consider further limiting prepayment penalties, particularly in those cases where consumers have already been charged excessive points, but certainly support the changes thus far proposed.

5) Prohibited Acts and Practices, 209 CMR 32.32(5): We strongly support the changes proposed to be made to this section, which prohibit lenders from making high cost loans in those situations where the lenders believe that consumers will be unable to make the scheduled payments to repay the obligation. The regulation had previously required consumers to establish that the lender was engaged in a pattern or practice of disregarding consumers' abilities to make scheduled payments, and we believe that such requirement was unduly burdensome for individual borrowers.

6) Unfair High Cost Loan Practices, Financing of Points, Fees or Charges, 209 CMR 32.32(6)(a): We strongly support the changes proposed by this section, which would prohibit lenders from making loans where consumers are required to finance more than 5% of the points, fees and costs of a loan, including the costs associated with disability, unemployment and/or life insurance costs. This provision would work to eliminate the types of practices that we saw, for instance, in our prosecution of the First Alliance Mortgage Company case, where consumers regularly paid points as high as 20% of the mortgage loan amount. In every instance, the points paid by First Alliance borrowers were financed. We believe that the First Alliance Mortgage Company consumers simply would not have paid First Alliance Mortgage Company thousands of dollars in cash to cover the points charges that were imposed upon them.

7) Frequent Refinancing of Existing High Cost Loan with New High Cost Loan (Loan "Flipping"), 209 CMR 32.32(6)(b): The changes proposed to be made by these new provisions would greatly reduce the occurrence of "flipping," and we support them. The proposed regulation provides that points and fees cannot be charged to a borrower if, among other factors, the last financing was within two years of the current refinancing. We believe that the two year

period proposed makes good sense. For instance, in the First Alliance Mortgage Company case, we certainly saw cases where more than a year had passed and consumers were charged excessive points again, and would urge that this time period not be shortened.

8) Loan "Packing", 209 CMR 32.32(6)(c): We support the proposed regulation to address problems seen when lenders sell unnecessary and voluntary insurance products with a mortgage loan. Presumably because of high pressure sales tactics, consumers often believe that certain insurance products are mandatory when such is not the case, and end up financing the costs of such insurance without being adequately informed about the product. This regulation requires that consumers be better informed, and it imposes new disclosure requirements.

9) Advertising, 209 CMR 32.32(6)(e): We support the changes proposed by this regulation which would prohibit lenders from stating in advertisements that refinancing pre-existing debt with a high cost loan will reduce consumers' monthly debt payments, unless lenders also disclose additional information about the actual costs of the loan.

10) Unreasonable Charges, 209 CMR 32.32(6)(g): We believe that this section, which would prohibit lenders from charging fees for services that are not actually performed, or for which the fees bear no reasonable relationship to the value of the services actually performed, or which are otherwise unconscionable, will give consumers a useful tool when dealing with abusive mortgage lenders, and we support it.

11) Mandatory Arbitration and Class Action Provisions: We strongly agree that it is unfair for mortgage lenders to require consumers to sign mandatory arbitration agreements and to waive participation in class action lawsuits. These agreements, which are now becoming standard fare, appeared in each and every First Alliance Mortgage Loan file of Massachusetts borrowers. Thus, consumers who sought to bring consumer protection claims against First Alliance Mortgage Company for alleged unfair and deceptive acts and practices, first had to overcome the hurdle presented by these arbitration provisions. Predatory and abusive mortgage lenders should not be permitted to charge consumers excessive fees and costs, and then avoid liability for doing so by requiring consumers to sign these arbitration agreements. Further, consumers should be permitted to bring claims in the appropriate legal forum -- for abusive lenders to cut off those rights at the time the loan is consummated is unfair, and a regulation to that effect is important. We strongly suggest eliminating the second sentence of this proposed regulation that provides that arbitration agreements that "comply with the standards set forth in the Statement of Principles of the National Consumer Dispute Advisory Committee shall be presumed not to violate this regulation." To begin with, we are unaware what this organization is, and we are unfamiliar with its principles. But more to the point, we are unpersuaded that any form of arbitration, including those with the highest standards, should be imposed upon consumers in the manner that has now become commonplace. We therefore strongly recommend eliminating this sentence.

2) Counseling, 209 CMR 32.32(6)(m): While we support the requirements contained in

subsection (1) of this regulation that lenders supply a list of counselors to all borrowers that are provided by the Division of Banks and the Executive Office of Elder Affairs, we have concerns with the requirements contained in subsection (2) which provide that borrowers that are 60 years of age or older be required to have completed a counseling program before being able to obtain a loan. We therefore recommend adopting the first section, and eliminating the second.

Conclusion

In closing, the Attorney General hopes that the Division's focus on the important issues of predatory mortgage lending will bring these matters to the attention of the public and will result in the adoption of these regulations. The Attorney General's Office has been a leader in the area of predatory mortgage lending abuses, and has helped to define consumers' rights in this area in Massachusetts, and we offer our assistance in your effort to adopt predatory mortgage lending regulations.