



## Neighborhood Economic Development Advocacy Project

73 Spring Street, Suite 506, New York, NY 10012  
Tel: (212) 680-5100 Fax: (212) 680-5104  
www.nedap.org

### STATEMENT OF JOSH ZINNER, CO-DIRECTOR, NEDAP

## **HEARING ON RESIDENTIAL MORTGAGE FRAUD IN NEW YORK STATE**

### **NYS SENATE STANDING COMMITTEES ON BANKS AND CODES**

October 28, 2009

Thank you, Senators Foley and Schneiderman, and other members of the Standing Committees on Banks and Codes, for holding today's hearing and for inviting me to testify. I am the Co-Director of the Neighborhood Economic Development Advocacy Project, known as NEDAP. NEDAP is a non-profit resource and advocacy center that works with community groups in New York City and State to promote economic justice and to eliminate discriminatory economic practices that harm communities and perpetuate inequality and poverty.

NEDAP has been at the forefront of fighting abusive lending in New York City and State since the mid-1990s, using a variety of strategies, including policy advocacy, community education and outreach, coalition organizing, technical support and capacity-building, and research and documentation. NEDAP convenes the New York City Anti-Predatory Lending Task Force, the Immigrant Financial Justice Network, and New Yorkers for Responsible Lending (NYRL), a state-wide coalition of 147 affordable housing, senior, consumer, civil rights, legal services, and mortgage counseling groups, as well as community development financial institutions, dedicated to combating predatory lending. My own experience with this issue began with my prior job, where I served for nearly a decade as the Director of the Foreclosure Prevention Project at South Brooklyn Legal Services, where we assisted hundreds of lower income homeowners facing foreclosure as a result of abusive lending practices.

Unfortunately, abusive lending is not a new phenomenon in New York City. Particularly since the mid-1990s, when the expanded securitization of subprime mortgages provided easy liquidity to the subprime market, subprime lenders targeted low and moderate income neighborhoods of color with an array of abusive mortgage products.

### **Refinance abuse and fraud**

A common characteristic of many of the high-cost loans has been their lack of affordability at the time of origination. In the refinance market, loan flipping—or repeated refinancing of loans with little benefit to the borrower – has been rampant, as have the packing of hidden fees and costs, and widespread misrepresentation by brokers and lenders about the true terms of a loan.

Borrowers have been routinely steered to higher cost subprime loan products – particularly on the basis of race-- when they otherwise should have qualified for a lower cost loan. Yield spread premiums – or bonuses paid directly by lenders to mortgage brokers to reward the broker for placing the borrower in a higher-cost loan than the borrower otherwise would have qualified for – create a perverse incentive to gouge borrowers, and have been a particularly egregious abuse. Reportedly,

yield spread premiums have also more recently emerged in the reverse mortgage market, setting up seniors for unnecessarily expensive reverse mortgage products that strip equity from the home but do not provide an additional benefit.

Earlier this decade, lenders flooded the refinance market with non-traditional mortgage loans – such as 2/28 adjustable rate mortgages (ARMs), Payment Option ARMs, no-doc or low-doc mortgages, that are highly profitable for the industry, difficult for borrowers to understand, and based on dubious underwriting standards. The use of no-doc loans by brokers and lenders to fraudulently inflate borrowers' income was extremely widespread.

Brokers and lenders also fraudulently and aggressively marketed Payment Option ARMs to unsuspecting homeowners, promising low monthly payments and low rates while deceptively hiding the fact that the low payments were merely minimum payments, that the balance due would escalate even as payments were made, and that the inevitable payment shock when the loan recast would force the borrower into default.

Another, more recent pattern of refinance fraud has surfaced in which brokers are inducing unsuspecting borrowers to enter into financing deals as an "LLC" for the purpose of making the deal look like a business transaction, thus avoiding the purview of state and federal laws designed to protect residential homeowners.

### **Fraud in the home purchase market**

Unscrupulous speculators also relied on lax underwriting standards in the industry to induce first-time, working poor homeowners into purchasing intentionally over-appraised properties in poor condition – a practice known as property flipping. Property flipping schemes were often operated through "one-stop shops", which market the American dream and lure first-time homebuyers in with a promise to help with all aspects of the home buying transaction. Many of the first-time homebuyers targeted in these schemes ended up with unaffordable mortgages, and lost their only shot at homeownership. The parties to the fraud walked away with big profits after selling the unaffordable loans into the secondary market.

For several years, many of these abusive home purchase transactions were financed by FHA loans (loans guaranteed by the Federal Housing Administration). There have been many problems through the years with lax oversight of the FHA program by HUD – as a result, numerous abusive lenders were licensed to lend through the FHA program, enabling them to make risky and unaffordable loans guaranteed by the government, and, ultimately, the taxpayers. At the time, FHA loans were only allowed on home purchase loans, so that there were no refinancing abuses through FHA.

Around 2003, the one-stop shops started financing abusive home purchase deals in huge volume through "piggy-back", or 80/15 mortgages. These high-interest piggyback mortgages were made in lieu of down-payments, and disguised the fact that the financing was completely unaffordable to the borrower. The piggyback mortgages were then sold off to investment banks and securitized. The piggyback mortgages are causing huge problems now in NYC, as they are almost universally in default and greatly complicate efforts to prevent foreclosure on already unaffordable first mortgages.

## **Civil rights implications of mortgage fraud**

Abusive and fraudulent lending has been and still is a civil rights issue in New York City and throughout the State. The same New York City communities with the highest concentration of homes owned by people of color that mainstream lenders historically subjected to redlining – such as Bedford Stuyvesant, Flatbush, and East New York in Brooklyn, and Jamaica, St. Albans, and Springfield Gardens in Southeast Queens – have now been subject to “reverse redlining,” where higher cost and abusive loans are heavily marketed. The resultant high rates of foreclosure have significantly destabilized these neighborhoods.

Lenders have used these loans to strip hundreds of millions of dollars in equity from homeowners and communities of color. Many seniors and families who had owned their homes for generations lost all of their equity and were forced out of their communities. The unaffordable loans that have resulted from property flipping schemes have deprived huge numbers of young, working class families of color of any chance of viable homeownership. Lenders have widely steered people of color with decent credit histories into higher cost loans simply on the basis of race, propelling them into a cycle of debt and foreclosure. The attached map, produced by NEDAP, shows the extent to which lenders have concentrated high-cost subprime loans in communities of color, and the extent to which these loans have led to high numbers of foreclosures. This discriminatory targeting makes the massive abuses in the subprime market even more egregious.

Although the subprime industry has touted itself as having provided expanded homeownership opportunities, it is abundantly clear that the explosion of irresponsible subprime lending has led to diminished homeownership opportunities. This is especially true since the bulk of unsustainable subprime loans have been in the refinance market, where already existing homeowners have been induced into loans that put their homes at risk.

## **The secondary market and Wall Street responsibility for mortgage fraud**

Wall Street investment banks shoulder a huge responsibility for the subprime fiasco. Without the easy liquidity provided by the securitization process, mortgage lenders could not have continued to originate such a high volume of unaffordable, unsustainable, and fraudulent loans. The securitization of subprime loans became so highly profitable, that investment banks aggressively marketed exotic and non-traditional products to the mortgage lenders, urging them to make a higher dollar volume of loans regardless of sustainability.

There was no incentive at any level of the process to make responsible and sustainable loans to borrowers—in fact, fraud was heavily incentivized. Mortgage brokers got their fee up front regardless of affordability, lenders were guaranteed a secondary market for unaffordable loans, and the Wall Street underwriters of the securitization trusts made a killing bundling the loans and selling various creative slices of the trusts to investors. The ready accessibility of bond insurance, and the consequent AAA rating from the ratings agencies, ensured that everyone profited, except the working poor and working class homeowners themselves, who were left holding the bag. There was virtually no accountability in the process, due to a serious lack of oversight by federal banking regulators. There was certainly never any consideration in this process for the plight of borrowers – the mortgages which put so many families at risk were seen as little more than commodities to be traded and profited from.

## **Is there currently a secondary market for abusive subprime mortgages?**

When the securitization of subprime mortgages largely crashed in the middle of 2007, it made it difficult for the most abusive lenders to sell junk mortgages into the secondary market, and many went bankrupt. Today, the subprime market has largely shifted to FHA loans, which can still be sold into the secondary market because they are government-insured. Last year, in an attempt to open up the mortgage markets and address the foreclosure crisis, Congress authorized the FHA program to insure refinance loans as well as home purchase loans. While this makes sense as a matter of public policy, it also creates a great risk of abusive refinance lending within the FHA program.

This risk is exacerbated by the fact that the FHA has granted licenses to a number of lenders with a history of questionable lending practices. HUD must be aggressive going forward in its enforcement of violations in the FHA program – HUD’s recent action against Lend America, one of the worst of the abusive FHA lenders, is encouraging. It is also important for authorities to be vigilant about false advertising by FHA lenders, as many unscrupulous lenders have advertised their FHA lending as somehow “government sanctioned”, leading borrowers to believe that they can per se trust the lender and the loan.

It is too early to tell if the FHA refinance loans originated since the FHA program expanded last year are rife with fraud or if they will lead to high rates of default and foreclosure. We are hopeful that Banking Law 6-m, passed last year, will help reduce abusive practices in the subprime market.

## **Criminal enforcement**

It is also too early to tell if Penal Law Article 187 has had a positive effect in curbing mortgage fraud. When I was at South Brooklyn Legal Services, during the worst of the subprime lending abuses of the late 1990’s and through 2007, the District Attorney in Kings County did far too little to address mortgage fraud. For much of that time, there was half of an attorney devoted to prosecuting mortgage and real estate fraud cases for all of Kings County, despite the massive wave of fraud sweeping the borough -- the lack of criminal enforcement against egregious mortgage fraud reinforced the lack of accountability that helped fuel this wave. Those cases which were prosecuted were often prosecuted as a fraud against investors rather than homeowners. My understanding was that the other NYC DA offices had a similar record during the worst of the crisis. There is clearly a need for more aggressive prosecution of mortgage and real estate fraud by the District Attorneys on behalf of low and moderate income homeowners. Hopefully the new law will help spur these aggressive prosecutions; the results have yet to be seen.

## **Needed amendments to Banking Law 6-m to prevent abusive lending practices**

Yield Spread Premiums should be banned. The approach taken in the current Banking Law 6-m, to require enhanced disclosures for subprime YSPs, is clearly insufficient.

As FDIC Chair Sheila Bair wrote in an April 7, 2008 letter to Federal Reserve Chairman Ben Bernanke, “the FDIC recommends that the FRB prohibit the use of YSPs to compensate mortgage brokers...Disclosures alone will not address the fundamental problem with YSPs, which is that they provide an inappropriate financial incentive for mortgage brokers to steer consumers to unaffordable loans.” As Bair adds in the same letter, “there are ample alternative means of compensation available, such as flat fees or fees based on the total principal amount of the mortgage, which would not present skewed incentives to increase borrower costs and which would be much more transparent

and understandable to borrowers.” Banking Law 6-m should be amended to ban YSPs for all subprime loans.

Steering should be specifically prohibited. Steering unfairly and discriminatorily traps people of color in a cycle of high cost debt, and has devastating effects on neighborhoods of color. “Steering, counseling, or directing a consumer to rates, charges, principal amount, or prepayment terms that are more expensive than that for which the consumer qualifies”, should be expressly prohibited under New York law.

“Non-traditional” loans, such as Payment Option ARMs, should be included in the threshold definition for Banking Law 6-m. Payment Option ARMs and other non-traditional products with exploding costs are inherently confusing and abusively marketed, and will continue to lead to high foreclosure rates for years to come. They should be covered by the provisions of Banking Law 6-m as a matter of law.

Remedies under Banking Law 6-m should be strengthened to include statutory damages. Stronger remedies create a stronger deterrent against abusive lending practices.

### **Foreclosure rescue scams and loopholes in the “distressed property consultant” law**

Distressed property consultants, or for-profit loan modification companies, continue to widely exploit desperate and vulnerable homeowners by aggressively and deceptively soliciting borrowers facing foreclosure, and charging several thousand dollars up front with the promise of help with mortgage relief, only to take the cash and provide little or no services. Worse, they are taking this badly needed cash for services that can be performed for free and with much higher quality through a non-profit loan counselor. These abusive practices are being particularly targeted at people of color in NYC, and are greatly exacerbating the foreclosure problem. These loan modification companies heavily use false and deceptive advertising, promising to stop foreclosure and sometimes pretending to work in conjunction with various government programs or agencies. *See the attached loan modification solicitation as an example.*

The law on distressed property consultants, passed as part of Chapter 472 of the Laws of 2008, is a positive step, prohibiting up-front fees and requiring transparency. However, there are two big loopholes in the law, for mortgage brokers and attorneys; unfortunately, loan modification scammers are using these loopholes to skirt the provisions of the law. As an example, I was recently contacted by a legal services lawyer who was desperately trying to help a client vacate a foreclosure sale. The client had given money to a distressed property consultant to assist her when she was a few months behind on her mortgage. Her situation was resolvable at the time, and she would likely be out of foreclosure had she contacted a non-profit agency. Instead, unbeknownst to her, her property was just sold in foreclosure -- the loan modification company, despite taking \$3,000 from her up front, did nothing to assist her or even warn her of the foreclosure sale. The company that ripped her off and caused her to lose her home did not have to comply with the state law, because there was an attorney “fronting” for the company.

There is no reason why mortgage brokers should be exempted from the provisions of the law, and attorneys must only be exempted when they are negotiating a loan modification in the course of legal representation. These loopholes in the distressed property consultant law must be closed.

The Home Equity Theft Prevention Act, passed in 2006, has helped to reduce the number of “deed theft scams” that were rampant during the earlier part of this decade. In this scheme, speculators

sought out desperate homeowners facing foreclosure, tricked them out of their deeds with promises to help stop the foreclosure, and then cashed out with a big refinance loan and walked away. These scams have also been reduced due to the lack of easy financing to cash out. However, because these practices were so widespread, legal services offices still have numerous clients who were targeted for these scams and are struggling to get their house back.

### **Servicing issues**

The flip side of fraudulent and abusive lending has been high rates of foreclosure filings, and problems with the servicing industry have greatly exacerbated the foreclosure crisis. The securitization structure has given servicers a disincentive to work with borrowers and seek sustainable loan modifications. It costs servicers money to complete a loan modification (as cited in *Inside B & C Lending*), while servicers receive fees for foreclosures. Furthermore, servicers are supposed to act in the best interest of investors, but given the numerous tiers of investors for each securitization pool, it is often unclear whether that best interest would favor foreclosure or modification. Servicers have therefore resisted modifications and pushed foreclosures, even where modification would appear to be in the best interest of investors. The culture at the mortgage servicers has also been a problem, as the servicers made a lot of money aggressively collecting from borrowers and gouging borrowers for fees, rather than working with borrowers on a common sense solution.

Leading up to the Obama Administration's Home Affordable Modification Program (HAMP), the mortgage servicers, including the big banks that received billions of dollars of TARP money from taxpayers, were simply not offering affordable loan modifications to borrowers in most instances. Servicing abuses have included lengthy waiting periods, inaction, pyramiding of fees, the arbitrary denial of modifications, and the offering of unaffordable forbearance agreements with high up front payments required.

Although HAMP, which went into effect this Spring, has many shortcomings, it does present an opportunity to change the dynamic with loan modifications. Early results have been somewhat disappointing, with advocates finding that many of the participating servicers have not adequately trained staff about the program; are misinterpreting how the program should work; are failing to convert trial modifications to permanent modifications, and are arbitrarily denying applications for modifications under the program.

Under last year's Laws of New York, Chapter 472, the Banking Department was given the authority to regulate mortgage servicers. The Banking Department is currently working on that piece of the regulations that would regulate abusive practices by servicers and improve accountability; we hope that the final regulations that the Banking Department introduces are strong and enforceable.

Additionally, the Senate should introduce legislation that would regulate mortgage servicing abuses along the following principles:

#### **Servicer duties**

- Duty to act with good faith and fair dealing in any transaction, practice, or course of business associated with mortgage servicing.
- Duty to safeguard and account for any money handled for the borrower.
- Duty to follow reasonable and lawful instructions from the borrower.
- Duty to act with reasonable skill, care, and diligence.

- General duty of loss mitigation which includes a duty to make a good faith effort to negotiate with a borrower to resolve a delinquency or default, including by following the federal HAMP program, if applicable.

#### Prohibited practices and servicing standards

- General prohibition on fees that are not reasonable, bona fide, are not for services actually rendered, or are not previously disclosed according to reporting requirements.
- Regulation of late fees, specifically:
  - No late fees unless: specifically authorized by loan documents; the payment is more than 15 days past due; and the charge is not more than 5% of the late payment.
  - Payments received should be applied first to current installments, then to delinquent payments, and only then to late fees.
  - No late fee may be charged where a payment made is a full payment for the period, and the only insufficiency in payment is due to a late fee charged on an earlier payment (i.e.—no “pyramiding” of late fees).
- No fees for payoff statements, and payoff statements must be provided within three days of borrower request.
- Timely and proper crediting of payment – each payment received by the servicer should be accepted and credited on the date received, and should be credited toward interest and principal before being credited toward taxes, insurance, or fees.
- Servicer must promptly notify borrower if application is incomplete or requires supplemental information/documentation.
- Servicer must make decision on loan modification application within 30 calendar days of full submission of application.
- Where proposed monthly payment of workout is more than the pre-default payment, servicer must document that the workout payment is affordable based on documentation of the borrower’s income.
- No waivers of legal claims or defenses as condition for workout, unless the workout results in a loan modification that is affordable over the term of the loan.
- Prohibition on fees (or limitation on fees) for processing workout application, unless the workout results in a loan modification that is affordable over the term of the loan.
- Borrower only liable for attorney fees that are reasonable and actually incurred by the creditor, based on a reasonable hourly rate and number of hours.
- Escrow: servicer must disclose any payments from escrow account clearly and conspicuously to borrower on monthly statement, and must make all payments from escrow account for taxes, insurance, etc. in a timely manner.
- Force-placed insurance – servicer must provide written notice to a borrower upon placing force-placed insurance on the property, and must provide a refund for unearned premiums charged to a borrower if the borrower provides proof that the borrower has obtained coverage.
- Servicer must stay the foreclosure proceeding during the pendency of the loss mitigation application.

#### Servicer disclosure obligations to all borrowers

- Provide schedule of fees (annually or at least 30 days prior to any revision in the schedule).
- Provide copy of servicer manual (including any revisions thereof).

- Provide information on ownership of the mortgage and note (including notice of any transfer or assignment within 30 days of such transfer or assignment).
- Provide notice that the servicer is licensed, with information about how borrower can file a complaint about the servicer with the Banking Department.

#### Servicer disclosure obligations to borrowers in default

- Provide clear written explanation of loss mitigation protocols within 30 calendar days of request of borrower or authorized representative.
- Provide plain-language payment history within 30 calendar days of request of borrower or authorized representative.
- Provide written, itemized payoff quote with notice of default and with every subsequent communication from servicer to borrower.
- Disclose default interest rate in notice of default.

#### Record-keeping/reporting obligations to Banking Department

- Complete and current schedule of fees servicer charges borrowers, including attorney's fees (updated upon any revision).
- Servicer manual (updated upon any revision).
- Loss mitigation protocols (updated upon any revision).
- Quarterly data provided, including zip codes:
  - Number and types of mortgages being serviced
  - Number/percentages of serviced mortgages in default (including 30-, 60-, and 90-day delinquencies, and defaults up to 3 months, 3-6 months, more than 6 months, etc.)
  - Number/percentages of serviced mortgages in foreclosure
  - Loss mitigation details including number and type of modifications, and workouts effected (data on type of modifications should include whether there was interest rate reduction, principal reduction, principal deferral, extension of term, etc.); number of short sales (including amount of debt reduction)
  - Number of judgments of foreclosure and foreclosure sales
  - Number of REO properties held
- Records should be retained by servicers for three years after payoff, transfer of servicing rights, or foreclosure.
- Data and other reports should be publicly available.

#### Penalties

- Material violations should result in imposition of civil penalty (under North Carolina servicing statute, civil penalty is \$10,000 per violation).
- Servicers should be liable to borrowers for actual and statutory damages for material violations.

### **Foreclosure Settlement Conferences**

While the provisions in Chapter 472 for settlement conferences in certain foreclosure actions provides an unprecedented opportunity for homeowners to engage in court-sponsored negotiations with their mortgage servicer, there are a number of problems with the law itself and how the conferences are being implemented.

It is essential that servicers' representatives come to settlement conferences with the authority to settle, and that servicers negotiate in good faith. It is clear that many mortgage servicers are not making a good faith attempt to reach a constructive resolution. Contrary to the plain language in the law, servicers are not appearing with authority to settle cases. Servicers appear by their foreclosure counsel or, even worse, by "per diem" attorneys, both of whom typically have little information about the case, let alone actual settlement authority. This repeatedly leads to adjournments of the settlement conferences, even where there is a specific modification proposal that should be discussed at the settlement conference table. As a result, critical opportunities to resolve foreclosure cases through the settlement conference process are being wasted.

Courts must take a more proactive role in promoting settlement. Many of the courts are failing to take an active role and strongly encourage negotiations in foreclosure settlement conferences. This is in contrast to court-supervised settlement negotiations in other types of litigation, where judges often take an active role in pushing the parties to bridge their differences to settle. Borrowers have little leverage in the settlement conference process when the courts fail to exert any pressure on servicers to settle. The failure of some courts to strongly encourage good faith negotiation at the foreclosure settlement conference table represents a serious missed opportunity, particularly as the Obama Administration's foreclosure prevention plan presents unprecedented possibilities for mortgage servicers to make affordable loan modifications on a large scale. In general, courts must demand that the parties come prepared to negotiate a settlement and must themselves actively participate in discussions. If courts are not engaged in the process, servicers will view these conferences as nothing more than another procedural hurdle in the foreclosure process.

Servicers must bring key documents to the settlement conference table. In order to qualify for a loan modification, borrowers are expected to provide detailed information about their current financial circumstances and reason for defaulting. Servicers, however, are refusing to provide even basic and essential information about a loan, including the payment history and loan documents. Without a detailed payment history it is impossible to verify whether the homeowner actually owes the amount claimed by the servicer. Homeowners should not be expected to enter into modification agreements without information about what fees were charged to their account and verification that payments made were accurately credited. Courts must require that both parties, and not just borrowers, provide documents necessary to resolve the case.

The underlying foreclosure case should be stayed during the settlement conference, and servicers should not be permitted to file motions until the conference is concluded. Courts are not consistently staying the underlying foreclosure cases while settlement conferences are pending. Also, in many foreclosure cases, servicers are filing motions before settlement conferences are held, substantially increasing attorneys fees. These attorneys fees typically must then be paid by the borrower and are added onto any amount that the borrower must pay in order to get a loan modification, thus making cases more difficult and costly to resolve. The settlement conferences were designed to bring the parties together early in the foreclosure process to determine if a case could be resolved without costly litigation. This process is undermined if foreclosure actions are not stayed during the pendency of the settlement conference.

The following statutory changes are needed to improve the settlement conference process:

- Extend the 90-day notice requirement and the mandatory settlement conference process to all home loans (owner-occupied).
- Require the parties to make good faith efforts to settle, including by following the new federal HAMP guidelines, where applicable.

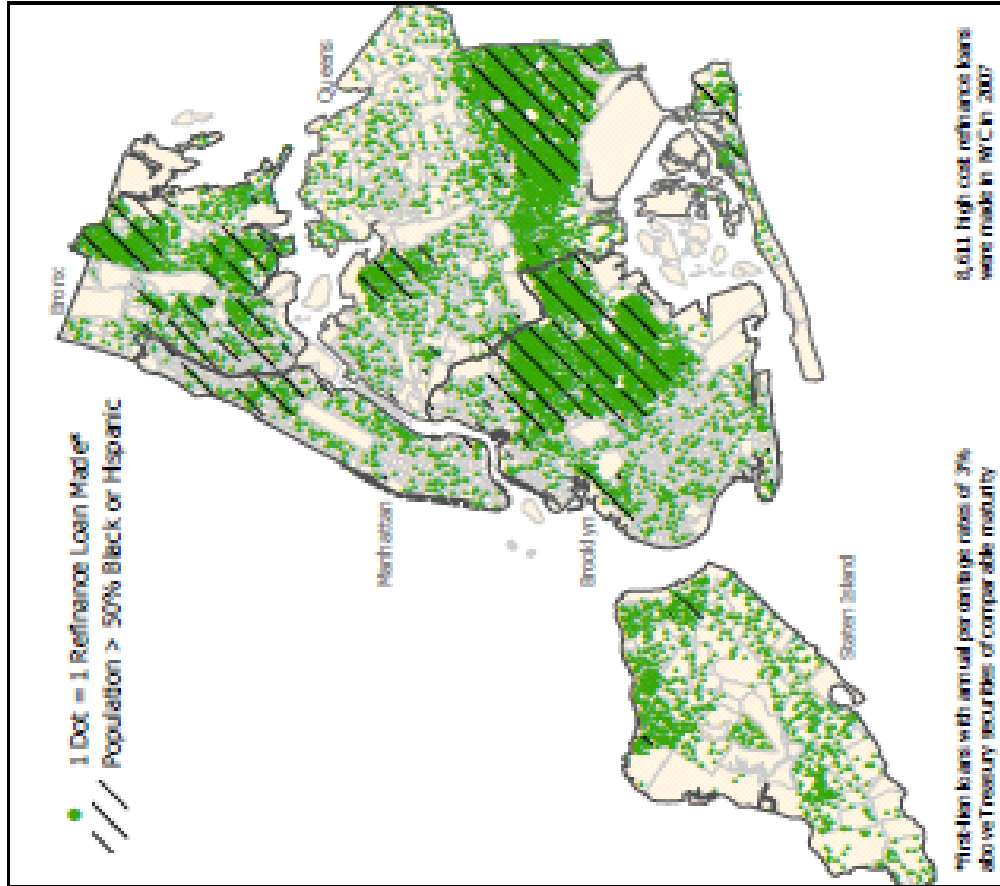
- Enable the court to mark foreclosure cases off the calendar, and, ultimately, dismiss without prejudice, if plaintiff/ servicer fails to negotiate in good faith and/or fails to send someone to the conference with authority to settle.
- Preclude plaintiffs from filing a summary judgment motion or motion for an order of reference until completion of the conference, including any adjourned dates.
- Require plaintiffs to bring critical documents to the conference, including the payment history and loan documents.
- Require courts to provide reports to the Office of Court Administration (OCA) on the outcomes of the settlement conferences.

Thank you for the opportunity to testify. I hope you will strongly consider the recommendations above, which are critical to addressing mortgage fraud, halting abusive lending practices, and reducing foreclosures in New York.

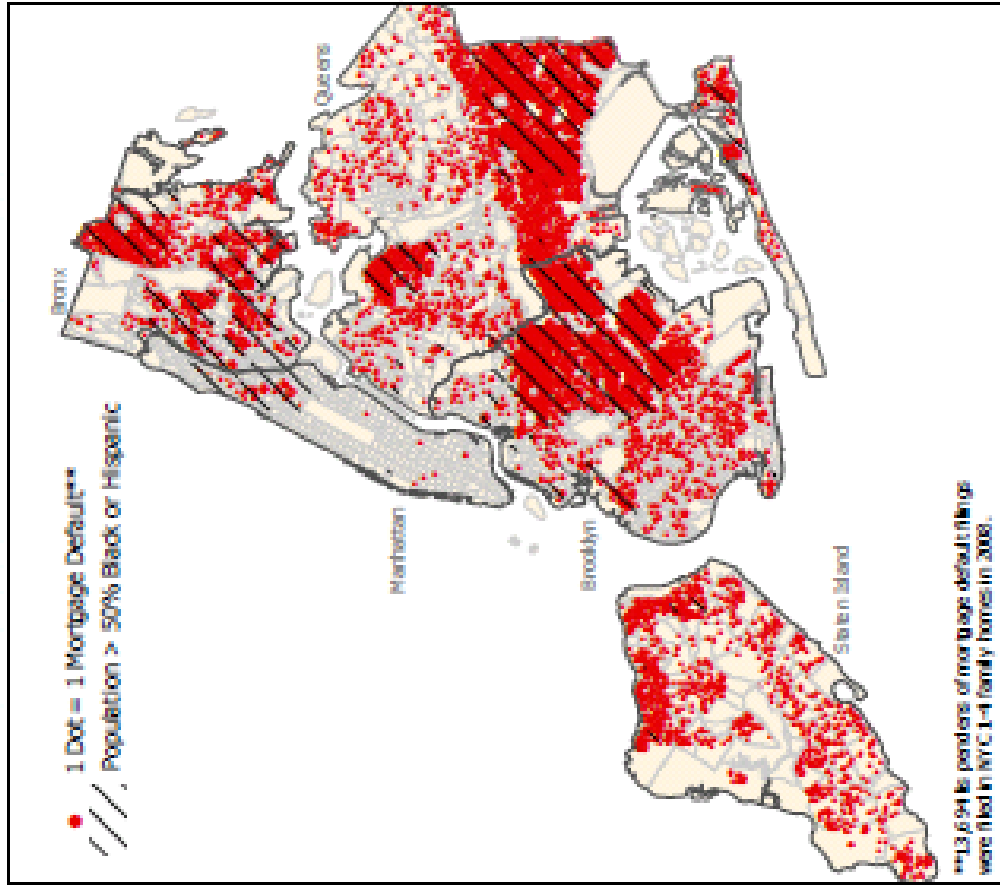


# NEW YORK CITY

## HIGH-COST REFINANCE LOANS MADE - 2007



## FORECLOSURE PATTERNS - 2008



**NEDAP** Neighborhood Economic Development  
 Advocacy Project (NEDAP)  
 (212) 680-5100 | [www.nedap.org](http://www.nedap.org)  
 ©2009-NEDAP Any unauthorized use of this material is prohibited.

Sources: HMDA (2007); Profiles Publications; U.S. Census (2000)