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Highlights

Highlights of GAO-04-280, a report to the Chairman and Ranking Minority Member, Special Committee on Aging, U.S. Senate

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CONSUMER PROTECTION

Federal and State Agencies Face Challenges in Combating Predatory Lending

Why GAO Did This Study

While there is no universally accepted definition, the term “predatory lending” is used to characterize a range of practices, including deception, fraud, or manipulation, that a mortgage broker or lender may use to make a loan with terms that are disadvantageous to the borrower. No comprehensive data are available on the extent of these practices, but they appear most likely to occur among subprime mortgages—those made to borrowers with impaired credit or limited incomes. GAO was asked to examine actions taken by federal agencies and states to combat predatory lending; the roles played by the secondary market and by consumer education, mortgage counseling, and loan disclosure requirements; and the impact of predatory lending on the elderly.

What GAO Recommends

GAO suggests that Congress consider providing the Federal Reserve Board with the authority to routinely monitor and, as necessary, examine nonbank mortgage lending subsidiaries of financial and bank holding companies to ensure compliance with federal consumer protection laws applicable to predatory lending. Congress should also consider giving the Board specific authority to initiate enforcement actions under those laws against these nonbank mortgage lending subsidiaries.

www.gao.gov/cgi-bin/getrpt?GAO-04-280.

To view the full product, including the scope and methodology, click on the link above. For more information, contact David G. Wood at 202-512-8678 or woodd@gao.gov.

What GAO Found

While only one federal law—the Home Ownership and Equity Protection Act—is specifically designed to combat predatory lending, federal agencies have taken actions, sometimes jointly, under various federal consumer protection laws. The Federal Trade Commission (FTC) has played the most prominent enforcement role, filing 19 complaints and reaching multimillion dollar settlements. The Departments of Justice and Housing and Urban Development have also entered into predatory lending-related settlements, using laws such as the Fair Housing Act and the Real Estate Settlement Procedures Act. Federal banking regulators, including the Federal Reserve Board, report little evidence of predatory lending by the institutions they supervise. However, the nonbank subsidiaries of financial and bank holding companies—financial institutions which account for a significant portion of subprime mortgages—are subject to less federal supervision. While FTC is the primary federal enforcer of consumer protection laws for these entities, it is a law enforcement agency that conducts targeted investigations. In contrast, the Board is well equipped to routinely monitor and examine these entities and, thus, potentially deter predatory lending activities, but has not done so because its authority in this regard is less clear.

As of January 2004, 25 states, as well as several localities, had passed laws to address predatory lending, often by restricting the terms or provisions of certain high-cost loans; however, federal banking regulators have preempted some state laws for the institutions they supervise. Also, some states have strengthened their regulation and licensing of mortgage lenders and brokers.

The secondary market—where mortgage loans and mortgage-backed securities are bought and sold—benefits borrowers by expanding credit, but may facilitate predatory lending by allowing unscrupulous lenders to quickly sell off loans with predatory terms. In part to avoid certain risks, secondary market participants perform varying degrees of “due diligence” to screen out loans with predatory terms, but may be unable to identify all such loans.

GAO’s review of literature and interviews with consumer and federal officials suggest that consumer education, mortgage counseling, and loan disclosure requirements are useful, but may be of limited effectiveness in reducing predatory lending. A variety of factors limit their effectiveness, including the complexity of mortgage transactions, difficulties in reaching target audiences, and counselors’ inability to review loan documents.

While there are no comprehensive data, federal, state, and consumer advocacy officials report that the elderly have disproportionately been victims of predatory lending. According to these officials and relevant studies, older consumers may be targeted by predatory lenders because, among other things, they are more likely to have substantial home equity and may have physical or cognitive impairments that make them more vulnerable to an unscrupulous mortgage lender or broker.