

PREDATORY LENDING FAQs

What Is Predatory Lending?

Predatory lending generally refers to abusive mortgage lending practices. The Center for Responsible Lending has identified "Seven Signs of Predatory Lending."¹ These are:

Excessive Fees - Points and fees are costs not directly reflected in interest rates. Because these costs can be financed, they are easy to disguise or downplay. On competitive loans, fees below 1% of the loan amount are typical. On predatory loans, fees totaling more than 5% of the loan amount are common.

Abusive Prepayment Penalties - Borrowers with higher-interest subprime loans have a strong incentive to refinance as soon as their credit improves. However, up to 80% of all subprime mortgages carry a prepayment penalty -- a fee for paying off a loan early. An abusive prepayment penalty typically is effective more than three years and/or costs more than six months' interest. In the prime market, only about 2% of home loans carry prepayment penalties of any length.

Kickbacks to Brokers (Yield Spread Premiums) - When brokers deliver a loan with an inflated interest rate (i.e., higher than the rate acceptable to the lender), the lender often pays a "yield spread premium" -- a kickback for making the loan more costly to the borrower.

Loan Flipping - A lender "flips" a borrower by refinancing a loan to generate fee income without providing any net tangible benefit to the borrower. Flipping can quickly drain borrower equity and increase monthly payments -- sometimes on homes that had previously been owned free of debt.

Unnecessary Products - Sometimes borrowers may pay more than necessary because lenders sell and finance unnecessary insurance or other products along with the loan.

Mandatory Arbitration - Some loan contracts require "mandatory arbitration," meaning that the borrowers are not allowed to seek legal remedies in a court if they find that their home is threatened by loans with illegal or abusive terms. Mandatory arbitration makes it much less likely that borrowers will receive fair and appropriate remedies in cases of wrongdoing.

Steering & Targeting - Predatory lenders may steer borrowers into subprime mortgages, even when the borrowers could qualify for a mainstream loan. Vulnerable borrowers may be subjected to aggressive sales tactics and sometimes outright fraud.

¹ See <http://www.responsiblelending.org/issues/mortgage/sevensigns.html> (accessed on December 12, 2007).

What Is A Subprime Loan?

A subprime loan is a loan that is given to people with a bad credit record. The interest rate on a subprime loan is likely to be a lot higher than an interest rate you would expect on a loan from a bank.

Many people will use a subprime loan when they cannot get credit to help repair their credit rating.

According to a government study, over half (51%) of refinance mortgages in predominantly African American neighborhoods are subprime loans, compared to only 9% of refinances in predominantly white neighborhoods.

Why is the Mortgage Bailout Plan Inadequate?

The bailout plan is a lending industry response to the threatened wave of home foreclosures. The plan is designed for borrowers who could be facing foreclosure when the interest rate on their loan upwardly adjusts and the borrower is no longer able to afford the loan. The borrower must have 3-5% equity in their home. Yet with an option loan, for example, that many African Americans were placed into, building even 3-5% equity in a recent home purchase is impossible for many borrowers. Moreover, borrowers who have already fallen behind on their mortgage payments are not eligible for the rate freeze, while borrowers who were never in subprime loans and who could afford upwardly adjusting interest rates, i.e. white America, will benefit the most from the interest freeze.

Why Do Borrowers Sign Up For Subprime Loans If They Can't Afford Them?

Lenders who engage in predatory lending practices purposefully confuse borrowers, fail to disclose information, and intentionally mislead borrowers into believing that the loan they are receiving is an affordable loan, and that no better loan is available to them. Borrowers rely on representations made by lenders, who are perceived as professionals who better understand the loan industry.

Is There Any Evidence that African Americans Are Discriminated by Lenders?

There is overwhelming evidence by way of published surveys and reports from a number of organizations who all concluded that African Americans are placed into subprime loans at a disproportionately higher rate than similarly situated white borrowers.

In a 2006 study, the Center for Responsible Lending found that African-Americans were 31 to 34 percent more likely to receive higher-rate, more expensive subprime loans than similarly situated white borrowers.

The National Community Reinvestment Coalition revealed that lenders on average made high-cost subprime loans to higher-qualified African Americans 54% of the time, as compared to 23% of the time for whites, even when the Caucasian applicants were less qualified.

Similarly, the Federal Reserve Board concluded that African Americans were more likely to pay higher prices for mortgages than their Caucasian counterparts. The United States Inspector General cited that report as showing "significant" differences, making it "clear" that African Americans were "much more likely to get higher-priced loans" than whites. For example, a 2006 study by ACORN showed that African Americans were 3.6 times as likely as whites to be put into a subprime purchase loan, and 6.1 times as likely to be refinanced into such a loan.

These statistical disparities are the result of systematic and predatory targeting of African Americans, as well as facially neutral bank policies and practices that have a disparate impact on African Americans.