PREDATORY LENDERS

Flipping, Packing, Stripping, and Ballooning Their Way to Profits

Introduction

Predatory lenders have been robbing the poor in our society for thousands of years. In Ezekiel 18:13, the prophet Ezekiel stated that "lending at usury and taking excessive interest is a detestable thing". In Nehemiah 5:10 the prophet Nehemiah stated "let the exacting of usury stop". In John 2:14, Jesus Christ himself became angry at the moneychangers in the Temple because they were gouging the poor with exorbitant and usurious interest rates.

From biblical times until the 1900's, predatory lending was done through small time operators like the street corner loan shark. In the 1980's, after President Reagan's de-regulation of the banking industry, many large Wall Street Banks entered the predatory lending market. It is no longer a small street corner business, but is now a multi-billion dollar industry run by Wall Street's largest banks.

These banks handle predatory lending through their subsidiaries, as if they are ashamed of their own practices. If a low-income consumer enters the door of a major bank, he will be steered to its subsidiary to get a loan. There is one door for certain people, and other doors for others.

Predatory lenders make loans in what is called the sub-prime market. This is a market for consumers who are not considered creditworthy by traditional banks. Predatory lenders prey on the most vulnerable people in our society and typically target minorities, the working poor, and the elderly with their high priced loans. Because of this, these groups pay more for loans than others in our society. They pay a "poverty tax" and some have called it a "skin tax". These consumers are easy prey for predatory lenders because they cannot get loans elsewhere and must agree to take the loans on terms the lender requires. When they enter into these loans, they become enslaved to these lenders for life.

The four largest predatory lenders in the country are Citigroup, AIG, Wells Fargo, and Household Finance Corporation. Citigroup does its predatory lending through its subsidiary, City Financial. City Financial makes predatory loans itself and it also owns Associates, Transouth, Commercial Credit and Kentucky Finance, which likewise engage in predatory lending.

AIG does its predatory lending through its subsidiary American General Finance. Wells Fargo does its predatory lending though its subsidiary Wells Fargo Financial. Household Finance Corporation does its predatory lending through its subsidiaries including Beneficial. Since the major banks entered the sub-prime market, predatory lending has grown substantially, from $18.7 billion to over $60 billion per year.

The Schemes

Predatory lenders have concocted many schemes that in effect, strangle its victims. These schemes include credit insurance packing ("packing"), forced refinancing ("flipping"), equity stripping ("stripping"), balloon payments, ("ballooning") high prepayment penalties, negative amortization and arbitration. All of these schemes are designed to keep minorities, the working poor and the elderly in debt forever while fattening the profits of the lenders. In some of the schemes, the predatory lenders actually charge effective interest rates of over 300%.

Insurance Packing is one such scheme. It involves the lender selling worthless insurance to the consumers at the time of the loan and financing the premiums. The insurance policies are underwritten by the lender's subsidiary. The Consumer Federation of America calls credit insurance a $2.5 billion a year rip-off and states that it is more prevalent in the loans of minorities and the unsophisticated. Critics have called credit insurance the "tail that wags the dog" because lenders make loans more for insurance profits than for financing profits.

There are many types of credit insurance. Credit life insurance is designed to pay off the loan in the event the customer dies. Credit disability insurance is designed to make the loan payments if the customer is disabled. Credit property insurance is designed to reimburse the lender if the collateral is lost. This insurance is particularly bad because lenders force consumers to use bogus collateral like cane fishing poles, clock radios, ladders or blankets solely to be able to charge insurance on it. Lenders also push involuntary unemployment insurance, which is designed to make the consumer's payments if he is laid off from work.

As stated earlier, all of these insurance products are sold through subsidiaries of the lender at exorbitant prices and the lender charges interest on these premiums. The policies rarely pay the consumer anything. Many times the consumer doesn't even know he has these products, so he doesn't know to make a claim. If he does make a claim at the branch, the claims often are not turned in. An example of some types of credit insurance sales is shown in Exhibit A, which is attached.

The next way that predatory lenders strangle its victims involves forced refinancing or flipping. When a consumer is almost through paying for a loan, he is paying mostly principal. This is not profitable for the lender, therefore the lender must get this loan off the books by refinancing it into a new loan. Therefore, the lender entices the victim back to the branch by offering him a very small pre-approved loan. When the victim arrives, instead of receiving a small, separate loan and keeping his old loan, the lender requires him to refinance the old loan in order to get the new money. Thus, the consumer no longer has an old large loan and a new small loan as promised, but now has one new large loan with all new insurance charges. This is very common in the predatory lending market. Most predatory lenders flip the average consumer three times. An example of one consumer who was flipped six times can be seen in Exhibit B, which is attached.

Another predatory lending trick is equity stripping ("stripping"), also known as equity theft. Stripping is where the lender makes the loan based on the asset and not on the ability to repay. In other words, the lender targets someone who owns their own home and has no debt on it. This usually involves the elderly and minorities. The lender knows that the loan can never be repaid based on the victim's income. The victim defaults on the loan and the lender takes the house, evicts the victim, and sells and finances the house for someone else.

Many predatory lending victims are steered into high priced loans that involve balloon payments ("ballooning"). The victim gets to the end of the loan and thinks the loan is paid off and then there is this huge balloon payment at the end. The victim cannot afford this, therefore, he is forced to refinance. The victim is forced to do this over and over again to keep from losing his home.

Predatory lenders also put high pre-payment penalties in the loans in an effort to keep its victims in debt. If consumers ever want to refinance or pay off the loan in order to get a lower priced loan, he cannot because of the high pre-payment penalties.

Predatory lenders also use negative amortization. This involves making the payment so low that the consumer is not even covering the interest each month. Therefore, the balance is going up every month instead of going down. At the end of the loan, the victim is forced to refinance.

In addition to other unconscionable practices, predatory lenders use arbitration agreements in its loans. If a victim ever wants to take the predatory lender to court, he cannot. He will be forced into arbitration where one person decides whether or not his claim is paid. The arbitrators are picked by the predatory lender. The filing fees to get to arbitration are very high and there is no appeal. Consumers almost never win in arbitration.

This actually shuts the courthouse door and hurts efforts to hold the predatory lenders accountable.

The above mentioned schemes of predatory lenders are the most common, though it seems the industry is constantly devising new ways to wreak havoc on its victims.

The Regulators

Regulators such as the Federal Trade Commission and the Attorney Generals have tried for years to stop predatory lending. In fact, in 2002, Citigroup was fined by the Federal Trade Commission $215 Million for its predatory lending practices. Likewise, in 2002, Household Financial Corporation was fined by the Attorney Generals throughout the country $484 Million for its predatory lending practices.

Other Regulators have also condemned predatory lenders. The FDIC stated that high cost predatory home loans are running rampant in this country. A few unscrupulous lenders are tricking cash strapped unknowing borrowers into expensive home-equity loans and mortgages. The big risk: if you can't repay the loan you could lose your home.

Likewise, HUD's predatory lending task force stated that, curbing predatory home mortgage lending is a high priority. HUD stated that we needed to improve consumer literacy and disclosures, prohibit harmful sales practices, restrict abusive terms and conditions on high-cost loans and improve market structure.

Another regulator, FREDDIE MAC, has taken a strong stance against predatory lending. It has stated that it is committed in its mission to combat predatory lending practices.

In 1994, the U.S. Congress tried to stop predatory lending by passing The Home Loan Protection Act. The Federal Reserve Board has now proposed new rules that would broaden the scope of the Act to prohibit "flipping" and "stripping".

The Fed specifically stated that homeowners in certain communities, particularly the elderly and minorities, are targeted with offers of high-cost home secured credit. The loans carry high up-front fees and may be based on a homeowner's equity in their homes, not their ability to make their scheduled payment. When the homeowners have problems repaying the debt, they are often encouraged to re-finance the loan. Frequently, this leads to another high-fee loan and provides little to no economic benefit to the borrower. Even Federal Reserve Chairman Alan Greenspan stated that "enough was enough" on the excesses of predatory lending.

The regulators have repeatedly tried to end predatory lending, but because of the industry's power have been unable to do so.

Cities and States

Predatory lending has reached monumental proportions in many places in America. According to Judith C. Rice, treasurer for the city of Chicago, predatory lending is on the rise in the Chicago area and must be stopped.

Predatory lending became so widespread in Georgia that it recently passed one of the toughest predatory lending laws in the country. Under Georgia's predatory lending law, anyone in the lending process, (bankers, brokers, and those with the right to collect payments) can be liable if the loan is found to be predatory. Penalties include up to 6 months in jail and $1,000 fine per violation. Likewise, Alabama's Banking Commissioner has stated the predatory lending must stop in Alabama.

Other states have had predatory lending problems. According to the Dayton Ohio Business Journal, predatory lending is responsible for an epidemic of housing foreclosures in this state. It stated that 25,000 families in Ohio lost their homes to foreclosures in 2001.

North Carolina has also seen predatory lending on the rise. According to Responsible Lending, over 50,000 consumers in North Carolina have been victimized by abusive lenders, losing their homes or a large portion of their wealth they spent a lifetime to build. Even Habitat For Humanity borrowers have been flipped approximately 10% of the time.

To the contrary, in Trent Lott's Mississippi, where predatory lending is as bad as anyplace in the country, the industry showed it's power by passing legislation that gave predatory lenders virtual immunity. This immunity applies even when it targets certain people and intentionally cheats them out of their life savings or their homes.

Most cities and states continue to search for ways to stop the evils of predatory lending. However, the devastating power of the industry is highlighted by what happened in Mississippi.

Consumer Groups

According to Consumers Union, publisher of Consumer Reports Magazine, the most vulnerable areas for predatory lending were lower income, high minority neighborhoods with a higher than average share of elderly residents. It also stated that President Bush's state of Texas is one of the worst places for predatory lending in the country. It specifically stated that Houston, San Antonio, and Austin, Texas rank in the top ten cities in the nation for predatory lending amongst African-American borrowers. It urged government agencies to do something to stop these practices.

The AARP has this to say about predatory lending. There are a growing number of aggressive, dishonest lenders who advertise their services to people in financial need – people who may have fallen behind on property taxes, or need money for medical bills, or face costly home repairs. Instead of offering a fair loan, these lenders use smooth talking salespersons, high interest rates, outrageous fees, and unaffordable repayment terms. Homeowners can be tricked into taking out loans that they cannot afford to repay. Some homeowners may lose their homes to foreclosure.

The Association of Community Organizations for Reform Now (ACORN) issued a paper in November, 2002, entitled "Separate but Unequal". It stated that sub-prime lending is disproportionately concentrated among minority, low-income, and elderly homeowners. It also stated that minorities are 4.4 times more likely to receive a sub-prime loan when re-financing than whites. It also stated that while the face of predatory lenders may appear to be those of small time crooks, the kingpins behind predatory lending can be found among some of the worlds largest financial institutions. Investment firms bankroll predators by securitizing their mortgages and selling them to investors.

The Federal Trade Commission in seeking to stop these predatory lending practices stated that these lenders target homeowners who are elderly and who have low incomes or credit problems and then try to take advantage of them by using deceptive practices. It cautions all homeowners to be on the lookout for the deceitful practices of predatory lenders.

The Social Investment Forum Foundation, Co-op America, and the National Consumer Law center are organizations that also seek to end predatory lending and have likewise stated consumers must beware of predatory lending practices such as flipping, packing, stripping and ballooning.

Many consumer groups are trying to stop predatory lending, but are not making much progress because of the power and wealth of the industry.

Testimony Under Oath

Testimony at the Senate Special Committee on Aging's hearing on "Equity Predators: Stripping, Flipping, and Packing Their Way to Profits", showed that we have "financial apartheid" in our country. We have low-income, often minority borrowers who are charged unconscionably high interest rates, either directly or indirectly through the cover of added charges.

Former employees of this industry tell the worst horror stories regarding these practices. One such employee testified in the hearing on March 16, 1998 and stated that his company tried to do business with blue-collar workers, older people on fixed incomes, and people who have equity in their homes. He stated the perfect customer was an uneducated widow on a fixed income with her house paid off, living on credit cards and having a hard time paying the bills. Their goal was always to sell the customer the biggest loan possible. The daily requirement for his branch was to obtain at least two applications from present borrowers to try to flip them. The more naïve the customer, the more insurance he would pack on the loan. He stated that insurance drives profits, and it is more important to the company's profitability than the spread on interest rates. Eighty percent of the loans were required to have insurance on them.

Likewise in litigation in Alabama and Mississippi employees of finance company dealers admitted under oath they were specifically trained to target African-Americans in their predatory lending activities.

The sworn testimony of these employees speaks volumes about the unconscionable practices of these predators.

Real Life Victims

Predatory lending becomes even more clear when we consider real life examples of real people.

Sam and Lula Baldwin, an elderly African-American couple who lived on Social Security, have an 8th grade education and cannot read at all. Sam has a job as a restroom attendant at a rest stop in Pine Level, Alabama and works from 4 p.m. to 12 a.m. Sam built the home he lives in himself in the 1970's and financed it with a reputable bank. In the 1980's, he refinanced it with a predatory lender. His loan was then flipped, and he was required to purchase credit life insurance with a cost of $9,600 plus interest. He also was required to pay many other costs associated with the new loan. His monthly payment was raised to $800 a month, which he could not afford. Sam and Lula got behind on their payments and the predatory lender has foreclosed on their home. The were scheduled to be evicted in January 2003.

Betsy Smith is a 70 year old lady who obtained a 5-year mortgage in the amount of $54,000 at a rate of 12.85%. She is paying $596.00 a month, but she will still be left with a final balloon payment of nearly $48,000 in the year 2011, when she is 83 years old.

Arletta Williams, who is a 68 year old African-American, took out a mortgage on her home in the amount of $20,334 in the early 1990's. Her loan was flipped 6 times in as many years, bringing the final loan payment to nearly $55,000. She paid for credit life insurance all six times with each premium exceeding $2,300.

Sam Phillips, who is 72 years old, was flipped 3 times in 4 years. Over the course of the 3 flips, the loan amount doubled from $16,500 to $33,000. The final loan had an interest rate of 16.85%. Living on Social Security and unable to afford monthly payments, Phillips sought bankruptcy in an attempt to save his house.

An 82-year old African-American widow who was retired and living on Social Security retirement benefits had owned a home in Norcross, Georgia for 36 years. She obtained three loans from a subsidiary of a large northeastern bank. The first loan was a mortgage of $15,000 with an annual percentage rate of 16.8%. The second loan was a signature loan for $780 at a rate of 42%. The third loan was a mortgage loan which refinanced the two previous loans. This loan was for $16,851 and had a 51% interest rate. The predatory lender eventually foreclosed on her home, and this 82 year old widow was evicted.

These victims tell the true story of how predatory lenders hurt the working poor, minorities and the elderly.

Conclusion

Predatory Lending has been around for thousands of years. It has always been detestable. The working poor, minorities, and the elderly are subject to a poverty tax or skin tax which enrich unscrupulous lenders. Wall Street's biggest banks are unfairly gouging the poor and reaping billions in profit each year by enslaving a whole class of Americans to debt.