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Laying the Foundation for Equal Access to Credit:

How Improved Financial Oversight Can Build Wealth for Hispanic Borrowers

Submitted to:

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Submitted by:

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Good morning. My name is Janis Bowdler. I am the Deputy Director of the Wealth-Building Policy Project at the National Council of La Raza (NCLR). NCLR is the largest national Hispanic civil rights and advocacy organization in the United States, dedicated to improving opportunities for Hispanic Americans. I oversee our research, policy analysis, and advocacy on issues critical to building financial security in Latino communities, such as homeownership, consumer credit, auto lending, and financial counseling. During my time at NCLR, I have produced a number of publications on housing issues important to the Latino community, including *American Dream to American Reality: Creating a Fair Housing System that Works for Latinos* and *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market*. In addition, I have served as an expert witness before this committee, the U.S. Senate Committee on Banking, Housing, and Urban Affairs, and the Board of Governors of the Federal Reserve. I would like to thank Chairman Frank and Ranking Member Bachus for inviting us to share our views on the creation of the Consumer Financial Protection Agency (CFPA).

For more than two decades, NCLR has actively engaged in relevant public policy issues such as preserving and strengthening the Community Reinvestment Act (CRA) and the Home Ownership and Equity Protection Act (HOEPA), supporting strong fair housing and fair lending laws, increasing access to financial services for low-income people, and promoting homeownership in the Latino community. For the last ten years, NCLR has been helping Latino families become homeowners by supporting local housing counseling agencies. The NCLR Homeownership Network (NHN), a network of 52 community-based counseling providers, works with more than 38,000 families annually and has produced more than 25,000 first-time homebuyers in its first decade. More recently, our focus has shifted to helping families keep their homes. NHN members have counseled more than 7,000 homeowners facing foreclosure. Our subsidiary, the Raza Development Fund (RDF), is the nation's largest Hispanic Community Development Financial Institution (CDFI). Since 1999, RDF has provided $400 million in financing to local development projects throughout the country. These relationships have increased NCLR's institutional knowledge of how Latinos interact with the mortgage market, their credit and capital needs, and the impact of government regulation of financial services markets.

The economic consequences from the recession and historically high foreclosure rates are broadly and deeply felt by middle-class families nationwide, and communities of color have been hit particularly hard. Congress has a responsibility to plug the holes in a broken financial system that allowed millions of families to watch their savings and wealth evaporate and their debt skyrocket.

In my testimony today, I will discuss the structural flaws in the credit market that led to millions of families being shuffled into ill-fitting credit products. Then I will offer NCLR's feedback on the proposed CFPA, followed by recommendations.

A Broken System

Most Americans share a fundamental goal of achieving economic sustainability and wealth that they can pass to their children. To do so, they rely on financial products such as mortgages, car loans, credit cards, insurance, and retirement accounts to facilitate their upward mobility. Unfortunately, structural flaws in our financial market have resulted in unequal access to those products key to economic success and the proliferation of deceptive practices. As a result, Hispanic families routinely pay more for credit, often accompanied by risky terms. Not surprisingly, they also bear a disproportionate share of the consequences, as demonstrated by declining income, wealth, and homeownership levels.

Despite having the necessary authority and mandates, federal regulators failed to reign in the worst practices or advance policies that could have set families up for financial success. In fact, rollbacks on regulations and oversight paved the way for many troubling practices. Borrowers that were otherwise qualified for credit but considered hard-to-serve were often shut out of the market and forced to rely on inferior products. Issuers of subprime mortgage and credit frequently targeted minority communities as fertile ground for expansion, often as a *replacement* of prime products rather than a complement. Much of this lending was conducted by under-regulated finance companies. In the years before the burst of the housing bubble, true market oversight was nearly impossible and gaming the system became widespread.

Under such a regime, Latino borrowers and neighborhoods fared poorly. The lack of strong oversight, inability to identify disparate impact trends, and general inactivity to prevent deceptive practices have manifested real consequences for struggling families. Specifically, deficient oversight failed Latinos, other communities of color, and those of modest means in the following ways:

- **Access to prime products was restricted, even when borrowers had good credit and high incomes.** This most often occurred because short-term profits were prioritized over long-term gains. For instance, many Hispanic borrowers have unique profiles that creditors often consider "hard-to-serve."[1] Despite the fact that sound underwriting models and products exist that can service consumers with these characteristics, there was little incentive to sell them in the marketplace. Such models earned issuers little profit, while subprime models had streamlined underwriting processes and were easy to line with high fees and inflated interest rates. The profitability of the models was also set in part by the price that Wall Street was willing to pay for risk. As their appetite for risk grew, expensive and risky subprime credit became readily available while affordable and low-risk prime credit was restricted. In this way, expensive and risky products drove out those that were most favorable to borrowers. As a result, Latino families have paid more for credit in most market segments. They are 30% more likely to receive high-cost mortgages, nearly twice as likely as White families to have credit card interest rates over 20%, and more likely to be charged costly markups on their auto loans.

- **Disparate impact trends and practices were not properly identified, investigated, or acted upon.** Despite clear evidence that minority borrowers were paying more for credit and being steered into subprime credit when they qualified for prime, the trends went unnoticed by federal regulators. Federal analysts claimed that not enough data was available to take enforcement action against specific lenders. However, the Federal

[1] See Janis Bowdler, *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market*, Issue Brief no. 15 (Washington, DC: National Council of La Raza, 2005).

Reserve and other agencies did not exercise their authority to further investigate clear and obvious signs of trouble. For example, a recent study shows that even after controlling for percent minority, low credit scores, poverty, and median home value, the proportion of subprime loans originated at the metropolitan level correlates with racial segregation.[2] In fact, a study conducted by the Department of Housing and Urban Development (HUD) in 2000 found that *high-income* Blacks living in predominately Black neighborhoods were three times more likely to receive a subprime purchase loan than *low-income* White borrowers.[3] Simple investigations would have turned up enough information to justify new lending rules and guidance, and possibly enforcement action. In fact, in one private meeting with a major mortgage lender, NCLR discovered that the company's wholesale portfolio consisted almost entirely of Black clients and only offered high-cost loans. The company was clearly targeting minority communities with its subprime affiliate while catering to affluent White households with its retail operation. A similar practice has also been revealed by whistleblowers in *Baltimore v. Wells Fargo*, who claim that deliberate strategies were employed whereby agents would target communities of color to market subprime mortgages.[4] Other research has shown that payday lenders, "buy here pay here" auto dealers, and other fringe financial providers tend to cluster in minority and low-income communities.[5]

- **Shopping for credit was nearly impossible.** Many experts pointed to the growing complexity of credit products and many reports demonstrated that consumers lacked the information necessary to make sound decisions. Credit card, auto, and mortgage offers are not transparent, and borrowers are often unaware of the hidden costs in their loans. Few shopping tools exist that can help borrowers create true apples-to-apples cost comparisons. As a result, many borrowers forego shopping all together. According to one survey, only 7% of Hispanic consumers who carry a credit card balance report "substantial" shopping for credit, compared to 12% for similar White consumers; approximately 25% of Hispanic card users that had been denied a loan did not reapply for fear of rejection.[6] In the case of mortgage and auto loans, mortgage brokers and auto dealers serve as an intermediary between the borrower and the lender. While many borrowers believe these agents are shopping for the best deal on their behalf, they are under no legal or ethical responsibility to do so. While most consumers do not proactively shop for credit, credit issuers shop aggressively for borrowers. Roughly 5.2 billion credit card solicitations were sent to U.S. households in 2004.[7] Through the

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[2] Gregory D. Squires, Derek S. Hyra, and Robert N. Renner, "Segregation and the Subprime Lending Crisis" (paper presented at the 2009 Federal Reserve System Community Affairs Research Conference, Washington, DC, April 16, 2009).
[3] U.S. Department of Housing and Urban Development, *Unequal Burden: Income and Racial Disparities in Subprime Lending in America*. Washington, DC, 2000.
[4] Michael Powell, "Bank Accused of Pushing Mortgage Deals on Blacks," *New York Times*, June 6, 2009, http://www.nytimes.com/2009/06/07/us/07baltimore.html?_r=2&pagewanted=1&sq=wells%20fargo&st=cse&scp=2 (accessed September 29, 2009).
[5] See Wei Li et al., *Predatory Profiling: The Role of Race and Ethnicity in the Location of Payday Lenders in California* (Washington, DC: Center for Responsible Lending, 2009).
[6] Unpublished data from the *2004 Survey of Consumer Finances* tabulated by the Federal Reserve on behalf of NCLR.
[7] Government Accountability Office, *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*. Washington, DC, 2006.

collection of consumer financial information, issuers essentially prescreen and select their customers. Meanwhile, federal regulators sat on major reforms for years that could have improved shopping, such as a revised Good Faith Estimate and other documents made available under the Real Estate and Settlement Procedures Act (RESPA) and reforms defining unfair and deceptive marketing practices.

While some would be happy to allow market forces to continue unchecked, this regulatory philosophy has had serious consequences for families and local and national economies. For example, credit card companies made over $17 billion in penalty fees in 2006[8] and banks will make $38.5 billion in customer overdraft fees in 2009,[9] money that could otherwise be used for household expenses or savings. Subprime foreclosures are estimated to cost states and local governments $917 million in lost property tax revenue,[10] while payday lenders drain nearly $5 billion per year from the earnings of working people.[11] After reaching an all-time high, the homeownership rate for native-born Latinos has declined by nearly three percentage points in just three years.[12] As wealth and savings have eroded, families are left with no safety net for emergencies and an uncertain financial future.

Establishing Commonsense Oversight

As members of this committee seek to revamp our financial regulatory system to prevent further crisis, they must fill the gaps in oversight and accountability that left Hispanic borrowers vulnerable to steering and other unfair practices. Specifically, lawmakers must ensure that borrowers have the opportunity to be matched to credit products that truly reflect their risk of nonpayment in the most affordable terms possible. This includes improving competition and transparent shopping opportunities, promoting a viable and nonpredatory subprime market, advancing new consumer decision-making tools, and increasing product innovation to serve a wide range of credit needs. Furthermore, any reform must also establish strong market accountability. Credit markets and practices are dynamic, as are the tricks bad actors use to lure borrowers into products laced with risky and expensive features. While some argue that it is the borrower's responsibility to be on the lookout for deception, it is unreasonable to expect individual families to be able to regulate the market and, in effect, detect what the Federal Reserve did not. Lessons from the market implosion suggest that simply having good products available does not guarantee that they will reach the intended population. Bad practices often kept best practices and products at bay. The ideal regulatory structure would be able to identify and eliminate deceptive practices and enforce strong consumer protection laws.

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[8] U.S. PRIG Education Fund, "A Consumer's Guide to Credit Cards" (Boston, MA: U.S. PIRG Education Fund) http://www.uspirg.org/html/Credit_Card_Booklet.pdf (accessed September 2009).
[9] Reuters, "U.S. banks to make $38 billion from overdraft fees: report," August 10, 2009, http://www.reuters.com/article/newsOne/idUSTRE5790YM20090810 (accessed September 2009).
[10] Majority Staff of the Joint Economic Committee, *The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here*. Washington, DC, 2007, http://jec.senate.gov/archive/Documents/Reports/10.25.07OctoberSubprimeReport.pdf (accessed September 2009)
[11] Center for Responsible Lending, "A 36% APR cap on high-cost loans promotes financial recovery" (Durham, NC: Center for Responsible Lending, 2009), http://www.responsiblelending.org/payday-lending/policy-legislation/congress/payday-and-the-economy.pdf (accessed September 2009).
[12] Rakesh Kochhar, *Through Boom and Bust: Minorities, Immigrants and Homeownership* (Washington DC: Pew Hispanic Center, 2009).

The Consumer Financial Protection Agency (CFPA), proposed by the Obama administration and members of this committee, is the dominant policy proposal currently under consideration to address these issues. NCLR supports the creation of a new agency dedicated to consumer protection, product innovation, and equal access to financial markets. While some are pointing to recent actions by federal regulators as evidence that the necessary regulatory capacity exists, conflicts of interest prevent federal agencies from focusing expressly on the needs of consumers, especially those of color. Federal regulators missed key trends impacting Latinos and all consumers, acting only when it was too late to stop an implosion of the credit market. That said, the CFPA must be established with the authority, jurisdiction, and funding necessary to carry out to accomplish its mission. As laid out in the discussion draft of the "Consumer Financial Protection Act of 2009,"[13] the agency stands to improve market oversight in critical ways. Other aspects, however, still require strengthening.

As this committee moves forward with its deliberations, we urge you to retain the following aspects of the discussion draft:

- **Elevation of fair lending laws.** As described above, many Latino consumers were steered into subprime loans, even when they had high incomes and good credit. Had federal regulators better enforced fair lending laws, many such tactics would have been eliminated. The discussion draft authorizes CFPA to assume responsibility for overseeing the financial industry's compliance with fair lending laws currently under the jurisdiction of the federal regulators. It also explicitly incorporates civil rights into the agency's mission, as well as its structure, by establishing an Office of Fair Lending and Equal Opportunity. These additions elevate the enforcement of fair lending as a major priority within the agency. We urge lawmakers to go one step further in tasking CFPA with identifying trends and practices that have disparate impact on minority and underserved populations, and taking the steps necessary to curb such behavior.

- **Strong supervision and consumer protection rule-writing ability.** In the most recent draft, CFPA has been granted robust rule-writing authority that will allow it to consolidate enforcement of consumer protection laws and better protect financial services consumers. It also provides the agency with an independent Executive Director, which will allow the agency to stay objective in its assessments of the market. Moreover, rules issued by CFPA will not preempt stronger laws elsewhere, ensuring that no borrowers lose protection as a result of CFPA action. These provisions should not be weakened.

In addition to these provisions, NCLR has also been working closely with members of the committee to lay the groundwork for greater access to financial advice. Timely advice and information is critical to improving the way consumers make decisions, promoting wealth-building and preventing cycles of debt. It is not enough for CFPA to develop passive and generic materials. Instead, they must actively promote the delivery of financial counseling from trained professionals to families that need it most.

[13] Available at http://www.house.gov/apps/list/press/financialsvcs_dem/discussion_draft_of_cfpa_bill_092509.pdf (accessed September 28, 2009).

CFPA could be a strong vehicle for improving the way financial markets serve their Latino clients. However, more could be done to ensure that this new agency can fully accomplish its goals. NCLR strongly encourages Congress to strengthen or reinstate key provisions to guarantee that Hispanic consumers are well-served. Specifically:

- **Improve access to simple, prime credit products.** Ensuring that one can obtain the most favorable credit product and terms for which one qualifies should be a principal goal of federal efforts to reform financial oversight. Provisions that would have required financial institutions and entities to offer basic, straightforward car and home loans or credit cards have been removed. This leaves a gaping hole in protections for households that struggle to connect to the most favorable products for which they qualify. CFPA must be able to promote and advance simple, standard products in the marketplace. This includes fostering innovation in product development to meet the needs of underserved communities. Borrowers should be qualified against that product first and opt for other products as necessary based on niche needs or qualifications.

- **Eliminate loopholes for those that broker financing and credit bureaus.** Cut off or underserved by many retail outlets, borrowers of color or those with modest incomes often rely on finance brokers to help them find a loan. Financing offered by auto dealerships, mortgage brokers, or real estate agents are major sources of credit that demand greater attention and oversight. Many of the worst abuses in the auto and home loan markets were at the hands of brokers and dealers. As those closest to the transaction, dealers, brokers, and agents have an extraordinary responsibility and opportunity to ensure that credit deals are fair and fitting to the borrower's circumstances. Moreover, an exemption was also made for credit bureaus. While not direct lenders, the practices of credit bureaus directly impact the quantity and quality of credit that flows to consumers. For example, credit bureaus set rules around the manner in which credit scores are calculated. Also, by making their data available to certain vendors, creditors are able to shop for consumers, limiting the information and offers made available to all. Real estate agents, brokers, auto dealers, and credit bureaus should not escape greater accountability. Committee members should ensure that they are within the jurisdiction of CFPA.

- **Reinstate community-level assessment in CFPA.** CFPA must be able to assess product offerings at a community and regional level. Without such an assessment, favorable credit products may be developed but will remain unavailable in entire neighborhoods. Subprime lenders, creditors, and fringe financial providers often target entire neighborhoods based on the demographics of the area. Their efforts are often successful because those offering more favorable products are physically absent or do not cater to the needs of local residents. With CRA removed from the jurisdiction of CFPA, there is no mechanism for promoting access to credit and eliminating abuses at the community level. To be successful, CFPA must be able to assess the delivery of products at the community level, as well as the products and industries themselves. Including CRA in the CFPA will give the agency the authority necessary to make such an assessment.

Conclusion

Poor oversight and market inefficiencies have diverted untold sums of hard-earned income and savings away from households. Rather than waste money, a sound financial market should provide opportunities to achieve financial security. NCLR supports the committee's efforts to improve market oversight and accountability with this shared goal in mind. As one of the hardest-hit communities by the current recession, Latinos stand to benefit from an improved market where credit is more equitably distributed. We support the concept of a strong, independent CFPA that can serve as a consumer watchdog and level the playing field for those of modest means. We also look forward to working with the committee and other policymakers on further reforms of the financial oversight system and credit markets.