



Predatory Lending Practices and Subprime Foreclosures – Distinguishing Impacts by Loan Category

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June 21, 2007

(Standard disclaimer applies)



Do we understand enough?

- “When we understand how to distinguish well enough between predatory and legitimate lending, probably a federal statute would be a good idea.”
 - Chairman Ben Bernanke, February 15, 2007

- Results suggest we do not yet understand enough
 - Caution warranted on *national* restrictions on particular loan features.



Some questions we need answered:

- What is the relationship between predatory loan features and the probability of foreclosure?
- Does the relationship vary according to loan category?
- Do combinations of loan features impact foreclosures differently than single features?
- Is the relationship consistent across subprime markets nationwide?



Data

- LoanPerformance subprime data for Chicago
 - 1999QI-2003QII
 - 31,300 loans, over 200,000 loan-quarter observations

- Predatory loan features under study:
 - Long (> 3 years) prepayment penalty period
 - Balloon payment
 - Low- or no-documentation



Change in probability of foreclosure relative to a loan with no predatory features – **Refinance FRMs**

- **Long Prepayment Period: -38%**
- **Balloon Payment: +78%**
- **Low/No Documentation: +54%**
- **Prepay + Balloon: +52%**
- **Prepay + LowNoDoc: +227%**
- **Balloon + LowNoDoc: +66%**
- **All Three PLPs: +108%**



Change in probability of foreclosure relative to a loan with no predatory features – **Purchase FRMs**

- Long Prepayment Period: +3%
- Balloon Payment: +1%
- Low/No Documentation: -15%
- **Prepay + Balloon: +78%**
- Prepay + LowNoDoc: -54%
- **Balloon + LowNoDoc: -47%**
- All Three PLPs: +20%



Change in probability of foreclosure relative to a loan with no predatory features – **Refinance ARMs**

- **Long Prepayment Period: +16%**
- Balloon Payment: ----
- **Low/No Documentation: +21%**
- Prepay + Balloon: ----
- Prepay + LowNoDoc: +22%
- Balloon + LowNoDoc: ----
- All Three PLPs: ----



Change in probability of foreclosure relative to a loan with no predatory features – **Purchase ARMs**

- Long Prepayment Period: +0.4%
- Balloon Payment: ----
- Low/No Documentation: -4%
- Prepay + Balloon: ----
- Prepay + LowNoDoc: +20%
- Balloon + LowNoDoc: ----
- All Three PLPs: ----



Results and policy implications

- Impact of a predatory feature on subprime foreclosures:
 - Highly dependent on loan category
 - Highly dependent on presence of other features
- Subprime market appears segmented along multiple lines, in ways not clearly understood
- Broad-brush regulation likely too blunt a policy tool
 - May eliminate potentially valuable contractual possibilities that in many cases do not seem problematic
- Regulation that does not differentiate among loan categories will be especially prone to causing unwelcome distortions



Caveats

- Analysis does not address equity stripping
 - Quantitative data not available
 - No compelling reason why complex effects on foreclosures would not apply to equity stripping
- Data from Chicago only
 - Problematic for *national* policy implications if:
 - Relationship between predatory features and subprime foreclosures is generally consistent nationwide, and
 - Chicago is somehow anomalous



Conclusions

- We do not yet know enough to confidently craft effective *national* anti-predatory lending regulation

- Recommend continued development of state and municipal regulation
 - More tailored to local market circumstances
 - Generate greater knowledge of what works