PRESBYTERIAN CHURCH (USA)

November 5, 2003

Testimony
By
Rev. William Somplatsky-Jarman
Committee on Mission Responsibility Through Investment
Presbyterian Church (USA)
Joint Hearings on "Protecting Homeowners: Preventing Abusive Lending While Preserving Access to Capital"
Subcommittees on Financial Institutions and Consumer Credit and Housing and Community Opportunity
United States House of Representatives Committee on Financial Services

The Presbyterian Church (USA), a major Protestant denomination with nearly 2.5 million members, is committed to consistency between its mission goals and ethical values and its investments. Through our Urban and Rural Church Networks, we are well aware of the need for access to capital to revitalize and maintain strong communities. We also are aware of roadblocks to such access, be they redlining or predatory lending practices. As investors in the major banking and financial institutions in this country, we have become increasingly concerned with predatory lending problems in the subprime loan market. Upon the acquisition of Associates First Capital in 2000 by CitiFinancial, a subsidiary of Citigroup, the Presbyterian Church (USA) and other church investors initiated a series of negotiations on their lending practices. These discussions along with Citigroup's settlement with the Federal Trade Commission regarding Associates practices, other regulatory investigations and pressures from community groups resulted in Citigroup having some of the best policies and practices in the subprime industry.

We, along with other church investors affiliated with the Interfaith Center on Corporate Responsibility, have been involved in dialogues with a number of subprime lenders, all of which have been subsidiaries of depository holding companies, including Washington Mutual's Long Beach Mortgage and Chase Manhattan Mortgage. We have just had our first meeting with Wells Fargo and expect to have dialogues with National City's First Franklin and KeyCorp's Champion Mortgage. One non-depository lender, Household, met once with the Sisters of Charity of the Incarnate Word and the General Board of Pensions and Health Benefits of the United Methodist Church, but the dialogue is on hold due to Household's acquisition by HSBC.

So far we have found that subprime lenders, which are subsidiaries of depository holding companies, largely have taken to heart the settlements of 2002 between the Federal Trade Commission and CitiFinancial and the 20 states attorneys general and Household, if they had not already had good practices in place.

Thus our concern is now turning to the smaller lenders, which are often finance companies and may be privately held or not widely held public firms. This new focus in part resulted from a chance reading of the *Denver Post* during our 2003 General Assembly last May. A story, entitled "Eccentric man loses his home but not his friends," described a 60-year old, disabled man who was evicted from the only home he had ever lived in because he could not pay a $387,000 mortgage received in 2001. The article observed that the man was a "notorious eccentric and pack rat who lived in squalor" and had no financial resources beyond Social Security disability checks worth less than $1,000 monthly. His home, in a trendy Denver neighborhood, was worth far more than the mortgage. A local mortgage company had made the loan at 4 points above the rate for people with good credit. Monthly payments were $3,254.11. No verification of financial status was done. The loan was sold to a bank specializing in subprime lending which foreclosed and then proceeded to buy the property at its own auction. The man's friends intervened to salvage a situation by buying the property from the bank, reselling it and establishing a trust to care for their friend. Whether this occurred, I do not know. Unfortunately, the story omitted why the mortgage company made the loan, and why the bank did not perform due diligence to insure that no predatory practices had been followed.

We find that these smaller lenders are usually not subject to any federal supervision other than through complaints filed with the Federal Trade Commission, and they probably represent some of the more egregious firms, such as First Alliance.

Thus the regulation of these smaller firms seems best achieved through secondary market mechanisms. The secondary market is the more logical route because these small firms usually do not have depository affiliates to supply their funding, and therefore they must sell their originated loans on a timely basis into the secondary market to preserve their liquidity.

There are actually two problems arising in the secondary market that we wish to address in our discussions: issuers and underwriters.

First is their need to perform adequate due diligence to eliminate their liability for handling loans from fraudulent loan originators such as First Alliance, where Lehman Brothers now has a court ordered liability of $5 million.

The second, perhaps more insidious case, is that of subservicing firms. These firms buy the servicing rights, often of the more risky loans. In buying these rights, they take on the job of dealing with loan delinquencies and foreclosures. In the case of Fairbanks Capital, the Federal Trade Commission has alleged that they counted on-time payments as late and assessed late fees, started unnecessary foreclosure proceedings to gain additional fees, etc.

Based upon the analysis of Dr. John Lind of CANICCOR, we are planning dialogues, especially with firms that serve as both issuers and underwriters, because these firms tend to handle loans from smaller lenders. These smaller lenders often use brokers as their primary source of loan applications. Since brokers are not employees of the lender, the lower level of control over the brokers can permit predatory practices by some of the brokers to go undetected. In addition, these issuer/underwriters use subservicers that have no relation to the lenders, and they may then use unethical practices in handling delinquencies and foreclosures. We believe that good policies and practices will promote more profitable companies in the long run.