TESTIMONY OF JOHN TAYLOR

On Behalf of the National Community Reinvestment Coalition

Before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Financial Services Committee

United States House of Representatives

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Good morning Chairman Bachus, Representative Waters, and distinguished members of the Subcommittee on Financial Institutions and Consumer Credit. My name is John Taylor, and I am president and CEO of the National Community Reinvestment Coalition (NCRC). NCRC is a national trade association representing more than 700 community-based organizations and local public agencies who work daily to promote economic justice in America and to increase fair and equal access to credit, capital, and banking services to traditionally under-served populations in both urban and rural areas. NCRC has represented our nation's communities on the Federal Reserve Board's Consumer Advisory Council (CAC), Community Development Financial Institutions (CDFI) Advisory Board, Freddie Mac's Housing Advisory Council, Fannie Mae's Housing Impact Council and before the United States Congress.

On behalf NCRC, I thank you for the opportunity to testify before you here today on an important issue that will impact our nation's progress in extending the American Dream of homeownership to minority and low-and moderate-income families: banks becoming real estate brokers. NCRC's community organizations are at the helm driving the reinvestment movement. Today, as a result of fair lending laws like the Community Reinvestment Act (CRA), which turns 25 this year, poor neighborhoods have been empowered by bank partnerships with community organizations to address credit needs and missed market opportunities. As a result, the number of loans to minority and working class borrowers over the last decade has increased faster than the number of loans to more affluent borrowers.[1] Bank CRA commitments have grown from a few million dollars a year to over $50 billion annually.[2] Without these loans and commitments, the economic flow of private credit and capital into our communities would be extinct and hence, certain death for disinvested neighborhoods.

NCRC is very concerned about the ramifications of financial holding companies and national banks entering the real estate brokerage business. As you can imagine from the industries represented here today, you will hear varying perspectives on banks and real estate for consideration. I would like to emphasize that my testimony today will focus on three areas that will be affected if the banking and real estate industry are allowed to merge: competition, consumer protections and serving our communities.

Competition

NCRC has always maintained the position that competition is beneficial for the revitalization of communities. Healthy competition provides low-income and working families with more housing and lending options, and offers them alternatives to high-cost and abusive loans. However, in our rapidly shifting financial marketplace in which our largest banks now own subprime lenders and insurance agencies, we wonder whether product choice is increasing for our communities or whether financial conglomerates are steering consumers into costly and unnecessary products, often layering one product on top of another to maximize their profits.

Over a decade ago, banks had a corner on the mortgage lending business with an overwhelming 80 percent market share.[3] Today, however, is a different story. In 2001, the mortgage broker industry estimated that their market share has dramatically grown to 65 percent of all residential mortgage originations.[4] Does this mean that banks are hurting for mortgage business? Absolutely not. Instead of relying on loan officers, banks now depend upon mortgage brokers to make loans in minority and low- and moderate-income communities. And too often, banks do not engage in sufficient due diligence or do not require brokers to follow fair lending safeguards. The situation would deteriorate if banks now owned a fleet of brokerage companies that combined lending and real estate services.

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The arena of competition has dramatically shifted in the wake of Gramm-Leach-Bliley (GLB), which blurred the distinction among financial industries. In March of 2000, the Federal Reserve Board issued a list of the first 117 bank holding companies that elected to become financial holding companies to take advantage of the opportunities of entering into the insurance and securities markets. As of April 2002, over 600 bank holding companies have elected to become financial holding companies in order to diversify their businesses.[5] Conversely, less than a dozen non-bank firms have converted to financial holding companies for the purpose of seeking a banking charter.[6] Banks are also taking advantage of an ownership stake (less than a controlling interest) in a financial subsidiary, meaning they form partnerships with firms offering a plethora of financial services including: investment planning, estate planning, asset protection, retirement planning, income tax planning and preparation, and education planning.

To reiterate, NCRC supports competition in its truest sense – when parties act independently and offer the most favorable terms to secure business. But one must wonder if today's financial market upholds the true meaning of competition when it seems like GLB has allowed all roads to lead back to the bank. While non-bank lenders own real estate companies, they have not utilized GLB to amass the market power that banks now enjoy after their mad rush to become financial holding companies. Would adding real estate to the menu of businesses that banks can own level the playing field between banks and non-banks or only serve to make banks more powerful to the detriment of real competition in the financial industry?

NCRC maintains that the addition of real estate to the already dizzying array of products now offered by "financial supermarkets" will lead to even greater consolidation of bank market power and result in fewer choices for consumers. Our worst nightmare in a consolidated financial market that includes real estate brokerage is:

- A bank offers favorable loan terms to its real estate affiliate, giving it significant advantage over a competing real estate business that does not have an affiliate.
- The bank with the real estate affiliate stops offering loans to customers of non-affiliated real estate competitors.
- The number of product choices offered to customers of non-affiliated real estate businesses decreases, resulting in higher cost loans.

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During consideration of GLB, NCRC and other observers worried that the consolidation afforded under GLB would lead to only higher prices. That is why GLB commissioned the Department of Treasury to study the effects of mergers among banks, insurance companies, and securities firms on access to loan and bank products for low- and moderate-income communities. Treasury's study in January 2001 concluded that it was too early to assess the impact on cross-industry mergers.[7] NCRC urges Congress and the federal financial supervisory agencies to delay allowing banks to enter yet another industry, specifically the real estate industry, until the Treasury rigorously measures the impacts of GLB on affordability and accessibility of financial services.

When considering banks in real estate, policymakers have not adequately addressed the negative impacts on small real estate businesses of further industry consolidation. Women- and minority-owned small businesses have played a significant role in community revitalization. Many of these real estate entrepreneurs have established themselves in working class communities and dedicated their business to helping rebuild formerly redlined neighborhoods through partnerships with affordable homeownership programs.

According to the most recent Economic Census, over 375,000 small women- and minority-owned real estate businesses operate in this country, generating over $41 million in sales annually. The wealth generated by these new-markets businesses plays a vital role in building a solid foundation from which veritable community reinvestment will flourish. Local real estate brokers are more likely than financial conglomerates to bring wealth back into their community and enter into business relationships with other neighborhood enterprises. The financial independence of small businesses in local communities increases an individual's stake in the economic empowerment of a community and improves the collective well being of our society.

NCRC strongly takes that position that by allowing banks into the real estate business, small real estate businesses will be forced out of the marketplace by the monopolized "financial supermarkets." Gone will be the days in which an entrepreneur dreams of opening a specialized financial business to serve his or her neighborhood customers. Instead, small real estate businesses, insurance businesses and small investment companies will be forced to make a

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decision: forfeit their ownership and affiliate with a bank or face going under when a larger "financial supermarket" opens next door. Not only will our nation's communities hurt, our entire economy will suffer.

Consumer Protection

Existing Problems in the Lending, Insurance and Real Estate Markets

The next area I would like to address in regards to today's subject matter is consumer protection. Repeatedly, I have been told by industry representatives advocating for banks in real estate that cross-ownership within these markets will benefit the consumer by offering greater choice, greater convenience and lower costs. NCRC, as a leader in fighting predatory lending, takes the issue of "benefiting the consumer" very seriously. Last summer, NCRC testified before the full committee during the two-day hearings on predatory mortgage lending practices about the plague of abusive lending and equity stripping from communities of color. Lenders are not alone at the receiving end of NCRC criticism. Our membership organizations who are entrenched in the front lines of protecting homeowners, also battle insurance redlining and unscrupulous real estate "property flippers." In testifying before you today, I must be honest to NCRC's mission of economic justice and state emphatically that injustice exists in the banking, insurance and real estate industries. Until the problems are solved to protect borrowers and consumers, these markets should not be commingled.

According to the Department of Housing and Urban Development's (HUD) just released report *Black and White Disparities in Subprime Mortgage Refinance Lending*, subprime refinance mortgages accounted for 36.3 percent of total refinance mortgages in low-income neighborhoods compared to 23.8 percent of total refinance lending nationwide in 2000.[8] Borrowers in prominently African-American low-income neighborhoods were 1.5 times more likely in 2000 to refinance with a subprime lender than borrowers in all low-income neighborhoods. Borrowers in upper-income African-American neighborhoods were 2.9 times more likely to refinance with a subrpime lender than borrowers in upper income neighborhoods overall.

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NCRC research has found similar disparities. For example, major subprime and manufactured home lenders made 47 percent of the refinance loans in predominantly African-American and Hispanic neighborhoods in the District of Columbia in 2000, a significant increase from 39 percent of the loans in 1999 and 25 percent of the loans in 1994. In contrast, subprime and manufactured home lenders made less than 4 percent of the loans in predominantly white neighborhoods in the three years of the study.

Substantial evidence suggests that subprime borrowers in minority communities experience price discrimination. Over the last several years, Home Mortgage Disclosure Act (HMDA) data has indicated that African-American applicants are denied twice as often as whites. NCRC believes that it does not necessarily follow that African-American are twice as likely to have bad credit. And given that African-Americans are denied twice as often for conventional loans as whites, it does not follow that minority communities should be five times as likely to receive subprime loans as documented in an earlier HUD study.[9] In some geographical areas, the disparity is much greater than five to one.

The major secondary market institutions have found pricing inefficiencies in subprime loans. Freddie Mac states that up to 30 percent of subprime borrowers were creditworthy for prime loans. Fannie Mae's CEO, Franklin Raines, is quoted as saying that half of all subprime borrowers could have received prime loans.[10]

A study by the Research Institute for Housing America (RIHA) concludes that minority borrowers are more likely to receive subprime loans after controlling for credit risk factors.[11] RIHA cautions against a conclusion that price discrimination alone explains this since minority borrowers may have different techniques of searching for lenders. However, considering the totality of the research by NCRC, HUD, Fannie Mae, Freddie Mac, RIHA, and others, it seems fair to say that the burden of proof lies with those who assert that discrimination does not occur in the subprime market.

The issue of insurance redlining is also a problem, but unlike home mortgage lending, insurance data is limited to only a handful of states. Since 1995, California has required insurance

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companies to file data indicating the race and gender of policyholders, the number of policies sold and cancelled, and location of offices and agents, all sorted by ZIP code. Working with the California Department of Insurance, consumer advocate Birny Birnbaum of the Center for Economic Justice (CEJ) obtained data that show disparities between the rate at which insurance companies write policies in low-income communities and the rate at which policies are written in middle- to upper-income communities. For example, in 1995, CEJ reported that approximately 16 percent of California's population lived in underserved communities; however, the data reported by State Farm revealed the company had only 2.59 percent of its agents in those communities.[12] CEJ further concluded that the average insurer wrote only 5.57 percent of its private passenger automobile liability policies and only 6.62 percent of its homeowners policies in low-income, minority ZIP codes.

State Farm, one of the nation's largest insurance companies, is also a federally chartered thrift. As such, it offers a full range of banking services, including taking deposits and making various types of home mortgage, auto and home equity loans, in addition to full range investment products. Interestingly enough, one month ago, State Farm, California's largest insurer of homes, indicated it has stopped writing new homeowner policies in the state due to a surge in the amount of claims over the last two years.[13] If lawmakers add real estate services to the roster of State Farm products, would this only increase the clout of State Farm and other giants? Would conglomerates turn product flow "on" or "off" in order to obtain concessions from regulatory agencies in states dependent upon their services?

As I mentioned, the real estate market is not without its unscrupulous actors either. Property flipping involves buying a home at a low price and then reselling it at fraudulently inflated price within a short time frame, often after making only cosmetic improvements to the property. NCRC has seen the following practices employed in property flipping schemes:

- Real estate investors continually buying neglected properties at sheriff sales and reselling homes at escalated prices to unsophisticated first-time homebuyers;
- Using real estate agents, licensed and non-licensed individuals, as a front;
- Targeting immigrant communities, particularly non-English speaking individuals;
- Colluding with property appraisers to inflate property value;

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- Colluding with home inspectors to secure clean reports; and
- Tricking homeowners into thinking they are dealing with legitimate real estate companies.

In 2000, the Department of Housing and Urban Affairs' Inspector General (IG) testified about the rampant flipping rings the agency was combating.[14] One investigation alone uncovered over 1,200 flipped loans totaling approximately $160 million. Twenty-five percent of the loans were in default. The IG indicated that approximately 100 representatives of lending and real estate industries colluded on this scheme. Another IG flipping investigation involved a HUD employee who conspired with a real estate agent to carry out a systematic scheme of selling HUD-owned properties at prices far below HUD's listed price. The FHA Insurance Fund lost several million dollars as a result of this scam. If Congress allows banks and real estate firms to combine without strengthening the consumer protection laws, our communities are more likely to be victims of scams than beneficiaries of greater product choice and lower prices.

Consumer Choice

As I previously mentioned NCRC was vocal during the consideration of Gramm-Leach-Bliley about the potential of banks product packing without regard of true customer needs.[15] Banks are not shy about advertising their cross-marketing strategy: targeting an existing customer is easier and more profitable than acquiring a new one.

The Bank Holding Company Act, as amended, prohibits a bank from extending or varying the consideration for credit on the condition that the customer obtain any other non-banking product from the bank holding company or any other subsidiary of the bank holding company. This prevents a bank from offering a reduced interest rate on a loan that may be used only to purchase products made or sold by an affiliate of the bank. However, the statute provides exceptions and exemptions that "financial supermarkets" can take advantage of when cross-selling their products.

Another problem for unsophisticated banking consumers is the perception that approval of their loan is contingent on their purchasing insurance or other products from bank affiliates. NCRC

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believes that banks should not force consumers to buy unwanted or unnecessary products, nor should they offer incentives to induce borrowers to purchase more products than they can afford.

Last year Citibank sought and received a favorable exemption from anti-tying prohibitions to offer incentives to their credit card, mortgage, or loan customers who maintain a combined minimum balance in a package of products and services that include annuities, auto, homeowners, life, and/or long-term care insurance from insurance affiliates of Citibank.[16] The incentives would include lower interest rates and/or other items, such as airline frequent flyer miles or contributions to accounts maintained by a customer with other Citibank affiliates.

Is it really in the best interest of the consumer to be bombarded with credit card applications, insurance product brochures, investment fund prospectuses and now perhaps real estate marketing materials when they go to a bank simply to open a checking account? Allowing banks into yet another industry would only compound the abuses associated with incentives and inducements to purchasing an array of products.

Where are banks' priorities when there are over 10 million Americans who do not have checking accounts?[17] Today, NCRC issues a challenge to the lenders to open your doors to the unbanked; for every product package you market to existing customer, dedicate the same energy to marketing Individual Development Accounts and lifeline and low-cost accounts to underserved communities.

Finally, on the issue of choice, NCRC is very concerned that if banks are allowed in the real estate business, consumers using a bank affiliated real estate agent will be at a disadvantage when attempting to shop for the best priced loan product, particularly if a bank employs exclusivity with its affiliate.

Serving Our Communities

The final point that I would like to address is the stake our nation's communities have in the decision to expand banking business lines even further to include real estate. At the start of my

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testimony, I mentioned the great success story of how CRA has lead to the introduction of bank partnerships and commitments in formerly divested communities. I would briefly like to elaborate how CRA must be updated to cover all of the activities that financial institutions are now permitted to undertake.

As you know, CRA only applies to the depository subsidiaries of financial holding companies. Other parts of the holding companies have no obligation to serve the entire community in which they do business, including low- and moderate-income communities. As CRA increasingly applies to a smaller portion of burgeoning holding companies, the risk that low- and moderate-income communities will once again become neglected – after years of steady progress in expanding homeownership opportunities down the income ladder – increases. Despite the Federal Reserve Board's findings in its study mandated by GLB that CRA-related loans are profitable, financial holding companies will become tempted to overlook low- and moderate-income markets as they enter new lines of business.

It is a travesty to each and every underserved rural community and inner city neighborhood in our country that CRA basically ends with checking products and lending activities. When the Unites States Congress passed GBL, it missed a tremendous opportunity to extend community reinvestment requirements to all bank affiliates, insurance companies and securities firms. Thirty-six Members of the House of Representatives support our position and have co-sponsored the Community Reinvestment Modernization Act (H.R. 865). As an addendum to my testimony, I have attached the first few pages of this bill detailing purposes, findings and sections covered, and ask for your consideration of this important measure.

If the banks are allowed into the real estate market NCRC strongly advocates for CRA coverage to be extended to the real estate affiliates to ensure these companies have agents in low- and moderate-income communities to serve minority and working class families. NCRC also strongly encourages Congress to enact a strong anti-predatory law to prohibit abusive lending and property flipping.

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Real-Estate Based Lenders Lag CRA-Covered Lenders

NCRC's data analysis indicates that real estate companies that currently own mortgage companies lag behind banks and thrifts covered by CRA in lending to minority and low- and moderate-income communities. Using the testimony of Philip Burns, representing the American Bankers Association on May 2 before the Financial Services Committee of the House of Representatives, NCRC grouped the mortgage companies that Mr. Burns listed as affiliated with real estate companies. These mortgage companies are affiliated with the real estate firms Long and Foster, Cendant Corporation, USAA, and GMAC. NCRC compared these real-estate based lenders with banks and thrifts covered by the Community Reinvestment Act (CRA) in the years 1999 and 2000, using HMDAWare™ software produced by Compliance Technologies (NCRC's data analysis with detailed charts is attached as an appendix to this testimony).

Over the two year time period analyzed by NCRC, real estate lenders trailed banks by the greatest extent in the category of lending to Hispanics and Blacks. In 2000, CRA-covered lenders issued 13.1 percent of their single family loans (includes home purchase, refinance and home improvement loans to owner-occupants) to Blacks and Hispanics. Real-estate lenders, in contrast, issued less than half that portion, in percentage point terms. These lenders made only 4.9 percent of their loans to Blacks and Hispanics in 2000. In 1999, the disparities were similar. CRA-covered lenders made 11.6 percent of their loans to Blacks and Hispanics while real-estate based lenders issued only 5.1 percent of their loans to Blacks and Hispanics.

In the category of lending to low- and moderate-income borrowers (as defined in the CRA regulations of income levels up to 80 percent of area median income), real-estate based lenders also lag behind CRA-covered lenders by considerable margins. In 2000, CRA-covered lenders made 32.1 percent of their single family loans to low- and moderate-income borrowers (LMI) while real-estate lenders made only 27.7 percent of their loans to these borrowers. The same percentage point gap of (4.4 percentage points) occurred in 1999 between the share of loans real-estate based lenders and CRA-covered lenders offered to LMI borrowers.

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To the casual observer, 4 to 5 percentage point differences in the share of loans offered by real estate and CRA-covered lenders to LMI borrowers may not appear to be a huge difference. The differences, however, are large and critical when considering the actual number of loans. If CRA-covered lenders, for instance, offered the same percentage of loans that real-estate based lenders (or 27.7 percent of their loans) to LMI borrowers, they would have made 227,012 fewer loans to these borrowers during 2000. On the other hand, if real-estate lenders made the same percentage of loans to LMI borrowers as CRA-covered lenders (or 32.1 percent), they would have made 9,017 more single family loans to these borrowers.

NCRC's data analysis reveals that real-estate based lenders trail CRA-covered banks by income level and race of census tracts. In 2000, for example, CRA-covered lenders made 12.8 percent of their single family loans in LMI census tracts. Real-estate based lenders issued only 7.9 percent of their loans in these tracts. Likewise, CRA-covered lenders made 8.2 percent of their single family loans in substantially minority tracts while real-estate based lenders issued only 4.4 percent of their loans in these tracts. In 1999, real-estate based lenders trailed by similar margins in minority and LMI tracts.

NCRC expected the real-estate based lenders to perform better in the area of home mortgage lending (conventional and government-insured loans to owner-occupants combined) since real-estate based-lenders have associated real estate companies dealing directly with home buyers. Yet, NCRC found that real-estate lenders trailed CRA-covered lenders by almost identical amounts in home mortgage lending as with overall single-family lending. For instance, CRA-covered lenders issued 13.9 percent of their home purchase loans to Blacks and Hispanics while real-estate lenders made only 4.8 percent of their purchase loans to these borrowers in 2000 – almost the identical percentages as for overall single family lending. Likewise, CRA-covered lenders made 11.6 percent of their purchase loans in LMI tracts while real-estate based lenders issued 7.7 percent of their loans in these census tracts.

The evidence clearly indicates that CRA has compelled banks and thrifts to focus on low- and moderate-income borrowers as well as minority borrowers and communities to a greater extent than real-estate based lenders. The hard data NCRC presents today reinforces our position that

Congress must update CRA to apply to real estate companies if Congress allows further combinations of the real estate and banking businesses.

Conclusion

In closing, I leave you with a true story of how a Realtor© helped identify a discriminatory, predatory lending practice and subsequently brought it to the attention of NCRC's Civil Rights Department for assistance.

The victims were an elderly minority couple who owned their home in the Mount Pleasant neighborhood, here in the District of Columbia, for over 43 years. In order to pay medical expenses, an independent mortgage company convinced the couple to take out an adjustable rate mortgage with a prepayment penalty and a loan payment that exceeded the couple's monthly income. Faced with imminent foreclosure, the couple was forced to consider a "short sale" of their home. The victims retained a Realtor© to facilitate the sale of the home, who quickly identified that the appraisal conducted by the mortgage company was substantially inflated. Ultimately, a buyer was identified and a purchase contract placed. Unbeknown to all the parties involved the victims had pre-payment penalty of $13,791.06 included in the note that stalled the real estate transaction. It was only after victims' Realtor© requested NCRC to intervene that the sale took place.

If the real estate agent had been affiliated with a predatory lender or any lender for that matter, it is doubtful that the agent would have acted as an independent watchdog. When we allow additional industry consolidation without providing stronger community protection laws, we remove the checks and balances that guard against abuses in power. Fewer independent businesses with stakes in their communities exist to protect against the exploitation and plunder of greedy conglomerates.

I thank you, Mr. Chairman, for this opportunity to testify and present the views of the National Community Reinvestment Coalition. I will be happy to answer any questions you may have.

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[1] The Joint Center for Housing Studies, Harvard University, *The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System*, (March 2002).
[2] National Community Reinvestment Coalition, *CRA Commitments* (2002). Note: The Joint Center for Housing Studies, Harvard University used NCRC's database to find that low- and moderate-income communities received a higher portion of loans in geographical areas in which lenders and community groups negotiated CRA agreements than in areas in which they did not.
[3] David Olson, Testimony before the Senate Committee on Banking, Housing and Urban Affairs' Hearing, *Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums* (January 8, 2002).
[4] Ibid.
[5] Financial Markets Center, *Firms electing to Become Financial Holding Companies Under the Gramm-Leach-Bliley Act* (April 26, 2002).
[6] Rick Lazio, President and CEO of Financial Services Forum, Remarks at American Enterprise Institute's Roundtable on the Gramm-Leach-Bliley Act (November 13, 2001).
[7] Robert E. Litan, Nicholas P. Retsinas, *et al.* for the Department of the Treasury, *The Community Reinvestment Act After Financial Modernization: A Final Report* (January 2001).
[8] Randall M. Scheessel for the Department of Housing and Urban Development, *Black and White Disparities in Subprime Mortgage Refinance Lending* (April 2002).
[9] Ibid. See also *National Anti-Predatory Lending Policy is Good for America*, NCRC Anti-Predatory Lending Toolkit (March 2002).
[10] Kathleen Day, "Fannie Mae Vows More Minority Lending." *Washington Post*, March 16, 2000, E1. Freddie Mac, *Automated Underwriting: Making Mortgage Lending Simpler for America's Families*, Chapter 5, (September 1996)
[11] Anthony Pennington-Cross, Anthony Yezer, and Joseph Nichols for the Research Institute for Housing America, *Credit Risk and Mortgage Lending: Who Uses Subprime and Why*? (October 2000).
[12] Consumer Union Press Release, *State Farm Loses on Attempt to Block Disclosure of Insurance Redlining Data* (March 8, 2000).
[13] E. Scott Reckard, "State Farm Won't Write New Homeowners Policies." *LA Times*, April 23, 2002.
[14] Susan Gaffney, Inspector General, Department of Housing and Urban Development, Testimony before the Senate Permanent Subcommittee on Investigations, Committee on Governmental Affairs' Hearing, *HUD's Government Insured Mortgages: The Problem of Property "Flipping"* (June 30, 2000).
[15] John Taylor, Testimony before the Testimony before the Senate Committee on Banking, Housing and Urban Affairs' Hearing, *Financial Services Legislation* (February 25, 1999).
[16] Opinion Letter of J. Virgil Mattingly, General Counsel, Federal Reserve (May 16, 2001).
[17] The Federal Reserve Board, *Survey of Consumer Finances* (1998).

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