**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

Commonwealth of Pennsylvania, by Attorney General Josh Shapiro; District of Columbia, through the Office of the Attorney General; Matthew J. Platkin, Acting Attorney General of the State of New Jersey; State of Oregon, *ex rel*. Ellen F. Rosenblum, in her official capacity as Attorney General; State of Utah, by Attorney General Sean D. Reyes; and State of Washington,

Plaintiffs,

v.

Mariner Finance, LLC,

Defendant.

Case No. 2:22-cv-3253
Hon. _______________

(Electronically Filed)

**COMPLAINT FOR PERMANENT INJUNCTION AND OTHER RELIEF**

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Claims for Relief

Plaintiffs, Commonwealth of Pennsylvania, by Attorney General Josh Shapiro, ("Commonwealth"); District of Columbia, a municipal corporation, through the Office of the Attorney General; State of New Jersey, by Matthew J. Platkin, Acting Attorney General of the State of New Jersey, Cari Fais, Acting Director of the New Jersey Division of Consumer Affairs; State of Oregon; State of Utah; acting through Sean D. Reyes, Attorney General of Utah; and State of Washington, (referred to collectively, "Plaintiffs" or "Plaintiff States") bring this action against Mariner Finance, LLC ("Mariner" or "Defendant") and allege the following:

## INTRODUCTION

1. Defendant Mariner Finance, LLC is a subprime installment lender engaged in a nationwide scheme that takes advantage of low-and-moderate income consumers. Among other aggressive sales tactics, Mariner engages in widespread credit insurance packing, which is the practice of adding costly insurance policies and other products ("add-ons" or "add-on products") to loans without the consumer's knowledge and, in some cases, despite the consumer's explicit rejection of the add-ons. These costly add-ons significantly increase the cost of the loan—and Mariner's profit. Additionally, Mariner encourages employees to "flip" existing loan obligations by deceptively inducing consumers to refinance their loans through frequent financings that result in little or no economic benefit to the consumer in order to increase Mariner's loan volume and generate new loan fees, additional add-ons, and more profits for Mariner.

### *Mariner Exists to Generate Ever-Increasing Profits for Its Executives and Private Equity Owners—At Great Expense to Its Customers.*

2. Mariner's unlawful behavior is motivated by the high-growth demands of its owner: a private equity fund managed by Warburg Pincus LLC, a Wall Street private equity firm.

3. Mariner was formed through an aggressive string of acquisitions financed by private equity. Mariner's first private equity investor was Milestone Partners III, LP and Milestone Partners Management Co., LP, which acquired a stake in Mariner in 2009.

4. Warburg Pincus LLC's fund then acquired Mariner in 2013 for $234 million. Warburg Pincus LLC has over $80 billion in assets under management and is led by CEO Charles "Chip" Kaye and President Timothy Geithner.

5. Warburg Pincus LLC controls Mariner's Board of Directors. At least two of Mariner's Board members are Warburg Pincus LLC Managing Directors. One of Mariner's Board members, Michael E. Martin, is the leader of Warburg Pincus LLC's Financial Services Team.

6. When Warburg Pincus LLC acquired Mariner, Mariner had 57 branches in seven states.

7. Today, just nine years later, a company that began with a single brick-and-mortar branch has morphed into a sizeable conglomerate with over 480 branches in 27 states. Mariner manages $2 billion in loans every year.

8. Mariner portrays itself as a community-oriented lender operating small, local branches with strong ties to its local geography. In reality, Mariner deploys aggressive, high-pressure sales tactics, dictated by a profit-driven model that operates according to the famous maxim articulated in *Glengarry Glen Ross*: Always Be Closing.

9. Contrary to Mariner's portrayal of itself as a "community based" lender, Mariner's policies and business practices are set and directed by headquarters, leaving minimal discretion to branch managers and loan officers to extend loans that work best for consumers according to their needs and financial condition. The primary directive is to sell.

10. Mariner exists to create value for its investors, not its customers. To that end, Mariner's private equity owners depend on and expect Mariner to generate substantial profits to create ever higher returns.

11. Mariner maintains several avenues of customer acquisition, including, among other things, soliciting potential borrowers through live check mailings, local branches, the Internet, telephone sales, acquisition of competitors' existing borrower pools and loan origination platforms, and acquiring leads through third-parties such as Credit Karma and LendingTree.

12. Mariner targets its loans and aggressive sales tactics at the most vulnerable borrowers, offering low-and-moderate income consumers small dollar personal loans with high interest costs. These are often subprime and deep subprime borrowers with FICO scores of 629 or less. They often already have significant credit card, installment loan, and/or student loan debt. These consumers are most likely to fall prey to lenders such as Mariner when an emergency or unplanned life event occurs because their income and credit history often makes it challenging to obtain a lower interest loan through a bank or credit union.

13. In states with usury laws, including but not limited to the District of Columbia, New Jersey, Oregon, Pennsylvania, and Washington, Mariner charges interest at or near the maximum allowable under state law.

14. To grow the company, Mariner engages in aggressive sales tactics in order to find and extend credit to new borrowers. Mariner markets the fact that consumers can come into a branch and procure a check on the same day (often within an hour), following a soft credit check. Mariner mails unsolicited "live checks" to consumers that Mariner prescreens using credit bureaus and "proprietary scoring data." Mariner also aggressively pushes consumers to refinance existing credit and take out new loans, even if it is not in the best interest of the consumer. These are the

kind of sales practices that can ensnare vulnerable consumers into a cycle of debt, keeping borrowers captive and away from competing financial service providers.

15. In order to drive growth internally, Mariner also requires employees to meet defined sales goals or face discipline, docking incentives, and possible termination.

16. Mariner employs a variety of aggressive tactics both to engage new customers and to keep existing customers in a perpetual cycle of debt. For one, the company mails unsolicited "live checks" to consumers that merely require endorsement and deposit to trigger a loan transaction. Mariner targets live checks to those consumers who meet Mariner's proprietary models. These consumers are often in financial crisis, decidedly unfamiliar with receiving unsolicited checks in the mail, and in desperate need of economic relief. Mariner uses live checks as an entrée to the most vulnerable portion of the targeted population.

17. After a consumer cashes a live check, Mariner immediately begins soliciting the consumer by phone, email, and other methods to come into the branch and borrow additional money by refinancing the loan.

18. If a borrower falls behind on payments, the first option Mariner offers the consumer is not a payment or deferment plan but is instead an offer to refinance the loan and borrow additional cash.

19. As described in detail below, when the consumer comes into the branch to refinance, Mariner maximizes the amount of the new loan by charging consumers for—and financing—hidden add-on products.

20. Mariner pushes each branch to sell a minimum amount of add-ons by setting baseline performance metrics connected to the sale of ancillary products that are incentivized through bonuses, and disciplining employees that fail to upsell.

21. Mariner's incentive structure thereby encourages its employees to deceive, mislead, and otherwise confuse financially desperate consumers into paying for products that add hundreds or thousands of dollars to the loan.

22. Most often, Mariner tells consumers nothing about these products, rushing consumers through electronic paperwork, keeping consumers in the dark about the existence and cost of the add-ons.

23. Mariner sells its add-ons only as single-premium products in order to maximize the consumers' long-term debt load. Single-premium means the entire premium is paid upfront and financed into the loan instead of paying the premiums in monthly installments. This unnecessarily inflates the size of the principal obligation for the unwitting borrower and balloons the interest Mariner earns over the life of the loan.

24. At the same time, Mariner retains a substantial portion of the premium charge for each insurance add-on as a sales commission—essentially a kickback to Mariner—ranging from 21% to 75% of the net written premium amount depending on the add-on and the state in which the loan is made. Mariner fails to disclose the commissions it earns.

25. While Mariner's stated policies discourage employees from hiding the add-ons from consumers—affording Mariner plausible deniability with regard to its sales and marketing misconduct—Mariner's marketing and sales incentives are, in fact, structured to drive this unlawful conduct. Mariner trains, instructs, and directs its employees to "offer" *every* add-on product to *every* consumer *every* time. And, Mariner regional and branch managers are disciplined for failing to meet expected add-on sales goals, thereby encouraging employees to disregard stated corporate policies related to the sale and marketing of these products.

26. Mariner's relentless internal sales goals and incentives ensure that there will be winners and losers among regional and branch managers and branch employees as a matter of their personal compensation.

27. Mariner incentivizes this pattern of unlawful conduct because it derives enormous profit from packing additional, hidden products into its consumer loans. In 2019 alone, Mariner charged consumers $121.7 million nationwide in premiums and fees for add-on products. Notably, these numbers exclude all of the interest Mariner earns on the add-on premiums.

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*Mariner's Corporate Policies and Practices Result in Employees Charging Consumers for Add-On Products They Do Not Know About and Have Not Consented to Buy.*

28. In many instances, Mariner tacks on charges for add-ons at loan origination without obtaining the consumer's consent. In other instances, Mariner mentions add-ons but falsely tells the consumer they are mandatory. As described in detail below, Mariner employees make misleading statements or material omissions concerning what it is consumers are actually agreeing to purchase, leaving many borrowers with no knowledge of the add-on product(s) or a mistaken belief about the value and/or cost of the product(s).

29. Mariner's corporate policies and practices encourage employees to perpetrate this unlawful conduct, including by rewarding employees who maximize add-on charges and formally disciplining branch managers whose levels of add-on charges fall below established, minimum expectations.

30. Mariner sells two categories of add-on products: (A) credit insurance products: (1) life (pays off the loan balance if the borrower dies), (2) disability (makes some payments on a loan if the consumer becomes disabled for a covered reason, after a waiting period), (3) involuntary unemployment (likewise, due to unemployment), (4) household property (pays to repair or replace

covered personal property due to a covered loss), and (5) non-filing insurance (protects Mariner from loss of its interest in the personal property collateral due to its failure to perfect a security interest); and (B) so-called "non-credit" or "ancillary" products: (1) accidental death & dismemberment insurance (AD&D) (pays for certain accidental injuries and death), (2) Auto Club (similar to AAA), (3) Home & Auto (similar to AAA), and (4) Guaranteed Asset Protection (GAP) (on a car title loan, pays any difference between the outstanding loan balance and the auto insurance payout in the event the car is a total loss).

31. Mariner stands to gain substantially more from a credit insurance policy than the borrowing consumer stands to gain because, *inter alia*: (A) Mariner makes itself the policy's primary beneficiary; and (B) Mariner earns substantial commission revenue that exceeds claim payouts on most or all insurance products.

32. Credit insurance products typically cost far more per dollar of coverage as compared to freestanding life or renter's insurance policies.

33. It is often not in the consumer's best interest to purchase credit insurance or other add-ons, particularly when the consumer has existing insurance or an AAA membership rendering Mariner's insurance product duplicative and unnecessary. For this reason, when asked, the vast majority or Mariner customers charged for add-ons say they would have declined if they had known about them.

34. Nevertheless, as explained below, Mariner charges its customers for one or more add-on products on 80% of its loans nationwide. It does so through a loan origination process that deprives most customers of any meaningful opportunity to review add-on product options and make an informed decision whether to purchase such products.

*Mariner's Corporate Policies and Practices Incentivize Employees to "Flip" Existing Loan Obligations into Refinanced and/or Larger Loan Obligations.*

35. Mariner's policies, practices, and incentive structure also encourage employees to "flip" consumers' loans into refinanced and/or larger loan obligations. Employees are expected to keep loan applications flowing, and Mariner tracks their performance using metrics based on the number of loans each employee closes per day. The only way for employees to meet Mariner's aggressive sales goals is by refinancing existing loans at every opportunity.

36. Mariner trains employees to reach out to consumers as soon as they miss a loan payment and to use a missed payment as an opportunity to induce consumers to refinance existing loans (which Mariner refers to as "renew the DQ"). By renewing instead of collecting overdue loan payments under the existing terms, and by selling the renewal as a benefit to consumers when it is not, Mariner's employees improve their sales metrics and qualify for additional compensation while simultaneously generating more add-ons charges and increasing Mariner's total loan volume. This is because Mariner typically requires the consumer to borrow at least $500 more in a refinancing.

## LEGAL AUTHORITY

37. Plaintiffs bring this action to prevent unfair, deceptive, or abusive acts or practices under Section 1042 of the Consumer Financial Protection Act of 2010 ("Dodd-Frank Act" or "CFPA"), 12 U.S.C. § 5552(a), which authorizes Plaintiffs to seek, and the Court to order, permanent injunctive relief, monetary relief, and other relief for Defendant's acts or practices that violate the CFPA.

38. Plaintiffs also bring this action pursuant to Section 1036(a)(1)(A) of the CFPA, 12 U.S.C. § 5536(a)(1)(A), which authorizes Plaintiffs to seek, and the Court to order, permanent injunctive relief, monetary relief, and other relief for Defendant's acts or practices that violate

other Federal consumer financial laws set forth in the CFPA, including the Truth in Lending Act, 15 U.S.C. § 1601 *et seq*. (TILA).

39. In addition, Plaintiffs bring this action pursuant to their respective state consumer protection laws:

a. The Commonwealth brings this action pursuant to the Unfair Trade Practices and Consumer Protection Law, 73 P.S. § 201-1, *et seq*. (PA CPL), to restrain unfair methods of competition or unfair or deceptive acts or practices in the conduct of any trade or commerce declared unlawful by Section 201-3 of the PA CPL.

b. The State of New Jersey brings this action pursuant to its authority under the New Jersey Consumer Fraud Act, N.J.S.A. 56:8-8, 56:8-11, 56:8-13, and 56:8-19 (NJ CFA), to permanently enjoin Mariner from engaging in unconscionable and deceptive commercial practices and misrepresentations, and to recover statutory civil penalties, consumer restitution, attorneys' fees and costs and other equitable and monetary relief.

c. The State of Washington brings this action pursuant to its authority under the Washington Consumer Protection Act, chapter 19.86 RCW (WA CPA), to enjoin Mariner from engaging in these unfair and deceptive practices, and to recover statutory civil penalties, consumer restitution, attorneys' fees and costs, and other equitable and monetary relief.

40. At all times relevant hereto, Mariner engaged in trade and commerce by marketing, offering, selling, and originating personal loans to residents of the Plaintiff States and by servicing and collecting on these loans.

41. The public interest is served by seeking before this Honorable Court a permanent injunction to restrain the methods, acts, and practices alleged, restitution, and disgorgement of

money that Mariner has derived from these methods, acts, and practices, as well as civil penalties and investigative and litigation costs.

42. Defendant is using, has used, or is about to use methods, acts, or practices declared unlawful by Section 201-3 of the PA CPL, the NJ CFA, the WA CPA, and/or by the CFPA.

43. The CFPA, which prohibits "unfair, deceptive or abusive acts or practices," explicitly delegates to state attorneys general the authority to bring Federal civil enforcement actions in order to enforce the Act and to secure remedies provided therein. 12 U.S.C. § 5552(a)(1). This provision is subject to a requirement that an attorney general provide prior notice to the Consumer Financial Protection Bureau (CFPB). Plaintiffs have provided such notice.

44. Section 1036 of the CFPA prohibits a "covered person" from offering or providing to a consumer any financial product or service not in conformity with Federal consumer financial law, or otherwise committing any act or omission in violation of a Federal consumer financial law, or from committing or engaging in any "unfair, deceptive or abusive act or practice" in connection with any transaction with a borrower for a consumer financial product or service, or the offering of a consumer financial product or service. 12 U.S.C. §§ 5536(a)(1)(A), (B). Defendant is a "covered person" within the meaning of the CFPA. 12 U.S.C. § 5481(6).

45. Citizens of the Plaintiff States are suffering and will continue to suffer harm unless the acts and practices complained of herein are permanently enjoined.

**JURISDICTION AND VENUE**

46. This Court has subject-matter jurisdiction over this action because it is "brought under Federal consumer financial law," 12 U.S.C. § 5565(a)(1), and presents a Federal question, 28 U.S.C. § 1331. Plaintiffs are authorized to initiate civil actions in Federal district court to enforce provisions of the CFPA. 12 U.S.C. § 5552(a)(1).

47. This Court has supplemental jurisdiction over the remaining claims under 28 U.S.C. § 1367.

48. Venue is proper in this district because Defendant is located, resides, and/or does business in this district, and/or a substantial part of the events or omissions giving rise to the claims occurred in this district. 28 U.S.C. § 1391(b), (c); 12 U.S.C. § 5564(f).

## PLAINTIFFS

49. Plaintiff is the Commonwealth of Pennsylvania, acting by Attorney General Josh Shapiro, with offices located at 15th Floor, Strawberry Square, Harrisburg, PA 17120.

50. Plaintiff is the District of Columbia, through the Office of the Attorney General, Karl A. Racine, with offices located at 400 6th Street, N.W., 10th Floor, Washington, D.C. 20001.

51. Plaintiffs are Matthew J. Platkin, Acting Attorney General of the State of New Jersey, with offices located at 124 Halsey Street, 5th Floor, Newark, NJ, and Cari Fais, Acting Director of the New Jersey Division of Consumer Affairs, with offices located at 124 Halsey Street, 7th Floor, Newark, NJ (collectively, the "State of New Jersey" or "New Jersey").

52. Plaintiff is the State of Oregon, *ex rel.* Ellen F. Rosenblum, in her official capacity as Attorney General for the State of Oregon, with offices located at 100 SW Market Street, Portland, Oregon.

53. Plaintiff is the State of Utah, acting through Sean D. Reyes, Attorney General of Utah, with offices located at Utah State Capitol, 350 N. State St. Suite #230, Salt Lake City, UT 84114.

54. Plaintiff is the State of Washington, through Attorney General Robert W. Ferguson, with offices located at 800 Fifth Avenue, Suite 2000, Seattle, WA 98104 ("State of Washington"

or "Washington"). The Washington Attorney General is also authorized to commence this action pursuant to RCW 19.86.080 and RCW 19.86.140.

## DEFENDANT

55. Mariner is a Maryland limited liability company with its principal executive offices located at 8211 Town Center Drive, Nottingham, MD 21236. Joshua Johnson is Mariner's President and CEO.

## BACKGROUND

56. Mariner's target consumers are subprime borrowers with below average credit history and low FICO scores.

57. Mariner offers loans of between $1,000 and $25,000, with terms between 12 and 60 months. Mariner charges high interest rates that range from 18.99% to 35.99%. For Mariner's "direct" branch loans, the average APR is around 28%, and the average loan size is about $3,650.

58. Mariner obtains leads for potential borrowers through online lead generators such as LendingTree and Credit Karma. Many branch loans also begin as "loans by mail" which can be refinanced into a larger loan at a branch.

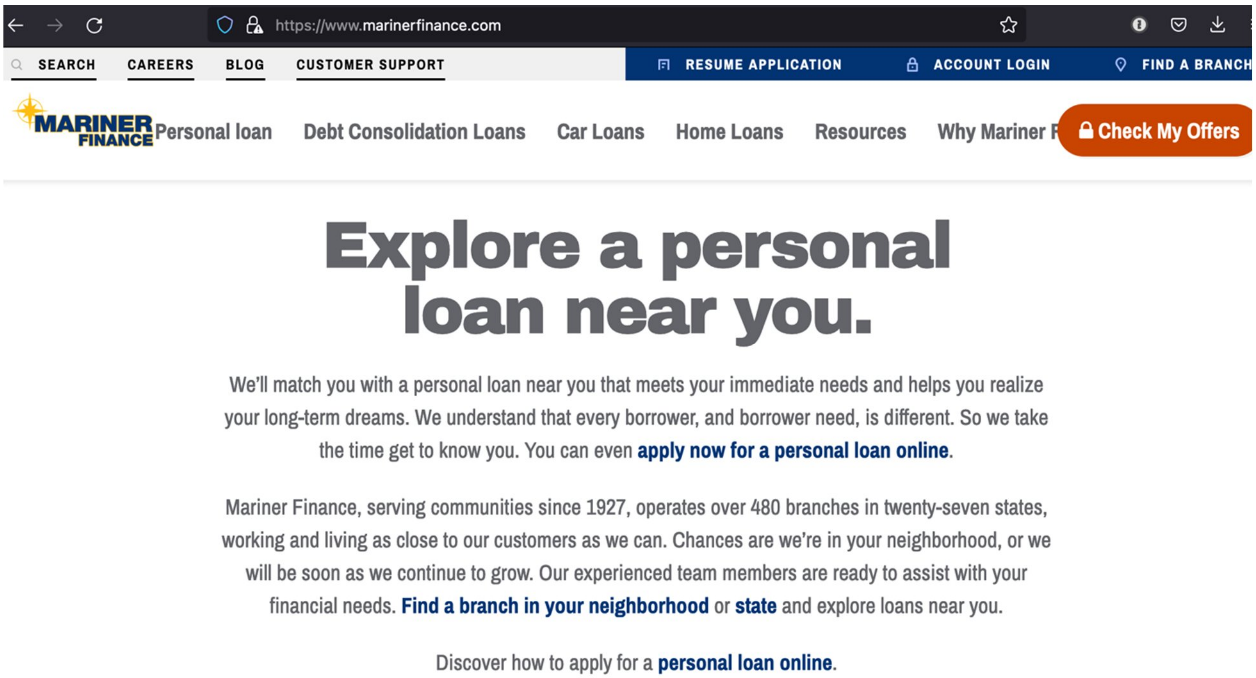
59. Mariner markets itself as a lender—not an insurance broker.

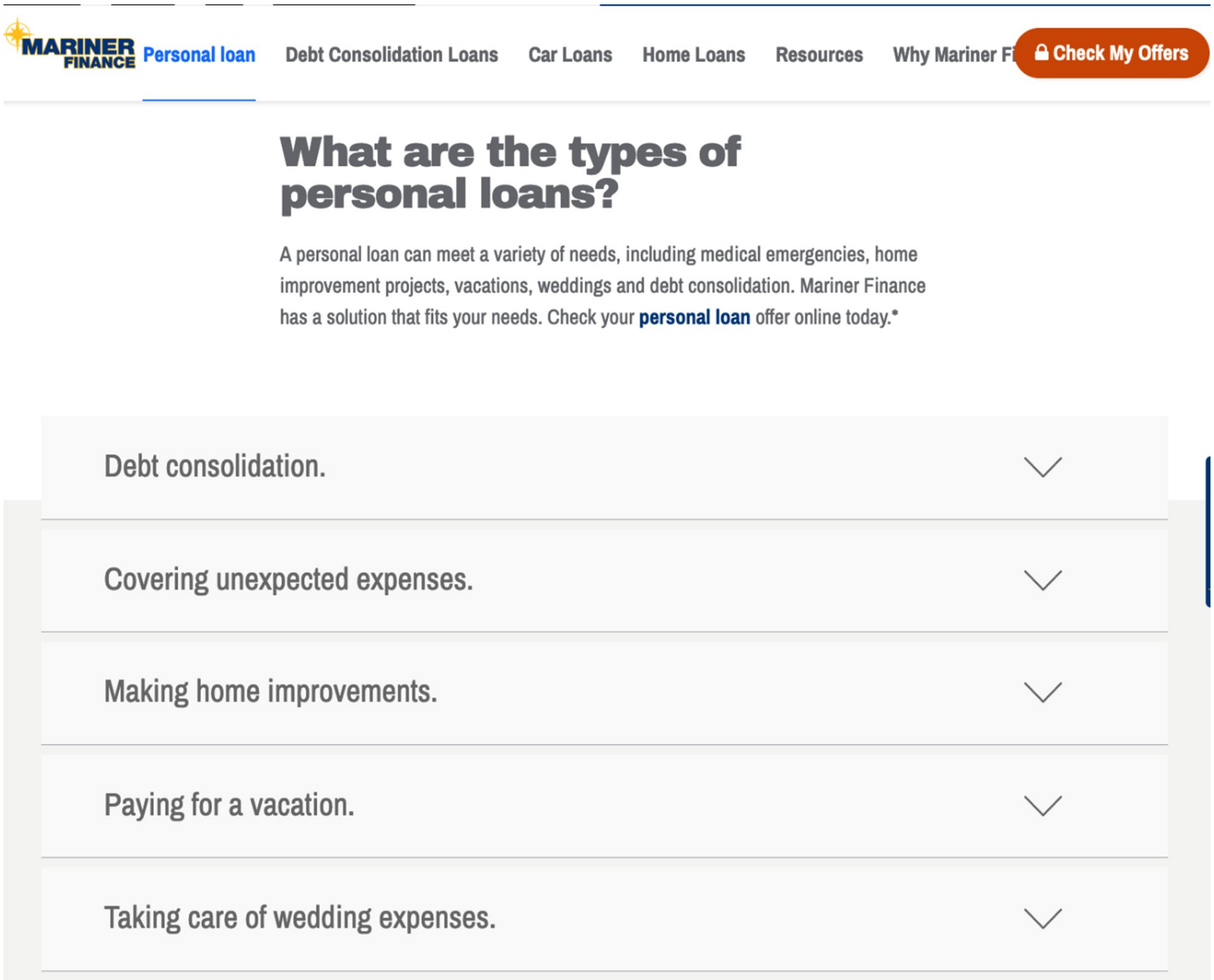
60. Consumers come to Mariner to borrow money; they do not come to Mariner for the purpose of buying insurance.

61. Mariner never sells insurance on its own, without a loan, and consumers cannot pay for the insurance premiums up front to avoid amortization of the costs of the add-ons. Rather, the premiums are added on top of the loans and incur additional interest over the course of the loans, increasing the profits for Mariner and increasing the cost to consumers.

62. Mariner markets itself to consumers as a place to get personal loans, debt consolidation loans, car loans, and—recently—mortgage loans. Mariner's website contains extensive marketing information and FAQs about every loan product. But the website contains no information about add-ons.

63. The following is typical marketing language from Mariner's website, captured on July 21, 2022:






64. Yet, despite the fact that Mariner does not mention its insurance products on its website and consumers do not come to Mariner seeking insurance, Mariner manages to charge the vast majority of its customers (about 80% of loans nationwide as of early 2020) for expensive insurance and other add-ons.

65. Add-ons are one of the key drivers, if not *the* key driver, of Mariner's profits.

*Hidden Add-Ons Cost Consumers an Average of $500 Per Loan Nationwide.*

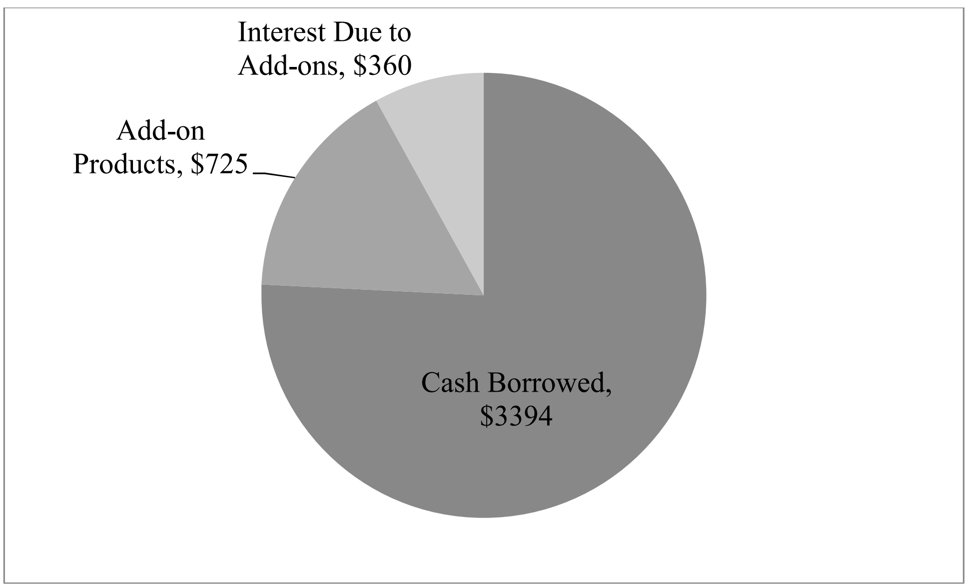
66. In 2020, nationwide, Mariner charged consumers an average of $360 in add-on products per loan. Since the premiums and fees are financed, these add-ons increase interest

payments by an average of about $180 in interest to the loan, for a total added cost to the consumer of approximately $540.

67. In some states, Mariner's add-on charges are far higher. For example, Mariner produced to the Commonwealth a random sample of 100 loan files for loans originated in Pennsylvania in December 2020. Of those 100 loans, 75 loans included charges for at least one add-on product.

68. For these 75 loans, the average cash borrowed was $3,394. The consumers were charged an average of $725 each for add-on products, plus $360 more in interest, as illustrated below.[1] This amounts to an average of $1,085 in add-on costs for every $3,394 in cash borrowed – or $32 in add-on costs for every $100 borrowed.

**Figure 1: Average Add-On Costs Per-Consumer from PA Random Sample, Dec. 2020**




[1] For each loan, interest attributable to add-ons was calculated by dividing the finance charge by the amount financed (including add-ons), and then multiplying that ratio by the add-on charges. Throughout this Complaint, dollar amounts are rounded to the nearest whole dollar.

69. In another example, Mariner produced to New Jersey a random sample of 42 loan files for New Jersey consumers with loans that originated in December 2020. Of those 42 loans, 21 included charges for at least one add-on product.

70. Of the 21 New Jersey loans that originated in December 2020 with one or more add-on products, the average cash borrowed was $4,667. These New Jersey consumers were charged an average of $267 for add-on products, which added $207 more in interest. This amounts to an average of $474 for every $4,667 in cash borrowed – or $10 in add-on costs for every $100 borrowed.

71. Of course, Mariner charges some consumers far more than the average. For example, one consumer borrowed $2,981 in cash in December 2020, at 27.69% APR. In addition to the cash loan, Mariner charged this consumer $1,700 for five add-on products, which added $1,135 in interest to the loan, for a total cost of add-ons of $2,835. Mariner charged this consumer $95 in add-ons for every $100 she borrowed.

72. In September 2017, another consumer borrowed $16,594 in cash, putting down a car title as collateral. Mariner charged this consumer $5,641 for the following *seven* add-on products: Auto Club ($432), Credit Involuntary Unemployment Insurance ($1,780), Accidental Death & Dismemberment (AD&D) (Policy 1) ($480), AD&D (Policy 2) ($480), Credit Accident & Health Insurance ($1,430), Credit Life Insurance ($1,025), and Non-Filing Insurance ($12). Mariner added $3,519 in interest to the loan as a result of these add-on charges. In total, Mariner charged this consumer $9,160 for add-on products, or $55 for every $100 borrowed on this particular vehicle title loan.

73. In another example, a consumer borrowed $5,000 in cash in December 2020, at 29.98% APR. In addition to the cash loan, Mariner charged this consumer $1,238 for four add-on

products, which added $371 in interest to the loan, for a total cost of add-ons of $1,609. Mariner charged this consumer $32 in add-ons for every $100 he borrowed.

*Mariner Uses an Electronic Closing Process to Conduct a Bait-and-Switch that Packs in Add-On Products and Results in Costs Far Higher than Consumers Expect to Pay.*

74. Mariner's add-on packing operation takes place primarily in its branch locations. As described in more detail herein, on average Mariner adds hundreds or thousands of dollars in add-ons to every loan—removing them only if the consumer notices and asks.

75. But most consumers have no chance to notice the add-ons. At the in-branch loan closings, Mariner rushes applicants through an electronic display of 44-plus pages of loan documents on a hard-to-read computer screen mounted on the wall. A redacted exemplar of a 57-page loan packet is attached as Exhibit A.

76. Within the electronic display of loan documents are purported disclosures about the add-on products. Mariner hides the disclosures from most of its customers, so they never know they are being charged hundreds of dollars for add-ons. The Mariner employee—not the consumer—controls the pace of scrolling.

77. For example, one consumer borrowed from Mariner in January 2021 after she drove by a Mariner location and decided to apply for a loan online. She reported that auto protection was offered on top of the loan, relaying that she thought it was "really weird" that a product like auto protection was being offered at a lending establishment. This consumer was given 15 minutes to look over the paperwork and shown the screen of a tablet displaying the documents, but was not given a chance to scroll through them herself before she signed. Mariner ultimately charged her for four add-ons, none of which she was aware: Life, Accident & Health, Involuntary Unemployment Insurance, and an auto membership. She borrowed $3,000 in cash, but was charged $909 in add-ons, totaling $1,236 in add-ons including interest; for every $100 she borrowed, she

was charged $41 in add-ons. She stated that had she been offered these products as optional, she would have declined all of them without any regard to how much they cost.

78. Because consumers are not afforded the opportunity to adequately read and understand the purported disclosures contained in the electronic display of loan documents before signing, most consumers rely on the oral representations of Mariner employees to explain what the add-on products are and how they work.

79. Mariner's oral representations of the add-on products during loan closings, to the extent they are even provided, fail to disclose the basic obligations and terms of the loan agreement and add-on products, including, among other things: (1) that the add-on products are an additional cost that is added to the loan; (2) that the entire premium of credit insurance products are financed upfront; and/or (3) that the purchase of add-on products is ostensibly optional and not required to obtain the loan.

80. Mariner further misleads consumers by concealing the substantial commissions it retains on the amounts it charges consumers for credit insurance by falsely stating in its written disclosures that the premium amount is paid "To Ins. Company," without disclosing the substantial commissions that Mariner deducts and retains for itself.

81. Mariner's acts and practices during and prior to loan closing are misleading and cause a likelihood of confusion and misunderstanding for consumers as to the cost of the loan and the add-on products Mariner is selling.

82. In addition to being unfair, deceptive, abusive, and/or unconscionable, Mariner's practice of requiring consumers to purchase add-on products through deceptive statements or omissions also violates the Truth in Lending Act (TILA), 15 U.S.C. 1601 *et seq*., and Regulation

Z, 12 C.F.R. § 1026, which require that mandatory charges be disclosed as part of the finance charge.

## FACTUAL ALLEGATIONS

### I. Mariner Charges the Majority of Consumers for Add-Ons Without Their Consent.

83. In many loan transactions, Mariner packs add-ons into the loan without properly obtaining consumers' consent. Although add-on charges commonly add hundreds or thousands of dollars to the loan, Mariner employees often make no oral mention of them and, given Mariner's failure to properly provide disclosures, many consumers do not notice that large sums have been added to what they believe they are borrowing.

84. In some instances, Mariner falsely tells consumers that add-on products are required to obtain the loan. In other instances, Mariner falsely tells consumers, explicitly or implicitly, that the add-ons are free or much cheaper than they in fact are.

85. In yet other instances, Mariner falsely tells consumers, explicitly or implicitly, that they are entitled to the add-on products as a "perk" or as a benefit to being a Mariner customer.

86. The methods differ, but the result is the same: consumers end up being charged and paying hundreds or thousands of dollars for add-ons for which they did not provide consent.

87. As demonstrated by extensive interviews with consumers who were nearly all chosen at random, Mariner misled the overwhelming majority of the consumers whom it charges for insurance in the Plaintiff States.

88. Of the 44 consumers the Commonwealth interviewed, at least 36 had one or more credit insurance or ancillary products added to their loan. Of these 36 consumers with add-on products, only one person provided her consent.

89. Of the 36 Pennsylvania consumers who were interviewed and had add-on products, 35 (97 percent) told the Commonwealth that they either: (1) did not know they had an add-on, (2) did not know it was optional, and/or (3) did not know that it cost additional money.

90. Of the 16 New Jersey consumers interviewed with loans that originated between November and December 2021, and who were charged for four or more add-on products, all 16 consumers told New Jersey that they either: (1) did not know they had add-on products attached to their loan, (2) did not know one or more add-on products were optional, and/or (3) did not know that one or more add-on products cost additional money.

91. Of the 10 Washington consumers who were interviewed and had add-on products, 9 of those consumers (90%) told Washington that they either: (1) did not know they had an add-on, (2) did not know it was optional, and/or (3) did not know that it cost additional money.

92. Mariner engages in many unfair, deceptive, abusive, and/or unconscionable acts or practices in charging consumers for add-on products. Most prominently, alternately or in combination:

a. Mariner designs its loan origination process to minimize the chance that consumers will notice the inclusion of add-on products in their loan documentation;

b. Mariner charges consumers for add-ons without ever mentioning them;

c. Mariner charges consumers for add-ons that consumers explicitly declined;

d. Mariner falsely claims that add-ons are mandatory; and/or

e. Mariner misleads consumers about the cost of add-ons.

This Complaint includes detailed examples from consumer interviews that illustrate these unfair, deceptive, abusive and/or unconscionable acts or practices. Based on consumer interviews in a number of states, the Plaintiffs aver that Mariner is engaged in these unfair, deceptive, abusive, and/or unconscionable acts or practices in every state in which it does business.

93. Nationwide, Mariner has charged consumers hundreds of millions of dollars in fees and interest for hidden and unwanted add-on products.

94. In 2019 alone, Mariner charged consumers nationwide $121.7 million in premiums and fees for add-on products. The average add-on premiums and fees was $364 per loan in 2020. These figures exclude interest.

*In Many Cases, Mariner Never Tells the Consumer About Add-On Insurance. In Some Cases, Mariner Pitches Insurance on an Unrecorded, Unscripted Phone Call.*

95. The first contact consumers have with Mariner is typically through the online application or by applying over the phone. Mariner never provides information about add-ons to consumers in its marketing or during the application process. Instead, the first time Mariner *might* mention the add-on products is on an "approval call."

96. The "approval call" is a telephone call that a branch employee makes to notify the consumer of the loan terms for which the consumer is approved for the loan closing. The approval calls are unrecorded and unscripted. Mariner does not have a policy of requiring its employees to explain the add-on products to consumers on the approval call, and many employees fail to do so.

97. In interviews, consumers recall being quoted monthly payment amounts that were significantly lower than the payments they ended up being charged by Mariner. This is because, on the approval call, some Mariner employees quote the monthly payment amount without any add-on products. Then, at loan closing, the monthly payment amount is significantly higher because the add-ons have been packed into the loan. Instead of providing a script for, or recording, approval calls to ensure its employees properly explain the add-ons, Mariner looks the other way when employees mislead consumers to reach the company's lofty sales goals.

98. On the "approval call," the Mariner employee focuses the consumer on two numbers: (1) the amount of cash that Mariner approved for the loan, and (2) the monthly payment amount. Whether or not consumers are informed of the monthly price including the add-on depends on the particular practices of individual Mariner employees.

99. One Pennsylvania Branch Manager said that her personal practice is to quote two monthly payments on the approval call: one with no add-ons, and another with add-ons. Mariner does not have a formal policy that requires this. Many consumers told Plaintiffs that Mariner never mentioned insurance and thus did not give two payment quotes.

100. But even if some of Mariner's employees do quote a monthly payment that includes add-ons on the approval call, this practice hides the full cost of add-ons by focusing the consumer's attention on the much smaller *monthly* cost of add-ons.

101. On the approval call, many Mariner employees simply offer the monthly payment that includes add-ons. For example, a District Manager in Wisconsin explained in a May 2020 email how his team had been so successful in selling Auto Plus plans: "I advised my team that the first quote given to the customer should include all qualified products, including a multi-year auto plus plan."[2]

102. In a similar example, one New Jersey-based Assistant Vice President instructed New Jersey branch managers to pressure consumers, during the introductory "approval call," into agreeing to commit to a monthly payment amount that includes all add-on products. He explained that "… the best way to offer is to make the initial quote payment with all products and then get verbal buy in from the customer that they are ok with the payment before they ever come into the office."

[2] Multi-year auto plus plans range from $380 (2 years) to $800 (5 years), excluding interest.

## II. Mariner's Rushed, Electronic Closings Deprive Consumers of the Chance to Read the Documents and Notice the Hidden Add-On Charges.

103. The consumer harm caused by Mariner's failure to properly explain add-ons is compounded by its all-electronic closing process, where consumers are not given a meaningful opportunity to read and understand the loan and add-on agreements, which typically consist of more than 44 pages of small text written in legalese.

104. Mariner often schedules loan closings when the consumer is on the way to or from work, when their time is limited, allowing Mariner to rush the consumer through the process.

105. At closing, Mariner brings the consumer into a small "closing room" or a cubicle that has a computer screen mounted on the wall. For many consumers, the screen is too far away and the text too small to read. For much of 2020 and 2021, Mariner had a clear 2 foot by 3-foot glass shield that separated the employee and the consumer on the table, which further obstructed the consumer's view of the computer.

106. When scrolling through the loan documents, Mariner exercises exclusive control over the pace and movement of the computer's displayed text of the insurance and loan agreement terms up, down, or across the computer screen. Mariner employees control the mouse and scroll through the pages quickly.

107. The Mariner employee pauses at more than a dozen signature and initial lines, indicating where to electronically sign. Mariner allows consumers to momentarily use a digital signature pad only to digitally acknowledge acceptance of the insurance and loan agreements.

108. As Exhibit A illustrates, Mariner buries the disclosures about the add-ons in the middle of the flurry of electronic documents, knowing that most consumers lack the time and financial literacy to read and understand all of the documents.

109. Even if consumers had the time and financial literacy to read and understand the terms and obligations contained in the insurance and loan agreements, consumers are not simultaneously provided a printed copy of those documents (except perhaps the loan note) when they are requested to digitally acknowledge them.

110. Numerous consumers reported that Mariner did not give them a chance to read the documents at closing.

111. For example, one consumer reported that he was not close enough to comfortably read the screen. He said, "I spent twelve years in the United States Army, so I usually like to read through the things I am signing. I did not feel like I had the chance to read through the documents."

112. Another consumer stated: "While we were electronically signing the loan documents by clicking 'I agree' on a signature pad, we could not see the loan documents at all. [The Mariner employee] had the computer monitor facing him, and he did not give us any chance to review or read the loan documents."

113. Another consumer said she was unable to "see everything [contained in the loan documents] because [the Mariner employee] scrolled through it so fast." According to the consumer, the entire "process took between 10 to 15 minutes."

114. Another consumer reported he was "unable to follow along with the document," as it was being described to him on a computer monitor and at "the end was told where to initial." The consumer reported that his loan closing "was very quick," and that he "finished reviewing the document[s] in 8 to 10 minutes."

115. Another consumer reported that the Mariner employee at closing went through the documents and summarized what they said, but that the consumer had "no chance to actually read" them and was "in and out in within 10 minutes." The consumer additionally reported that the

process did not include enough time to look over the paperwork and that it was "like you have to hurry up and get out."

116. Yet another consumer indicated that when a Mariner salesperson reviewed loan documents with her, "[t]he loan documents were on the computer screen. The salesperson did everything. They clicked everything and I just signed. I did not read over the paperwork. I wasn't given the time to sit and read it."

117. Even though Mariner's 44-plus page closing packets include disclosures about add-products being optional and costing extra, nearly every consumer interviewed who was charged for add-ons (more than 60 people) told the Plaintiffs that they did not know about the add-ons (or did not know they cost extra). Consumer interviewees were nearly unanimous in saying that they would have declined the add-ons if they had known the information contained in the disclosures.

118. Indeed, in every state where the Plaintiffs have interviewed consumers, the vast majority of consumers told the Plaintiffs that they did not know about the add-ons (or did not know they cost extra). Mariner's business model and policies are, with minor exceptions, the same in every state where it does business. Therefore the Plaintiffs aver that Mariner is charging consumers for hidden add-on products in every state where it does business. Since Mariner often lends to consumers who reside in neighboring states, Mariner's unlawful conduct also impacts the residents of many states where Mariner does not have brick-and-mortar locations.

119. In some instances, Mariner employees do not even have the customer provide electronic signatures. Of the 36 consumers interviewed by the Commonwealth who were charged for add-on products, three consumers (8 percent) said that the Mariner employee filled in all the signatures at closing. According to one of these consumers, the Mariner employee told her that "because of COVID" the consumer had to give verbal consent and the employee would click the

signature pad. Another customer said the Mariner employee signed all of his paperwork at the front counter.

120. Mariner headquarters has been aware that Mariner employees sometimes sign for customers since at least May 2021.

121. Mariner's policies and procedures do not require employees to provide consumers with paper copies of the loan documents, other than the 3 page loan note. Mariner does not track whether it gives a consumer a printed copy.

*Mariner Requires Its Employees to "Always" Offer Every Add-On.*

122. Formal corporate policy and daily reminders from executives and branch-level managers require Mariner employees to "offer" all eligible add-ons, for every loan, to every consumer, without exception.

123. This policy is featured prominently in the first pages of Mariner's employee training curriculum and is one of the first corporate rules on which employees are instructed. "Always offer all products that the borrower is eligible for" even when the consumer does not request or need such products.

124. In many cases, Mariner employees "offer" these products by including them in the loan without any prior consent from the consumer.

125. "Offering" add-ons in this manner leaves consumers with either: (A) no awareness of the products, or (B) the false impression that the products are mandatory.

126. To demonstrate compliance with this policy, Mariner employees are required to save a copy of the "payment calculation" screen in the loan origination system, showing the terms of the consumer's loan with every add-on product packed in.

127. In New Jersey, for example, Mariner has an explicit policy to always offer Credit Involuntary Unemployment Insurance and Credit Property Insurance to "all eligible customers" even if the consumer had not requested such products.

128. In addition to formal corporate policies, management at both the executive and branch levels of the company constantly monitor and aggressively pressure Mariner employees to offer all add-on products at every conceivable opportunity.

129. At the executive level, for example, a Mariner Vice President emailed all of the employees in his region—Pennsylvania, New Jersey, and New York—and accused the branches of not doing enough in "… Offering ALL Products to ALL customers ALL the time."

130. In another example, one New Jersey Branch Manager explained in an email that one of "the best way [sic] to steadily increase revenues over time," includes presenting all add-on products on every loan. The branch manager reiterated the Mariner-wide policy that "[i]nsurance must be presented on all loans …."

*Mariner Misrepresents the Extent of Protection Provided by the Insurance and Add-ons.*

131. Even when Mariner employees do mention the add-ons, they do so using misleading language that exaggerates their benefits. One Pennsylvania District Manager told the Commonwealth that, in his district, Mariner typically describes a loan with all potential add-ons as "fully protected." In his emails to his employees, he directs them to make "[f]ully protected payment calculations for every customer." When his employees are trying to sell insurance, they misleadingly describe a monthly payment with insurance as "fully protected."

132. The phrase "fully protected" is misleading to consumers in several ways.

a. First, calling a loan payment "fully protected" could lead the consumer to believe that the credit life, disability, and unemployment insurance covers all possible reasons for death, illness, job loss, etc. In fact, the insurance policies have a disability waiting period and many exclusions and limitations that make them far less than "fully" protective. These exclusions are buried in the fine print, and Mariner does not meaningfully discuss them with customers, if it discloses them at all.

b. Second, "fully protected" implies that without Mariner's insurance, a consumer will somehow be unprotected. In fact, many Mariner customers already have life, disability, or casualty insurance and do not need Mariner's duplicative policies. When deciding what add-ons to offer, Mariner does not take into account what insurance a consumer already has.

c. Third, Mariner calls a loan "fully protected" in reference not only to credit insurance but also to non-credit insurance products which do not "protect" against delinquency.

d. Fourth, even some of the credit insurance products that Mariner charges consumers for do not "protect" the payment: credit property insurance merely insures the consumer's personal property, which (unlike income) is not a source of funds for the consumer to repay the loan. Mariner does not repossess personal property when consumers default on the loan, so the loss of a consumer's personal property has no bearing on whether the loan is "protected" from default. Like the AD&D insurance (*infra* at para. 184), the property insurance provides almost no value to consumers. Mariner customers are unlikely to make a claim against credit property insurance, which covers the consumer's property that Mariner lists as collateral for the loan. Nationwide, Mariner charged 79,834 consumers $18.9 million for credit property insurance in the year ending July 31, 2020. Only 234 consumers were paid a total of $557,000 in claims.

133. "Fully protected" is also used for internal communications: an email from a Mariner Senior Vice President (SVP) directed all Mariner North Branches to "[s]trive for secured, *fully protected* loan packages to all eligible customers." (Emphasis Added).

134. Similarly, a Mariner Vice President described consumers who did not buy credit insurance or other add-on products as "unprotected" and therefore potential upsell opportunities. "They are ALL Unprotected and [that] gives you an opportunity to provide Superior Customer Service by Offering All of our Coverages!"

*Mariner Has Known About the Insurance Packing for Years and Has Done Nothing to Stop It.*

135. Mariner has known for years that its employees were failing to disclose the ostensibly optional nature of the add-on products.

136. Yet the company has made few changes to its policies or practices to protect consumers. As a result, the insurance packing has continued unabated.

137. As mentioned above, most of Mariner's calls are not recorded or scripted. But Mariner does script and record a small portion of its calls: the loan by phone closings. During the COVID pandemic, loans by phone grew significantly. For example, in April 2020, Mariner made over 7,000 loans by phone, comprising nearly 35% of Mariner's loans nationwide.

138. Loan by phone closings were generally done by the branch personnel that the consumer would have dealt with in person if not for COVID.

139. Even on these loan by phone closings that employees know are scripted and recorded, Mariner has observed widespread misleading practices by its branch employees.

140. For example, on May 18, 2021, a Mariner Vice President in the Pennsylvania area sent an email to the District Managers of Region 4 that said, among other things:

> [T]he company is seeing a huge spike in employees not disclosing our Insurance Products as "Optional."
> I was amazed to learn it was nearly 50% of all loan closing [sic] observed. THAT IS UNBELIEVABLE TO ME.
> I am not a betting man, however if I were I would bet it is occurring right here in our branches as well.

141. The District Manager for District 515 (a Pennsylvania district within Region 4) forwarded this email to his Branch Managers, with a note that said:

> We have been over this several times in each branch… [sic] Please make sure after the note, that your people are reading the optional insurance section prior to go [sic] over the insurances. I have been going over this for months and still find issues. Please make sure we eliminate these issues ASAP.

142. The reason Mariner's District Manager for District 515 is still seeing insurance packing is simple: Mariner executives and managers talk out of both sides of their mouths in communicating with employees. On the one hand, this District Manager sends an occasional email instructing employees to "read[] the optional insurance section" to consumers at closing. On the other hand, as described below in paragraph 182, he sends his employees daily reminders that they should average at least $200 per loan in AD&D and Auto Club charges (not including interest) and offer every customer every add-on. And Mariner's compensation model incentivizes employees at all levels to maximize add-on charges.

*Mariner Obtains Beneficiary Names Under False Pretenses.*

143. In order to fill out the life insurance and AD&D policy applications in Pennsylvania, Mariner's employees must obtain the names of one or more beneficiaries for the consumer. Mariner's employees have obtained these beneficiary names under false pretenses in order to complete the applications while still keeping the add-ons hidden from the consumer.

**i. Obtaining Beneficiary Names Under False Pretenses: Consumer Example 1**

144. For example, a consumer refinanced his $3,837 loan balance at 26.63% APR in December 2020 in order to obtain $500 in additional cash. Despite never telling this consumer about add-ons, Mariner charged him $951 in premiums and $551 in interest for three hidden add-ons. *For every $100 in additional cash that he borrowed, Mariner charged him $300 in add-ons.*

145. Mariner asked for the consumer's daughter's name under false pretenses so that it could list her as the beneficiary on his life insurance policy. He said Mariner had asked for his daughter's name as an emergency contact or someone money could be disbursed to or if something happened to him and Mariner needed to reach his family. Mariner did not tell him it wanted to list her as a beneficiary on an insurance policy.

146. This consumer reported that he would not have purchased add-ons if Mariner had told him about them because he already had homeowners and life insurance.

**ii. Obtaining Beneficiary Names Under False Pretenses: Consumer Example 2**

147. A repeat Mariner customer came in for a new loan. He told Mariner he did not want any insurance products because he had coverage through his employer.

148. Mariner told the consumer that he needed to provide the name of someone to be responsible for the loan in case something happened to him, or he didn't pay. He assumed this meant that Mariner wanted a co-signer and therefore he provided his girlfriend's contact information.

149. On the loan documents, instead of listing the consumer's girlfriend as a co-signer, Mariner listed her as the beneficiary for a life insurance policy that the consumer did not ask for and did not want.

*Mariner Fails to Disclose Mandatory Add-On Charges as Finance Charges, as Required by the Truth in Lending Act.*

150. As described herein, Mariner charges many consumers for add-on products without their knowledge. Some consumers are completely unaware of the add-ons. Others think they are free. Others think they are required.

151. Under the TILA and Regulation Z, the add-ons constitute a "finance charge" because Mariner requires many consumers to pay for them "as a condition of or an incident to the extension of credit." 12 C.F.R. § 1026.4(a)(1)(i). As described above, Mariner requires the add-ons by either charging the consumer without the consumer's consent or by telling the consumer falsely that the add-ons are required or free.

152. Under TILA and Regulation Z, Mariner may only exclude credit insurance premiums from the finance charge if "[t]he insurance coverage is not required by the creditor."

153. However, Mariner does not disclose the add-ons as part of the finance charge. Rather, it counts them as part of the amount financed. As a result, for many consumers, Mariner fails to disclose the finance charge and annual percentage rate, in violation of Regulation Z, 12 C.F.R. § 1026.18(d), (e).

154. Moreover, even in instances when the consumer is not required to buy the add-on product, Mariner uses deceptive language within the loan agreement that obscures the charges for the add-on products. Mariner's standard "Note, Security Agreement & Arbitration Agreement" ("Loan Note") obscures from the consumer charges related to its Auto Club and AD&D Insurance products by deceptively characterizing the expenses as "Cash to Borrower(s)," rather than, as it does with the other add-ons, itemizing the cost of Auto Club and AD&D separately in the "Itemization of Amount Financed" section of the Note.

### III. Mariner Deceives Consumers by Failing to Disclose the Substantial Commissions It Retains on the Premiums It Charges Consumers for Insurance Add-Ons.

155. As described herein, Mariner's rushed closing process prevents consumers from reading the written disclosures and noticing the add-on charges.

156. But even if a rare consumer manages to read the Loan Note, Mariner further deceives the consumer by stating in its written disclosures that the premium charged for each insurance product Mariner adds to a consumer's loan is paid to "To Ins. Company" when, in fact, Mariner deducts and retains for itself a substantial portion of the premium for each insurance add-on product as a commission.

157. In the fine print "Itemization of Amount Financed" on the first page of each Loan Note, Mariner lists the premium charged for each insurance product added to the loan and states that the premium for such products is paid "To Ins. Company."

158. Next to that statement, Mariner includes an asterisk which refers the consumer to a deceptive caveat in fine print stating, "[w]e or our affiliates *may* receive benefits from your purchase of these items." (Emphasis added.)

**Itemization of Amount Financed**

1. $ 5,829.16 Net Balance-Prior Account
2. $ 92.26 Plus Accrued Interest
3. $ 5,219.79 Unpaid Balance-Prior Account
4. $ 272.70 To Ins. Company for Life Ins.*
5. $ 414.58 To Ins. Company for Dis. Ins.*
6. $ NONE To Ins. Company for Property Ins.*
7. $ NONE To Ins. Company for Non-Filing Ins.*
8. $ 623.42 To Ins. Company for Invol. Unemp. Ins.*
9. $ NONE To Ins. Company for Single Interest Auto Ins.*
10. $ NONE To us for GAP Contract*
11. $ NONE To Public Officials for Recording Fees
12. $ 1,500.00 Cash to Borrower(s)
13. $ 8,030.49 Amount Financed (Sum of 3-12)

*We or our affiliates may receive benefits from your purchase of these items.

At your direction and request, on your behalf and for your benefit, we will disburse the following (including any items described on Schedule B):

a) $ 1,500.00 To [redacted]
b) $ NONE To N/A
c) $ NONE To N/A
d) $ NONE To N/A
e) $ NONE To N/A
f) $ NONE To N/A
g) $ NONE To N/A
h) $ NONE To N/A

159. Mariner's statement that the premium is paid "To Ins. Company" is false because Mariner only pays a portion of the premium to the insurer.

160. Under its Producer Agreement with each insurer, Mariner keeps or a substantial portion of the premium charged for each insurance product, ranging from 21% to 75% of the net written premium amount depending on the add-on product and the state in which Mariner is making the loan.

161. Mariner's inadequate disclosure to the consumer that it or its affiliates "*may*" receive benefits from the amount charged for credit insurance is also deceptive because it contradicts Mariner's statement that the entire premium amount is paid "To Ins. Company."

162. The inadequate disclosure further misleads consumers by stating that Mariner "*may*" receive benefits when Mariner knows it is contractually entitled to receive a substantial commission on each insurance product.

163. For example, the itemization of amount financed for one consumer stated that she paid a total of $1,746 in premiums for credit life, credit disability, and involuntary unemployment insurance "To Ins. Company." Of that amount, however, $739 was retained by Mariner in commission, without written disclosure to the consumer.[3] The remaining $1,007 was the true price of the insurance premiums actually paid to the insurer.

164. Similarly, the itemization of amount financed for a different consumer stated that he paid Mariner a $227 premium for credit property insurance which, according to Mariner's written disclosure, was all paid "To Ins. Company." In fact, Mariner retained a $148 commission under its Producer and Commission Schedule for loans made in Washington, totaling 65% of the premium amount that Mariner itemized and described as going to the insurer.

[3] The commission breakdown was $144 for credit life ($361 premium at 40%), $221 for credit disability ($552 premium at 40%), and $374 for credit IUI ($831 premium at 45%), for a commission total of $739.

165. As a result of Mariner's failure to disclose, in the itemization of amount financed, the commission it retains on each insurance product it sells, the portion of the amount financed paid "To Ins. Company" is inaccurately stated and the true price of the credit insurance—after deducting the commissions Mariner retains—is hidden from consumers.

## IV. Mariner Employees Mislead Consumers Because Their Supervisors and Headquarters Set High Sales Goals and Pit Branches Against Each Other with Incentive Compensation.

*Mariner's Compensation System Incentivizes Field Employees to Pack Insurance.*

166. Mariner has more than 1,500 employees in the field. Its compensation system strongly incentivizes these field employees to maximize add-on charges because this increases the size of each individual loan. Like the rest of its policies that underlie the unlawful conduct described herein, the compensation system applies in every state where Mariner does business.

167. The targets Mariner sets for its employee bonus program can be met in one of two ways: making more loans, or making bigger loans by charging consumers for more add-ons per loan.

168. From at least 2016 until April 2020, when Mariner modified its compensation program, employee (and manager) bonuses were heavily tied to a metric called "new cash," which included not only monthly cash loaned out but also financed add-on charges. The use of this metric put significant pressure on employees (and their managers) to maximize the loan size.

169. In turn, Mariner employees had a powerful incentive to maximize add-ons on every loan. Although the maximum loan size that a consumer qualified for under Mariner's underwriting standards excluded the add-on charges, the value of the add-ons counted toward an employees' "new cash" amount. This means that a consumer who had been approved to borrow $2,000 in cash could be booked for a $2,700 loan if the Mariner employee added $700 in add-on charges. Until

April 2020, this additional $700 would have a direct impact on the "new cash" component of employees' quarterly bonuses.

170. Even after the April 2020 change, Mariner still allows add-ons to be added on top of a loan that is at the maximum size allowed by underwriting. Thus Mariner lends above a limit set by its own underwriting standards, making it more likely consumers will be unable to afford the loans and forcing more consumers into refinancings.

171. After April 2020, add-on premiums and fees are not included in the "loan amount" component of the quarterly bonus program. However, even after that policy change, Mariner branch employees are still under pressure from their superiors to maximize loan size and add-on charges, as shown by emails below.

172. Moreover, even if Mariner excludes add-on charges from "loan amount" for the quarterly bonus metrics, add-on charges remain a key factor in how Mariner measures its overall growth and profitability. Indeed, a slide deck for an August 2021 Board of Directors meeting has a slide entitled "Direct Loan Source of Business Key Metrics." One of the four "key metrics" is Net New Cash per Loan, which includes add-on charges.

*Managers Have Even Stronger Incentives to Maximize Add-On Charges.*

173. Managers (Branch Manager and above) have even stronger incentives to maximize loan sizes and add-on charges because their annual bonuses are tied to their branches' loan growth and return on assets (ROA). Both these figures are impacted by add-on charges and the interest that results from add-on charges. ROA is calculated using the following formula: ROA = (revenue – [charge offs + expenses]) / average net receivables. Charges for add-on products can positively impact ROA because add-on charges and interest are counted as part of revenue, and credit insurance can reduce charge offs.

174. To receive an annual bonus, a Branch Manager must meet or exceed a yearly ROA goal and the branch must be in the top 40% of ROA in its peer group.

175. This requirement that a branch be in the top 40% pits branches against each other. This competition between branches is something that Mariner headquarters directs the District Managers to remind branch employees about on a daily basis.

176. In an email on May 12, 2021 sent to all of his district employees, a Pennsylvania District Manager strongly emphasized the ROA metric:

> For the month The 515 [region] posted an ROA of 8.17% with a bottom line income of $218,363 with 6 of 7 branches North of 7% and 3 above 10%... YTD we fell under 10% and now sit at 9.55% with a Net Profit of $1,031,110. Very solid start to 2021!!!
> Always remember, Loan volume triggers everything!!! It increases Net Interest Income which is the fastest way to increase your ROA... It gives you a chance to sell more Credit and NON Credit Insurances, which also have a tremendous impact.

177. The District Managers' annual bonuses are tied directly to the Branch Managers' annual bonuses, which means they too have a strong incentive to maximize add-on charges within their districts. The VPs to whom the District Managers report, and the SVPs to whom the VPs report, also have incentive compensation that motivates them to maximize the loan sizes and add-on charges within their regions.

178. Mariner ties a significant amount of employees' compensation to quarterly performance goals. Non-managerial employees, who handle the bulk of Mariner's loan closings, can earn quarterly bonuses worth up to 20% of their salaries. In the first quarter of 2021, the average quarterly bonus for non-management employees was $1,038, and the maximum payout was $4,459. Of all eligible employees, 92% received a quarterly bonus.

179. Branch Managers and their superiors can also earn quarterly and annual bonuses worth thousands of dollars. In Q1 2021, the maximum quarterly bonus for Branch Managers was

$6,800 and the average was $1,338. Ninety-five percent of Branch Managers qualified for the quarterly bonus.

180. District Managers receive quarterly and annual bonuses that are tied to the performance of their Branch Managers. In Q1 2021, 99% of Mariner's District Managers qualified for a *quarterly* bonus averaging $3,789. The maximum District Manager *quarterly* bonus was $11,348. In 2020, a Pennsylvania District Manager could have received up to $63,000 in *annual* bonus, which is 50% of the sum of seven Branch Manager bonuses.

181. Thus, all of Mariner's consumer-facing employees—managers and non-management employees—are highly motivated to meet the targets that Mariner attaches to its bonus programs.

*Mariner Managers Aggressively Push Employees to Sell the Most Profitable Add-Ons with Explicit Sales Goals.*

182. Mariner's District Managers are expected to send daily emails to all of their branch employees, drawing attention to key profit measures that are selected by headquarters. The daily email contains, among other information, the latest numbers for the most profitable add-ons: non-credit products (e.g. AD&D and Auto Club). Mariner headquarters does not provide a script for the daily email, but it does give (via Vice Presidents) the District Managers direction on the metrics that the email should focus on. These metrics are periodically updated.

183. Mariner headquarters also provides District Managers with certain goals that are then pushed out to their employees in the daily emails. For example, in Pennsylvania Region 4, Mariner set a goal of averaging $200 per loan for "ancillary" charges, which (in Pennsylvania) refers only to AD&D insurance and Auto Club. This goal does not include the additional interest that AD&D premiums accrue.

184. Charging consumers for AD&D without their knowledge is particularly harmful because Mariner customers are highly unlikely to receive any claim payments from an AD&D policy: from August 2019 to July 2020, Mariner charged 53,028 consumers $12.3 million for AD&D, but only 33 consumers received a total of $673,000 in claim disbursements. One reason there are so few AD&D claims is that AD&D excludes many leading causes of death and disability (disease, suicide, drug overdoses, military service, alcohol, pre-existing conditions) that are covered by typical term life and disability policies.

185. The $200 per loan ancillary sales goal in Region 4 was in place from at least July 2020 to July 2021. Upon information and belief, other regions had similar ancillary sales goals.

186. One Mariner Vice President, expressing frustration and dissatisfaction over lower than expected add-on sales for one New Jersey branch, stated in an email to the branch manager that: "[y]ou're [sic] A&H and IUI Credit Products are down and shouldn't be?[sic] … This must improve immediately. I want you to review each Quote prior to Approval/Funding and assure we are offering ALL eligible Products to ALL customers ALL of the time. Let's get those products back on track!"

187. The following excerpts are from daily emails sent by a Pennsylvania District Manager to the employees of the seven branches in his district. The emails rank the branches on several different metrics, and they rank employees as well.

> May 2, 2021:
>
> WE WILLL [Sic] OFFER 100% OF OUR PRODUCTS TO EVERY CUSTOMER 100% OF THE TIME. Team Reading led the way with $1,299 in Ancillary Sales, they were followed by Team Wilkes Barre with $1,020, Team Bloomsburg $840, Team Pottsville $558, Team Pittston $390 and Team Dickson City $199. MTD [month to date] we are at $210 per loan, GREAT JOB!!! .. Now to stay above $200/loan... ... Team, We are to be offering to every customer every time…Keep

the focus .....We need to get to $200 per loan in every branch as we start to raise the bar . . . .

May 4, 2021:

Top 5 Ancillary April

| | | |
|---|---|---|
| 1) | [Employee name redacted] | $7,870 |
| 2) | [Employee name redacted] | $6,381 |
| 3) | [Employee name redacted] | $6,120 |
| 4) | [Employee name redacted] | $4,981 |
| 5) | [Employee name redacted] | $4,980 |

**Team, the bottom line #'s for 2021 start at** LPE [loans per employee], minimum 2 DACC [auto title loans] per month and **$200/loan in Ancillary**... It starts with 2 apps daily, following the DACC process, BM [Branch Manager] involvement and the Daily sense of Urgency to WIN!!!!!
(Emphases in original.)

May 12, 2021:

AREAS to Drive Income: . . . 3) Credit and Non Credit Insurance- Added income but also protects your customer which protects your balance.

188. At the individual branch-level, Branch Managers also encourage their employees to hit high sales goals for add-ons. In one example, a New Jersey Branch Manager suggested that to improve the total number of add-ons sold in his branch, "[e]ach employee [meet] a monthly goal in auto plus [sales], and everyone understand the importance of hitting that goal." This branch manager also took the additional step of "creat[ing] a board so everyone [will] know where they are at as far as insurance sale and auto plus [goals]."

189. In sum, Mariner employees face constant pressure from their managers to sell more add-on products. Each branch's add-on sales numbers are compared via email to the other branches, and individual employees' numbers are also emailed around to the whole region for everyone to see.

190. Finally, in addition to providing strong financial incentives to sell more add-ons, Mariner *punishes* employees for failing to sell enough add-ons.

191. Mariner has placed numerous Branch Managers in multiple states on formal performance improvement plans (PIP) for failing to meet its performance metrics, including those related to add-on charge targets. For example, in September 2019, a Branch Manager was put on a PIP for, among other things, failing to meet expectations for loan originations, specifically because the branch was not producing at *minimum* a $7500 overall ancillary product volume per month. (emphasis added).

192. In a March 2020 PIP, an employee was cited because the branch's ancillary sales were below the minimum of $100/loan. The employee was instructed to "offer optional products to all consumers that 'qualify'" without further explaining what constitutes eligibility.

193. Additionally, an employee was placed on a PIP for failing to meet the expectation of $100/loan for all Auto Club enrollments. This employee was directed to "include the auto club cost in the overall quote."

## V. Mariner's Board and Top Executives Are Directly Involved.

*Mariner's Top Executives and Board of Directors Receive Regular Updates on the Company's Add-On Revenue and Initiatives.*

194. Mariner headquarters closely monitors the sales of add-ons using a "Monthly Insurance Business Review" slide presentation and other reports. The monthly review is sent to its President and CEO, Joshua Johnson, its COO, James Schneider, and its CFO, Mark Keidel. These slides track credit insurance trends and non-credit add-ons on a "dollars per loan" basis. For the month of March 2020, the highest insurance sales on a dollars per loan basis were, among Plaintiff States: Pennsylvania ($528), Utah ($440), Washington ($389), and New Jersey ($300). Of course, these numbers do not include the additional interest attributable to insurance charges.

195. The Monthly Insurance Business Review tracks month-to-month changes down to the state level. For example, the August 2020 Review slides note changes in insurance sales:

- Large decrease [in credit insurance sales] due to change from Securian feature forms sold in July to LOTS [Life of the South] products sold in August
- State did a good job mitigating the loss with Non Credit sales
- Sales should stabilize in September

The comment that Mariner's branches in this particular state "did a good job mitigating the loss with Non Credit sales" suggests that Mariner headquarters views the add-on products as fungible. Mariner does not care which kind of add-ons its branch employees charge consumers for, as long as they reach or exceed their add-on sales and revenue goals.

196. Mariner's COO, to whom all the field employees and their chain of command report, emails regular updates on financial results to his fellow executives, including the CEO. For example, on Friday, April 9, 2021, he sent an email with the subject line "April MTD" (month to date). Among other things, the email said:

> Following a slow start last week, things have been picking up the past few days – hopefully a sign that the stimulus checks and their negative impact on consumer demand (and our lending efforts) are behind us! . . . **Sales of non-credit and credit products at/near all-time highs at $104.16 and $298.24 per unit respectively – NICE!**

(Emphasis added.)

197. Mariner's executives are well aware that Mariner itself collects most of the claims on the insurance policies. For example, according to the Monthly Insurance Business Review slides, in December 2020, Mariner made $1,341,594 in claims against credit insurance policies. By comparison, Mariner consumers nationwide received only $243,621 in claims that month. This compares to $11.2 million in add-ons (not including interest) that Mariner charged consumers on loans originated that month.

198. The push to maximize loan size is a goal that Mariner's highest executives and Board of Directors from Warburg Pincus LLC explicitly set for themselves. In an August 2021 Board of Directors slide deck, a slide entitled "The State of Mariner Finance" lists one of the Opportunities as "Maximizing loan size opportunities in our credit grades and online lending." The Board of Directors deck also includes, as part of the Q2 2021 P&L, Insurance Income of $9.2 million (up from $7.9 million in the prior year but less than the $10.0 million in the Plan).

199. Mariner's SVP for insurance is so focused on maximizing revenue from add-on products that he told the CFO in a September 2020 email with the subject line "RE: Insurance Income by State" that Mariner should research what add-on products it can sell in a state to help it decide whether to expand into that state. He wrote: "we don't have Legal identify products until we identify the state (for expansion). Should probably be the other way around."

200. Mariner headquarters emphasizes the importance of add-on product sales to profitability in its communications with its managers in the field. In an August 2021 Field Leadership Meeting, a Mariner executive presented a slide on "State Profitability Analysis" that says, in part, "we will need to *continue to emphasize Optional Product sales* as a way to offset the inevitable increase in Cost of Funds rates" (emphasis added).

201. In an email to the heads of all four of Mariner's Regions, the COO attached a report on sales of Auto Plus, broken down by branch, district, and divisions. He wrote:

> I hope you are all using the attached report to recognize your top producing districts and branches, and coaching/training the low/non-producers. . . . Please be sure to take advantage of the FIMC [Auto Plus provider] sales team and their resources to get the low producers trained up and selling. **No room in our new "lean and mean" organization for non-producers.** Accountability starts today.

(Emphasis added.)

*Mariner's CEO is Personally Involved in Expanding the Company's Add-On Offerings and Increasing Add-On Revenues.*

202. Mariner's CEO was personally involved in reviewing FIMC Home & Auto, a new, more expensive add-on that Mariner began offering in 2020. Mariner's top executives met with the FIMC CEO about this product in September 2020. FIMC's presentation to Mariner was entitled "New Revenue Opportunities" and said "FIMC Can Help You **Maximize Revenue**" (emphasis in original).

203. The slides that FIMC sent Mariner's CEO and other top executives estimated that the new add-on product would increase Mariner's commission revenue by about $2.8 million annually because the retail price (and commissions) range from $330 to nearly $1,200, up from the previous product's price of $200 to $800:

## Home & Auto Conversion Opportunity

- We estimate Mariner's commission revenue will increase by +34% by converting Auto Plus to Home & Auto. This would generate an additional ~$2.8M in commission revenue.
- Assuming 100% flow through of H&A commission revenue, and not including the benefit of incremental interest expense, that results in incremental $2.8M in cash flow every year for Mariner.

Mariner Product Conversion from Auto Plus to Home & Auto

| | Baseline 2019 | | | | | | Proforma Run-rate | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Term | Auto | H&A | % of Net Units | Auto Plus Retail Price | Net CAR | Net Sales | Auto | H&A | % of Net Units | H&A Retail Price | Net CAR | Incremental Net Sales from H&A Conversion |
| 1 Year | 54% | 1% | 55% | $199.95 | 9.7% | $6,090K | 11% | 44% | 55% | $329.95 | 9.7% | $3,142K |
| 2 Year | 24% | 0% | 24% | $379.95 | 4.3% | $4,975K | 5% | 20% | 24% | $499.95 | 4.3% | $1,242K |
| 3 Year | 16% | 1% | 17% | $499.95 | 3.0% | $4,263K | 3% | 14% | 17% | $599.95 | 3.0% | $662K |
| 5 Year | 3% | 0% | 3% | $799.95 | 0.6% | $1,308K | 1% | 3% | 3% | $1,195.95 | 0.6% | $518K |
| Total | 98% | 2% | 100% | $287[1] | 17.6% | $16,636K | 20% | 80% | 100% | $384[1] | 17.6% | $5,564K |

Note: (1) Refers to blended net average price per unit. Net of impact of renewals and cancellations.

The FIMC slide notes that this potential added commission revenue does not include "the benefit of incremental interest expense."

204. In October 2020, Mariner's Senior Vice President responsible for add-on products emailed the CEO regarding the introduction of Home & Auto in Kentucky. He said the "Goal is to increase overall sales with a product that provides good value to the consumer and then consider the product for other states based on the test."

*In Marketing the New, More Expensive Add-On Products to Consumers, Mariner Deliberately Conceals the Price.*

205. As described above, Mariner does not tell consumers the price of add-on products until the consumer is set to close on the loan and, even then, the price is buried in many pages of fine print. This is intentional and directed by Mariner's executives at the most senior levels. In May 2020, the SVP responsible for add-on products received an inquiry about a marketing email to be sent prior to closing to certain Mariner borrowers about the FIMC Auto Plus plan. The marketing person asked, "Do we want to include any cost information in this email?" The SVP responded, "Short answer is, no." Mariner leaves the cost information out of the marketing email because disclosing the high cost will make the consumer more likely to notice and reject the add-on product.

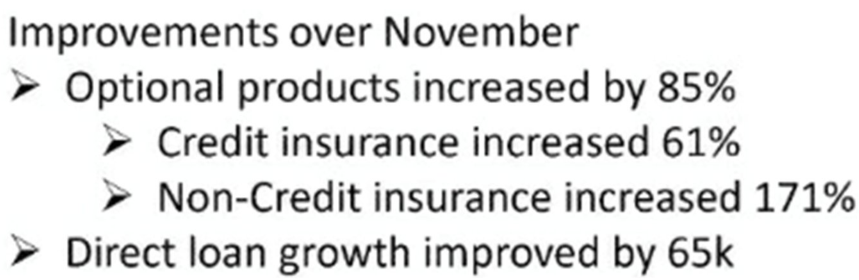
206. Some consumers asked to see information about Auto Plus before deciding whether to buy it. But until at least late June 2020, Mariner senior executives prohibited employees from sending that information to consumers—even though Mariner had a trifold brochure in the branches that it could have emailed.

207. Without any cost information in the marketing email or a brochure on what the product covers, consumers cannot make an informed decision on whether to buy a product.

*Mariner Headquarters Deploys a "Focus Team" to Help Branches Increase Insurance Sales.*

208. In 2018, Mariner established a Focus Team that travels around the country to help branches become more profitable. One priority for the Focus Team is increasing the sales of add-on products. The Focus Team prepares a monthly "Impact Report" that summarizes sales increases in branches it recently visited.

209. For example, in a December 2019 "Impact Report," one slide touted improvements in add-on sales in a particular branch:




The slide for each branch visited provides a detailed chart that breaks out the total volume of credit and non-credit insurance sales and average insurance sales per unit.

210. In November 2019, this branch's average add-on charges per loan was $396. Thanks to Mariner headquarters' Focus Team's visit in November, the branch nearly doubled add-on charges—to $721 on average (or over $1,000 with interest) in December 2019.

211. In March 2020, a Focus Team visited a Pennsylvania branch and wrote, "Penetration remains steady, but does leave opportunity for improvement in most all products." Under Next Steps, the Team wrote, "All staff to work up all loans for *largest possible deal*. Utilize DACC [auto secured loan] worksheet to present, and *overcome objections*" (emphasis added).

*Mariner's Compliance Management System Is Woefully Inadequate.*

212. Mariner's compliance management system is woefully inadequate. Despite knowingly charging consumers for insurance without their consent for years, Mariner does not

provide its employees with scripts for marketing and approval calls. Nor does Mariner permit its employees to email customers, which would create a written record. Nor does Mariner record phone calls so that it can monitor its employees and verify what consumers were told when they complain about insurance charges.

213. Banks and other consumer lenders make it a standard practice to record every single call. Yet despite having the technological capability to record calls since at least March 2020, Mariner has refused to implement this practice except on loan by phone closings.

214. Even when they know they are being recorded, Mariner employees *still* fail to disclose and describe the add-on products it is packaging with the consumer's loan. In May 2021, Mariner discovered that in "nearly 50% of all loan closing observed" for loans by phone, the employee failed to describe the add-ons as optional.

215. When Mariner does disclose the add-on products as optional, consumers often decline them. Penetration rate data suggests that Mariner employees have a harder time charging consumers for add-ons when they are on a (purportedly scripted) recorded phone closing than they do when they have an unscripted closing that is not recorded: in April 2020, Mariner charged consumers for at least one add-on on 72% of loans by phone, compared to 81% of in-branch loans.

## VI. Mariner Engages in Other Harmful Practices to Maximize Add-On Charges.

*Mariner Mails Hundreds of Thousands of Unsolicited "Live Checks" to Consumers Each Year, Exposing them to Identity Theft Risks.*

216. Mariner acquires half of its customers with its Loan by Mail (LBM) program, using prescreening of consumer files from a consumer reporting agency. Mariner mails live checks made out in targeted consumers' names, with loan terms on the back. If a consumer or someone who intercepts the consumer's mail cashes an LBM check, Mariner opens a loan in the consumer's name. A true and correct copy of an LBM solicitation is attached and includes the following:

MARINER FINANCE
*Money when you need it most*

T00001****AUTO**MIXED AADC 390

[redacted] 000001
Lancaster, PA 17601-4934

Dear [redacted],

You have been selected to receive extra money from Mariner Finance! **The attached check is real.** It represents a loan for you to use for whatever purpose you choose. Simply sign the back of the check and deposit it in your bank account, or cash it today!

**Why cash this check?**

Use this money for auto repairs, home improvements, or for any purpose you choose! Once you deposit this check, you'll receive a coupon booklet in the mail confirming the due dates and monthly payments. The Loan Agreement and Disclosure Statement are on the reverse side of this letter. This letter and the Loan Agreement and Federal Disclosure Statement are your Statement of Contract. Keep it for your records. The check is good for 30 days. The estimated Loan Date is 1/23/2015 and the estimated Maturity Date is 05/23/2018. So, cash it today and enjoy the benefit of your new purchasing power!

Remember, you can cash this check, today! If you don't want to receive future solicitations of this type, call us at (443) 438-2036, email us at LBM@marinerfinance.com, or write us at the address on the reverse side of this letter and let us know.

**Who is Mariner Finance?**

With over 160 branches in 11 states, Mariner Finance is a trusted financial institution whose goal is to provide consumers like you with **money when you need it most.**

**Need more money?**

If you should need a loan amount larger than the amount on this check, call your local **Lancaster** Branch at **717-208-7025, or visit us at 2044 Fruitville Pike, Lancaster, PA 17601**, to speak with a knowledgeable member of our staff. We'll be glad to arrange for you to receive a larger loan.* You may also visit us online at www.marinerfinance.com.

Sincerely,

Josh Johnson
President and CEO

No prepayment penalties

Need even more money? Contact your local branch!*

Still not sure? We offer a **15-day satisfaction guarantee,** so if for any reason you are not satisfied with your loan, you can return it risk-free.†

***You can choose to stop receiving "prescreened" offers of credit from this and other companies by calling toll-free 1-888-567-8688. See PRESCREEN & OPT-OUT NOTICE on reverse for more information about prescreened offers.***

†If, for any reason, you are dissatisfied with your loan and you repay it within 15 days, we will refund all finance charges and cancel all coverage with no penalties. *Subject to normal lending requirements.

MARINER FINANCE

BANK OF AMERICA

7-163
520
000001-6004

*Date: 1/23/2015*
*Check #0002552230*

Pay TWO THOUSAND FIVE HUNDRED THIRTY NINE AND 00/100 **$2,539.00**

Payee's Endorsement and Two Forms of ID Required

TO THE ORDER OF

[redacted]
Lancaster, PA 17601-4934

000001

AUTHORIZED SIGNATURE
VOID AFTER 30 DAYS FROM DATE

[redacted]

217. Numerous consumers have complained to law enforcement that the unsolicited checks create an unreasonable risk of identity theft. Multiple consumers report checks stolen from their mailboxes, cashed in their names, and loans opened with Mariner without the consumer's knowledge or consent.

218. LBM loans carry high interest rates. But Mariner uses them as a mere foot in the door to originate larger branch loans. The company's stated goal is to convince consumers to refinance as many LBMs as possible. Mariner regularly contacts LBM customers by unsolicited mail, marketing emails, and telephone calls inviting them into the branch to borrow more money.

219. If a consumer falls for Mariner's pitch to borrow more money, Mariner employees are instructed to draw up a whole new loan, which refinances the existing loan, adds additional cash, and—typically—includes hundreds or thousands of dollars in add-on products.

## VII. Mariner Continues to Hide Add-Ons from Consumers after Closing and Obstructs Consumers' Attempts to Cancel if They Do Discover the Add-Ons.

*Mariner Refuses to Give Consumers Printed Copies of Documents During and after Closing.*

220. When consumers call to ask for a printed copy of their loan documents during and after closing, Mariner has misrepresented that it is a "paperless" company and therefore cannot send consumers paper copies of disclosures related to their loans. Instead, Mariner employees tell borrowers to register for online access, log onto the website, and download and print the 44-plus pages of documents, at their own expense.

221. In New Jersey, Mariner does not simultaneously provide a printed copy of the loan documents when it requests or requires consumers to digitally acknowledge insurance and loan agreements.

222. The E-Sign Act requires that a person providing electronic records to a consumer must inform the consumer of any right to withdraw consent to electronic records and to receive paper copies of the information. 15 U.S.C. §§ 7001(c)(1)(A), (B)(i), (B)(iii).

223. Although Mariner's E-Sign Disclosure form permits the consumer to withdraw her consent for no fee and says that consumers "can obtain a paper copy . . . by requesting that we mail you a paper copy," Mariner branches are not offering consumers this option when they call and ask Mariner to mail them paper copies of agreements.

*Mariner's Loan Closings Do Not Comply with the E-Sign Act.*

224. Although Mariner's default method of providing disclosures is electronic, Mariner does not have a process in place to ensure that every consumer demonstrates that they can access electronic disclosures, as required by E-Sign.

225. The E-Sign Act requires that, "[T]he consumer . . . confirms his or her consent electronically, in a manner that reasonably demonstrates that the consumer can access information in the electronic form . . . ." 15 U.S.C. § 7001(c)(1)(C)(ii).

226. Although *some* Mariner customers demonstrate their ability to access electronic disclosures by applying on their own electronic device, many Mariner customers *do not*. Instead, these customers apply via a phone call or in person at a branch. For these customers, Mariner's process violates the E-Sign Act.

*Mariner's Website and App Hide the Loan's Unpaid Principal Balance which Obscures Add-On Charges from Consumers.*

227. On Mariner's website and app, when consumers go to look for their unpaid principal balance, Mariner displays a "balance" that equals the total of the remaining scheduled

payments on the loan. Mariner hides the unpaid principal balance (or payoff amount) on a page that requires multiple clicks to find.

228. By displaying only the total of payments and not the unpaid principal balance, Mariner makes it less likely that consumers who have been charged for add-ons without their knowledge or consent will notice the extra principal costs they have incurred. For example, a consumer who borrows $2,950 in cash and logs onto her Mariner account a few weeks after loan origination might be surprised to see a balance of $3,734 (the Amount Financed on the loan plus the add-ons). She might call Mariner to ask why the balance is higher than what she borrowed, and she might then discover the $785 that Mariner charged her for add-on products without her permission.

229. But instead of seeing the unpaid principal balance when she logs onto her Mariner account, this consumer sees her "balance" listed as $5,435, which is the total she will pay over her 36 month loan. This consumer is likely to believe that the difference between what she borrowed and her "balance" consists entirely of unpaid, future interest. In reality, her loan has $1,700 in finance charges (which includes interest on the add-ons) and $785 in hidden add-on charges.

230. Displaying the smaller unpaid principal balance first on the website could also incentivize consumers to pay off their loan more quickly, thus reducing Mariner's interest revenue over the long term. Conversely, if consumers think the loan balance is higher than it actually is, they may be less likely to even attempt to make additional payments to pay down the principal.

*Mariner Obstructs Consumers' Attempts to Cancel Add-Ons.*

231. Not only does Mariner harm consumers when it puts them into contracts for add-ons without their knowledge, but it compounds the harm to consumers who discover the add-ons and seek to cancel them.

232. All the add-ons that Mariner sells have a right to cancel and receive a pro-rated refund.

233. Mariner commonly tells consumers that if they cancel, it will not impact their monthly payment amount.

234. Even if a consumer says they never agreed to purchase the add-on products, Mariner will only provide a one-time, pro-rated refund. Mariner will not re-amortize the loan to reduce the monthly payment to the amount it would have been without the unwanted add-ons.

235. Consumers told the Plaintiff States that Mariner took the following actions when the consumer tried to cancel: (A) refused to cancel unless the consumer returned her original insurance documents to the branch; (B) required a consumer to obtain Manager approval and visit a physical branch location to sign a paper form; (C) required a consumer to contact the add-on provider; (D) refused to send a copy of the cancellation form and failed to provide written confirmation of the cancellation and refund; (E) cancelled only one add-on product despite the consumer asking to cancel all four add-ons on his loan; (F) refused to cancel property insurance unless the consumer listed Mariner on her homeowner's insurance policy; (G) falsely stated that the window of cancellation had long passed for all add-on products.

236. The examples above are drawn from interviews of a random sample of consumers. This conduct harms consumers by imposing charges that Mariner should have refunded.

237. Mariner requires all borrowers to sign E-Sign agreements, and it obtains electronic signatures from nearly every consumer at closing. Mariner has the ability to email documents to consumers for their electronic signature; it does so for every loan by phone.

238. Mariner's policy of requiring an in-person paper signature to cancel (but not to purchase) add-ons compounds the harm of the initial add-on charges.

## VIII. As a Result of this Conduct, Mariner Makes Enormous Ill-Gotten Profits from Add-Ons.

239. Mariner and its employees make substantial profits by charging consumers for hidden and unwanted add-on products. In May 2020, Mariner forecast that it would earn $51.9 million in insurance income in 2022.

240. Commissions on Mariner's insurance and non-credit products are high. The add-ons that Mariner sells are incredibly profitable because, with one or two exceptions, consumers make few claims against the policies. As a result, the insurers pay Mariner sales commissions that far exceed the amount consumers are paid in claims. Everyone wins in this arrangement *except* the consumer.

241. For example, a Mariner Senior Vice President reported in email that Mariner branches receive a 41% commission on every sale of the Auto Plus program to consumers.

242. Nationally, Mariner earned $600,000 in February 2020 on sales of AD&D. On average, Mariner's commission was $233 per sale, or 75% of the gross premium charged to the consumer. In May 2020, Mariner forecast that its annual AD&D revenue would grow to $12.5 million in 2022.

243. Adding hidden and unwanted add-on charges inflates the loan's amount financed, earning Mariner millions more in interest (at high APRs) than cash loans alone would generate. Often, this inflated amount financed is money the consumer would not have chosen to borrow or that Mariner's underwriting guidelines would not have allowed employees to loan—unless the consumer spent it on add-ons.

244. Add-ons also contribute directly to Mariner's revenue when consumers miss a payment for a reason covered by a credit insurance policy. Mariner makes the claim directly to the

insurance company, and the payment goes directly to Mariner, reducing Mariner's charge off rate and loan losses.

245. Finally, Mariner's offshore insurance subsidiary, MF Insurance, reaps further profits on the add-on products by selling reinsurance to Mariner's hand-picked insurance providers. According to the *Washington Post*, MF Insurance, which is based in the Turks and Caicos, made $20 million in premiums in 2017.

246. Since Mariner—not the consumer—chooses which add-on products to offer, Mariner can demand lucrative deals from its insurance and non-insurance partners. This enables Mariner to maximize its share of the insurance premiums, reinsurance and fees for non-insurance products. This market dynamic is known as reverse competition because, unlike a competitive market where the consumer can choose the lowest cost product, it is a market where a middleman (Mariner) chooses the product leads to higher prices, which maximize the middleman's fee. *See* Exhibit B, page 253, for a fuller explanation of reverse competition.

247. An example of reverse competition is Mariner's 2020 "Profit Improvement" initiative whereby it made Fortegra / Life of the South its sole credit insurance provider. In exchange, Life of the South agreed to pay Mariner a regular "marketing agreement bonus."

## IX. Mariner Incentivizes Employees to "Flip" Consumers' Existing Loans by Inducing Borrowers to Enter into Larger, Refinanced Loan Obligations that Impose Far More Costs Over Time.

248. In addition to Mariner's above-described conduct related to add-ons, Mariner misleads and fails to disclose relevant information to existing borrowers when it reaches out and invites them to renew or convert existing loans into larger, refinanced loan obligations.

249. Mariner's internal policies identify loan renewals and loan conversions as an important source of new loans for Mariner.

250. To that end, a Mariner internal report entitled "2021 Strength In Numbers" identified Mariner's "key drivers" to include "[i]ncreas[ing] conversions" and "[r]esolv[ing] Delinquency through Renewals."

251. Mariner defines a loan renewal (Renewal) as "[a] new Direct Loan transaction made to a current Direct Loan customer, where we refinance the balance of the current loan as part of the new loan and typically advance additional cash to the customer."

252. Mariner defines a loan conversion (Conversion) as:

> A new Direct Loan transaction made to a current LBM [Loan by Mail], Online, SF [Sales Finance], HI [Home Improvement] or Indirect Auto customer. The existing balance in the customer's current loan is typically refinanced into the new Direct Loan. An LBM Conversion takes an LBM loan customer and refinances the balance of the LBM into a Direct Loan plus advances new money to the customer. A SF Conversion is the same thing, but with a SF loan customer. The SF or HI loan balance doesn't have to be rolled into the new transaction, but a balance on an LBM or Online loan does have to be included.

253. In the consumer finance industry, the refinance or conversion of a retail installment loan, live check, or other small loan into a new personal or home equity loan is often referred to as "flipping."[4] Loan flipping, together with abusive insurance add-ons as those described above, is particularly common in sub-prime credit markets.[5]

254. Professor Gene A. Marsh of the University of Alabama School of Law testified about the practice of loan "flipping" before the U.S. Senate's Special Committee on Aging on March 16, 1998, describing the practice as follows:

> Finance companies frequently will contact existing customers, offering a few hundred additional dollars. … If the debtor bites at the apple, the existing loan will be "paid off" and a new loan will start, but with a great deal of the balance being

[4] *See* Ex. B at 31, "Equity Predators: Stripping, Flipping and Packing Their Way to Profits," Hearing Before the Special Committee on Aging, U.S. Senate, 105th Congress, Second Sess., March 16, 1998, Serial No. 105-18, at 31 (whistleblower testimony of "Jim Dough," former finance officer, assistant branch manager, and branch manager for three of the country's largest consumer lending companies).

[5] *Id*. at 44 (testimony of Professor Gene A. Marsh, University of Alabama School of Law).

> "old money." That is, after rebates (most likely credits on the account) for unearned interest and insurance premiums, the new amount financed will be comprised of the unpaid principal balance from the old loan, the few hundred additional dollars given to the debtor in the new loan, and new credit insurance products…that were sold and financed by the creditor.[6]

255. On February 21, 2003, the U.S. Office of the Comptroller of the Currency (OCC) issued Advisory Letter AL 2003-2, entitled "Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices" (OCC Alert). It later extended this guidance to Federal savings associations on November 12, 2013.

256. The OCC Alert's description of loan "flipping" is consistent with Professor Marsh's description above:

> Loan "flipping" is generally understood to mean the repeated refinancing of a loan under circumstances that result in little or no economic benefit to the borrower, with the objective of generating additional loan points, loan fees, prepayment penalties, and fees from financing the sale of credit-related products. In addition, the practice is frequently targeted to consumers with limited financial options. … As a general matter, many terms or practices associated with loan flipping carry risks that the borrower cannot reasonably be expected to appreciate in the absence of clear and understandable explanatory information.[7]

257. Mariner's practices with respect to its renewals and conversions of existing loan obligations bear all the hallmarks of abusive and predatory loan "flipping." In Mariner's case, loan "flipping" takes several forms, including: (1) converting LBMs and other indirect loans to branch (direct) loans, (2) renewing branch loans that are current, often where that loan is close to being paid off, and (3) refinancing delinquent loans instead of collecting a payment on the loan.

258. Consistent with the descriptions above, Mariner's policies, practices, and incentive structure encourage employees to "flip" consumers' loans through loan renewals and conversions, even where refinancing terms do not benefit the consumer. Mariner employees are expected to

[6] *Id.*
[7] Office of Comptroller of the Currency, "Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices," (OCC) AL 2003-2 (Feb. 21, 2003).

continually process loan applications and close loans, and their performance is tracked using metrics based on the number of loans each employee closes per day. This metric is also used to evaluate performance at the branch and district levels.

259. Mariner also trains its employees to contact consumers whose loan payments are delinquent by one to thirty days and use the missed payment as an opportunity to induce the consumer to renew their existing loan.

260. Mariner instructs its employees to prioritize refinancing for borrowers who have missed a payment, rather than asking them simply to make a payment. For example, the District Manager for Region 3 wrote the following in a July 2021 email, encouraging his 245 employees to use refinancing as the first option to reduce the number of "Current Month Lates": "Lend your way lower first, payments $2^{nd}$!"

261. Mariner's "permanent corrective arrangements"—policies intended for "[a]ccounts that are 60 days or more past due [that] may be considered an advanced collection situation"—specifically suggests soliciting from the consumer "a new loan [which] may be the best solution for the customer and for Mariner Finance."

262. Mariner's Refinance, Renewal, and Conversion Guidelines say, "it is our preference to renew a customer up to three times per year." Mariner pushes consumers to refinance even if the borrower is delinquent and unable to pay. Each time a customer refinances, Mariner collects a new service charge of up to $150, and of course it typically charges consumers for hidden add-ons as well.

263. As outlined above, Mariner's stated goal is to convince consumers to refinance as many LBMs as possible. Mariner regularly contacts LBM customers by unsolicited mail, marketing emails, and telephone calls inviting them into the branch in the effort to negotiate a

Renewal of the LBM. Indeed, Mariner trains, expects, and incentivizes its employees to sell Renewals in every welcome call following a new LBM.

264. Delinquent consumers, with LBM or direct loans, are easier to "flip," because Mariner employees can use the delinquency to pressure them to refinance their loans. Even though the consumer would nearly always be better off in the long term by simply making the payment due, Mariner pressures the consumer to renew the loan and skip another payment, thereby adding hundreds or thousands of dollars in interest to the loan.

265. Employees are continuously encouraged by everyone from Branch Managers to District Managers to Regional Vice Presidents to convert delinquent accounts into new loans by calling delinquent borrowers up to five times per day.

266. Examples of Mariner's company-wide emphasis on renewing delinquent loans abound in its internal documents and e-mail communications. In an April 24, 2021 email addressed to "Region 71," a Mariner Regional Vice President communicated in a "Friday recap":

> ***Delinquency***—no movement on our 30's yesterday----***maximize your 5 attempts per day, call all available numbers and skip trace where needed…. Then we look to renew!!!*** Don't give up!!! CML's [collateralized mortgage lines of credit] are running high as well—another great source of renewals!

(Emphasis added).

267. In another instance, a Mariner Regional Vice President forwarded the following communication to all his Branch Managers as "a success story that CAN BE DUPLICATED BY EVERYONE":

> The focus in March is sticking to basics and what makes us profitable. More importantly, achieving all the goals that are set in place, as a branch and individually. Basics are what? … Max out allowable calls to DQ [delinquent] accounts, and convert. EVERY CALL MUST INCLUDE AN OFFER TO RENEW. EVERY WALK-IN NEEDS TO HEAR WHAT WE CAN DO FOR THEM. Our customers do not know what their options are, unless….. WE TELL THEM.

(Emphasis original).

268. This message is also a frequent refrain of Mariner Branch Managers, such as an August 5, 2020 email from a Branch Manager in Puyallup, Washington with the subject "Daily Goal Board" indicating "DQ is [sic] still needs work but it is the 5th day of the month, we know to convert those DQ accounts into loans."

269. Mariner's policy of pushing refinancing aggressively is implemented at the highest levels. For example, one Mariner Vice President emailed instructions to several New Jersey and Pennsylvania-based Assistant Vice Presidents, among others, instructing them not to "[f]orget to [s]olicit a renewal BEFORE you start to collect."

270. Two common types of flipping, what Mariner calls Renewal and Conversion loans, provide limited funds to consumers because they only provide consumers with the amount of funds that they have already paid off. For instance, if a consumer's first loan was for $1000, and the consumer paid off $200 in principal, the consumer would receive only $200 in the refinance, to bring the new principal balance back to $1000.

271. As outlined above, each time a consumer enters into a loan Renewal or loan Conversion, Mariner collects a new service charge of up to $150, and it has another opportunity to charges the consumer for hidden add-ons.

272. Moreover, Mariner designed the terms of its hidden add-on policy contracts to maximize the cost to the consumer each time a loan is flipped. When a loan is paid off early (as it is when it is flipped), some of the unearned interest and unearned insurance premiums from are refunded. But Mariner fails to disclose to consumers that the methods it uses to calculate these refunds penalize consumers and reward Mariner when the loan is flipped early in the loan term.

273. First, under the AD&D policies that Mariner negotiates with its hand-picked exclusive insurance provider, Life of the South, Mariner, and/or Life of the South have chosen to calculate the earned premium using the short-rate method. This method allows the insurer to retain a greater percentage of unearned premium than would apply with a pro rata refund.

274. Second, Mariner chooses to use the Rule of 78's to calculate the interest refund. This method results in a disproportionate amount of interest being collected in the early part of the loan term (before the loan is flipped) as compared to the simple interest method.

275. In a loan flip, because the existing balance of the prior loan is rolled into a new loan, the term of repayment is extended and the borrower ends up paying more in interest than if they had just obtained a new loan and paid off each loan separately. Notably, in its communications with consumers, Mariner representatives fail to mention that refinancing, renewing, or converting a current loan is nearly always more costly over the loan term than simply making a late payment and/or obtaining a second loan.

### X. Mariner Ignores Pennsylvania Law that Requires the Sale of AD&D Insurance to Be Separated from the Loan Transaction.

276. Under the Pennsylvania Consumer Discount Company Act (CDCA) Regulations, 10 Pa. Code § 41.3(l), AD&D sales must be "completely voluntary." When an AD&D purchaser is also a borrower, "the disbursement of the loan proceeds to the borrower, shall be concluded before the licensee may initiate an effort to sell the services to the borrower."

277. Mariner completely disregards this regulation. Mariner has been on notice that its procedures violate this regulation since at least 2015, when Mariner exchanged letters on this topic with the Pennsylvania Department of Banking and Securities. Mariner promised to abide by the regulation's requirement that, "[i]n cases where the purchaser of AD&D insurance is also a

borrower, Mariner may not initiate any attempts to sell AD&D until the loan has closed and the loan proceeds have been disbursed to the borrower."[8]

278. Despite Mariner's promise to wait to sell AD&D until *after* closing, Mariner's policies and computer software require employees to sell the AD&D *during* closing. In policy and practice, the consumer is required to sign the AD&D application and agreement in the middle of closing. The funds are disbursed only at the end of closing—after all the paperwork has been signed.

279. Mariner is well aware of the CDCA Regulation and has designed a process that confuses consumers in an attempt to evade the Regulation. In order to pretend that it is "disbursing" the loan proceeds to the consumer and then having the consumer pay for the AD&D separately, Mariner lists the cost of AD&D on the TILA disclosures as a separate and simultaneous amount of cash to the consumer, prints one or more checks in the amount of the AD&D, and has the customer endorse and return the AD&D check(s) to Mariner.

280. This process has a tendency to mislead or confuse customers. One Pennsylvanian said that when a Mariner employee brought him three checks face down, shuffling between them and asking him to sign two and hand them back, he felt like he "was in Las Vegas playing three-card Monte."

281. Moreover, the procedure of giving the consumer the second check—and listing it on the TILA disclosure as cash disbursed to the consumer—is a façade. Contrary to Mariner's promise to the Department that it would follow the procedure that gives the consumer "the option

[8] Letter from Bonnie Klapaska, SEVP/Chief Compliance Officer, Mariner, to James Keiser, Administrator, Compliance Office, PA Dept. of Banking and Securities (Sept. 25, 2015).

not to purchase the product" and thus to keep the second check, Mariner never allows the consumer to keep the second check.

282. If the consumer refuses to endorse the second check, the Mariner employee is required to rewrite all of the paperwork to reduce the amount financed to the approved *cash loan* amount—thereby depriving the consumer of the funds that Mariner had previously approved and handed over in the form of the second check.

283. For many consumers, Mariner does not even go through the façade with the second check. In the December 2020 random sample of 100 Pennsylvania loan accounts, Mariner charged 55 consumers for AD&D. Of those 55 consumers, 13 consumers (nearly a quarter of them) were loan-by-phone transactions and thus never even saw a second check.

*Mariner's Failure to Name New Jersey Consumers as a Second Beneficiary Denies Consumers Their Rightful Benefits under the Credit Life and Disability Policies.*

284. Mariner is named as the primary beneficiary on the credit life and credit disability insurance policies it sells to New Jersey consumers.

285. Under these policies, if a consumer dies or becomes disabled but still owes money on their loan, the insurer agrees to pay Mariner a certain amount to reduce the loan's outstanding balance.

286. However, if the amount the insurer pays Mariner exceeds the outstanding amount owed on the loan, the credit life and credit disability insurance policies provides any excess amount " . . . be paid to the second beneficiary."

287. Failure to add a second beneficiary to credit life and credit disability policies is considered a violation according to Mariner's internal "*Credit and Compliance Audit*" procedures under designation "x11730."

288. Notwithstanding Mariner's own compliance rules and the representation Mariner employees make to consumers about the protection afforded by the company's add-on product offerings, Mariner routinely fails to name New Jersey consumers as a second beneficiary under the credit life and disability policies it issues.

289. For instance, in a sample of 18 credit life and credit disability policies reviewed by the State of New Jersey, 17 policies failed to name the consumer as the second beneficiary.

## XI. Interviews with a Random, Representative Sample of Mariner Customers Demonstrate Widespread Add-on Product Packing.

290. The following interview summaries are provided as additional examples of the ways that Mariner charges consumers for add-ons without obtaining their consent.

*Mariner Charges Consumers for Add-Ons without Ever Mentioning Them.*

### iii. Charging for Add-Ons With No Mention: Consumer Example 1

291. Many consumers reported that Mariner never told them about the add-on products. For example, an Army veteran said the Mariner employee never mentioned insurance products during or prior to the closing. When the consumer got home, he read through the paperwork and realized he had been charged for insurance policies that he did not ask for and did not want. This consumer said that he did not need any insurance coverage because he already had insurance policies through his employer, his credit union, and the Department of Veterans Affairs (VA), along with AAA breakdown coverage.

292. This consumer had been a customer of Mariner for nearly 13 years. In the past, Mariner did all of the loan documents on paper, and he could clearly see what was happening to his balance when he refinanced a loan. But since Mariner went to all electronic closings in 2019, this consumer found that doing business with Mariner has become more difficult. He said, "Now

everything is on the computer. When I look at the account online, the balance always seems much higher than I think it should be."

293. In October 2020, this consumer went to refinance his loan at a Mariner branch. At closing, the loan documents were all on a mounted computer screen that the Mariner employee controlled. The consumer was not close enough to comfortably read the screen. Mariner charged this consumer $1,911 in fees and $1,001 in interest for add-ons that he did not consent to. Despite being charged nearly $3,000 for add-ons without his consent, this 12-year Army veteran walked out of the Mariner branch with a check for only $1,000—the additional cash Mariner loaned him when it refinanced his car title loan.

**iv. Charging for Add-Ons With No Mention: Consumer Example 2**

294. Another consumer borrowed $8,621 at 26.62% APR from Mariner in December 2020 to finance the purchase of a vehicle. Without telling him about any add-on products, Mariner charged him $2,066 in premiums and $1,312 in interest for three add-ons: credit life insurance, credit disability insurance, and involuntary unemployment insurance. For every $100 he borrowed, Mariner charged him another $39 for hidden add-ons.

295. The Mariner employee did not give this consumer a chance to review the documents. According to the consumer, the employee inserted all of the signatures herself, and he never touched the mouse during the loan closing.

296. This consumer said that if the Mariner employee had told him about the add-ons, he would have declined them. He and his wife already had life insurance policies through their employers, and they did not want unemployment or disability insurance.

*Mariner Charges Consumers for Add-Ons that They Explicitly Declined.*

**v. Charging for Add-Ons Consumers Declined: Consumer Example 1**

297. In other instances, Mariner charges consumers for add-on products that they have explicitly declined. For example, a consumer refinanced her $2,422 balance in December 2020 and borrowed another $2,000 in cash at 27.31% APR. Mariner offered her insurance products at closing and she declined all of them because she has insurance through her job. This consumer reported that she has obtained other loans from Mariner and its competitors in the past, and, when asked, she has always declined the optional insurance products.

298. Despite the fact that this consumer declined all add-ons, Mariner charged her $1,439 in premiums and $941 in interest for 4 different add-ons. In other words, *Mariner charged her $2,380 for add-ons that she specifically declined*, on a refinancing where she borrowed just $2,000 in new cash.

299. After being interviewed and learning that she had been charged for the add-ons, this consumer called the Mariner branch where she took out her loans to cancel all of her insurance policies. The branch manager falsely told the consumer that she could not cancel the AD&D policy after 30 days.

**vi. Charging for Add-Ons Consumers Declined: Consumer Example 2**

300. When another consumer raised questions about charges for the Auto Plus Plan, the loan officer told her it was standard for the loan. After the consumer told the Mariner representative that he did not need the Auto Plus Plan, the employee said it would be taken off the loan. Yet Mariner still charged this consumer $380 plus interest for the Auto Plus Plan.

*Mariner Falsely Claims that Add-Ons Are Mandatory.*

301. In numerous instances, Mariner tells consumers that the purchase of add-ons is required to obtain the loan, purportedly due to company policy. In actuality, under Mariner policy, add-ons are supposed to be optional. Nevertheless, when consumers ask to have charges for add-ons removed, Mariner employees often tell them falsely that the charges are not optional.

**vii. Falsely Claiming Add-Ons Are Mandatory: Consumer Example 1**

302. For example, a Mariner consumer refinanced her $1,950 loan balance at 26.21% APR in December 2020 in order to obtain $1,000 in additional cash. Mariner charged her $785 in premiums and $357 in interest for four insurance policies. For every $100 in new cash she borrowed, Mariner charged her $114 for in add-ons.

303. At closing, Mariner's employee falsely told this consumer that these add-ons were included in the loan for no extra charge, and that the consumer could not decline them. The consumer said that she would have declined the add-ons if Mariner had told her the truth.

**viii. Falsely Claiming Add-Ons Are Mandatory: Consumer Example 2**

304. Another consumer borrowed $2,000 from Mariner in October 2020. At closing, the Mariner employee scrolled through the loan documents while giving the consumer summaries of what she was required to electronically sign.

305. The Mariner employee mentioned insurance products and led the consumer to believe the add-ons were included in the loan and mandatory. The employee did not tell the consumer that she would be charged for the add-ons. In fact, Mariner charged her $556 in premiums and $162 in interest for four insurance policies.

**ix. Falsely Claiming Add-Ons Are Mandatory: Consumer Example 3**

306. Mariner told a consumer that she was required to buy a Guaranteed Asset Protection (GAP) insurance policy in order to obtain the loan. The Mariner employee did not explain what purpose it would serve. The consumer said that, had Mariner given her the option to purchase the GAP policy, she would have declined it.

*Mariner Misleads Consumers about the Price of the Add-ons.*

307. Mariner employees mislead numerous consumers about the price of the add-ons, leading them to believe the prices are free or lower than they are.

**x. Misleading Consumers About Add-On Pricing: Consumer Example 1**

308. In December 2020, a consumer visited Mariner, intending to borrow $2,000 without putting down his car title as collateral.

309. The consumer walked out with a $4,081 loan at 25.73% APR, after putting down his vehicle title as collateral.

310. Mariner charged this consumer $1,980 for add-ons, which also added $989 in interest to the loan, for a total of $2,969 in add-on charges. For every $100 of cash he borrowed, Mariner charged him $73 for add-ons.

311. The consumer is a totally and permanently disabled combat veteran who was deployed four times while serving in the United States Army.

312. Prior to and during the loan closing, the Mariner employee who dealt with the consumer asked him questions about golf for nearly the whole time the consumer was in the branch, including while the consumer was trying to read the 44+ pages of loan documents. According to the consumer, the Mariner employee continually changed the subject back to golf throughout loan closing to distract him from noticing the details of the loan documents.

313. The loan officer told the consumer that credit life insurance and Auto Club were included with the loan for no additional fee. Relying on this misrepresentation, the consumer agreed to obtain the credit life insurance and Auto Club. He planned to cancel his AAA membership (which then cost $130 per year) since he thought he was receiving a free Auto Club.

314. In reality, Mariner charged the consumer $218 plus $109 in interest for the credit life insurance policy, and it charged him $380 plus $190 in interest for the Auto Club. The consumer said that, if he had known about these charges, he would have declined both products. He already had AAA, which offers better coverage and is cheaper than the Auto Club, and he had life insurance through the VA.

315. In addition to charging this veteran $897 for two products that the Mariner employee falsely said were free, Mariner charged him another $2,072 (including interest) for three more add-ons that its employee did not mention at all.

316. The consumer said that, if the Mariner employee had asked him whether he wanted to buy these policies, he would have declined them because he had life insurance through the VA and homeowners' insurance.

317. This consumer thought he was signing a loan for $4,081 and nothing more. He was completely unaware of the $2,969 in add-on related charges.

318. In January 2021, the disabled veteran saw his credit report and was surprised to see Mariner had reported his loan principal balance as over $6,000. He did not understand why it was so high when he had only borrowed $4,081.

319. He called a Mariner branch to ask about this discrepancy, and the employee who had misled him at loan closing lied to him again. The Mariner employee said that the loan had a

$2,000 mandatory "guaranteed fee" added to it and that even if the consumer paid off the loan early, he would have to repay at least $6,000—not just the $4,081 he had borrowed.

320. This "guaranteed fee" was a lie. There is no such fee in the loan. On the phone call, the Mariner employee did not mention anything about the $2,060 in charges for add-ons, which is actually what inflated the loan principal balance to $6,000.

**xii. Misleading Consumers About Add-On Pricing: Consumer Example 2**

321. Another Mariner customer refinanced her loans in December 2020. The Mariner employee falsely told her that Mariner only offered an "all or nothing" insurance policy that included credit life, credit disability, and involuntary unemployment insurance, and cost less than $100.

322. Relying on this false price and the false statement that the add-ons had to be bought together, the consumer agreed to buy the "all or nothing" policy. The actual cost of the add-ons was *fifteen times higher* than the Mariner employee had promised: $1,003 in premiums and $497 in interest ($1,500 total). This consumer said that she would not have agreed to buy the add-ons if she had known how expensive they were.

323. As described above, a Mariner Branch Manager in one Pennsylvania district has a personal practice of quoting two monthly payments on the approval call: one with no add-ons and one with all the add-ons for which the consumer is eligible. This practice could mislead a consumer into believing, as the consumer above did, that the insurance is "all or nothing" (*i.e.*, that the consumer must either purchase *all* of the insurance as a single package, or no insurance).

**xiii. Misleading Consumers About Add-On Pricing: Consumer Example 3**

324. A consumer who took out a loan in the amount of $3,000 to get her car fixed in December 2021 was charged a premium of $380 for the Auto Plus Plan. However, at the time of

loan closing, the consumer was led to believe that the add-on was included in the loan and she did not have to pay extra for it.

325. The Mariner loan officer explained that the Auto Plus Plan would provide roadside assistance and protection in the event of an accident.

326. In May 2022, this consumer totaled her car in an auto accident and she is turning to her private auto insurance for relief because the Auto Plus Plan sold to her by Mariner did not cover her accident.

327. In addition to charging this consumer $380 for the Auto Plus Plan add-on that the Mariner employee falsely said was free, Mariner charged her another $921 in premiums for three more add-ons—1) credit life, 2) involuntary unemployment, and 3) accident & health. The loan officer represented to the consumer that all of these products were included with her loan and that she would not incur additional cost.

## CLAIMS FOR RELIEF

### COUNT I – CFPA:
### Mariner Engages in Deceptive Acts and Practices by Charging Consumers for Add-On Products Without Obtaining their Consent and by Loan Flipping[9]

328. Plaintiffs re-allege and incorporate by reference the allegations contained in the preceding paragraphs of this Complaint.

329. Section 1036(a)(1)(B) of the CFPA prohibits covered persons from engaging in "any unfair, deceptive, or abusive act or practice." 12 U.S.C. § 5536(a)(1)(B).

330. As described above, Mariner misrepresents, either expressly or by implication, that the consumer is getting a loan with no add-on products, or that the add-on products are free,

[9] The CFPA claims (Counts I through VI) are asserted by all Plaintiffs.

required, or both. These misrepresentations are material because they are likely to affect a consumer's choice of a product.

331. In fact, Mariner charges consumers hundreds or thousands of dollars in premiums, fees, and interest for add-on products without their consent.

332. Mariner also misrepresents to (some) consumers that if they purchase the add-on products, their loan will be "fully protected." This is misleading in the ways described above.

333. In marketing its loans and in its rushed loan closings, Mariner omits key loan terms, including, *inter alia*: (a) that the monthly payment amount includes add-ons which are additional costs added to the loan, (b) that the purchase of add-ons is ostensibly optional and not required to obtain the loan, or (c) the price of the add-ons, including the added interest cost. This information constitutes a material omission because it would have influenced consumers' decisions whether to obtain a loan with Mariner, and whether to pay for add-on products from Mariner.

334. Mariner also misleads consumers through loan flipping: refinancing consumers' loans when it is not in their interest to do so. Mariner repeatedly refinances loans in order to maximize the loan balance and assess new fees and add-on products. Mariner misleads consumers by inducing them to refinance or renew LBM and other existing loans without disclosing that it is often more expensive for them to refinance an existing loan than to simply make a payment or take out a new loan.

335. Mariner's misrepresentations and omissions regarding loan refinancing or renewal are material because they are likely to affect a consumer's choice of a product.

336. The above-described statements and omission are likely to mislead a consumer acting reasonably under the circumstances.

337. As described above, it is reasonable for consumers to sign the loan documents and only expect to be taking out a loan because Mariner does not market add-ons products on its website or in any of its marketing materials. Unless a Mariner employee raises the add-on products in an honest manner, the consumer has no reason to know about them because they are buried in the flurry of 44-plus pages of electronic loans documents.

338. Mariner's loan sales process and rushed closings are likely to leave many of its consumers with the false net impression that their loans do not contain any add-on products.

339. Similarly, Mariner's loan flipping conduct is likely to leave consumers with the false net impression that refinancing will not significantly increase the cost of the loan and/or that a delinquent borrower has no other option except to refinance the loan.

340. These representations and omissions, in light of the representations made, are deceptive omissions and deceptive acts or practices that violate sections 1031 and 1036 of the CFPA, 12 U.S.C. §§ 5531, 5536(a)(1)(B).

341. The CFPA empowers this Court to grant any appropriate legal or equitable relief with respect to violations of Federal consumer financial law, including, without limitation, a permanent or temporary injunction, rescission or reformation of contracts, the refund of moneys paid, restitution, disgorgement or compensation for unjust enrichment, and civil money penalties. 12 U.S.C. § 5565.

342. The Plaintiffs believe that, after a reasonable opportunity for discovery, the evidence will likely show that Mariner knowingly violated a Federal consumer financial law when it engaged in the acts and practices described herein. Accordingly, the Plaintiffs seek the imposition of third tier civil penalties of up to One Million Dollars ($1,000,000) for each day during which such violation continues. *See* 12 U.S.C. §§ 5565(a)(2)(H), 5565(c)(1), 5565(c)(2)(C).

**COUNT II – CFPA:**
**Mariner Engages in Unfair Acts and Practices by Charging Consumers for Add-On Products Without Obtaining their Consent and by Loan Flipping**

343. Plaintiffs re-allege and incorporate by reference the allegations contained in the preceding paragraphs of this Complaint.

344. Section 1036(a)(1)(B) of the CFPA prohibits covered persons from engaging in "any unfair, deceptive, or abusive act or practice." 12 U.S.C. § 5536(a)(1)(B).

345. Mariner's acts and practices relating to charging consumers for hidden add-ons cause, or are likely to cause, substantial consumer injury. The hidden add-ons cause substantial injury by adding hundreds or, in some cases, thousands of dollars in unwanted charges to consumers' loans. The loan flipping causes substantial injury by adding hundreds or thousands of dollars in finance charges and even more add-on fees.

346. This consumer injury from add-ons is not reasonably avoidable because Mariner charges consumers for add-ons without obtaining their consent. In some cases, Mariner misleads consumers into thinking the add-ons are mandatory, free, or both.

347. The consumer injury from loan flipping is not reasonably avoidable because Mariner induces consumers into refinancing or renewing LBM or other existing loans without disclosing that refinancing is often significantly more expensive than simply making a payment or taking out a new loan

348. The substantial consumer injury caused or likely caused by Mariner's add-on practices and loan flipping is not outweighed by countervailing benefits to consumers or to competition. Charging consumers for hidden add-ons without their consent does not benefit consumers or competition. Any temporary benefit to some consumers from loan flipping—reducing delinquency fees or providing them a small amount of additional cash—does not

outweigh the harm caused by the extra interest and add-on fees that each flip adds to the consumer's account.

349. Therefore, Mariner's acts and practices as set forth herein constitute unfair acts or practices in violations of sections 1031 and 1036 of the CFPA. 12 U.S.C. §§ 5531, 5536(a)(1)(B).

**COUNT III – CFPA:**
**Mariner Engages in Abusive Acts and Practices by Designing and Implementing a Loan Closing Process that Materially Interferes with the Ability of a Consumer to Understand a Term or Condition of a Consumer Financial Product or Service and by Loan Flipping**

350. Plaintiffs re-allege and incorporate by reference the allegations contained in the preceding paragraphs of this Complaint.

351. Section 1036(a)(1)(B) of the CFPA prohibits covered persons from engaging in "any unfair, deceptive, or abusive act or practice." 12 U.S.C. § 5536(a)(1)(B).

352. The CFPA defines an "abusive" act or practice as, *inter alia*, one that "materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service." 12 U.S.C. § 5531(d).

353. As described above, Mariner's all-electronic closing process often includes at least 44 and sometimes more than 50 pages of small print. Mariner employees give consumers an oral "summary" of the paperwork, often misrepresenting or omitting key terms such as the cost and ostensibly optional nature of add-on products.

354. Mariner rushes consumers through the closing process, thereby depriving them of an opportunity to make a meaningful informed purchasing decision.

355. Mariner's practice of loan flipping also constitutes an "abusive" act or practice. Mariner repeatedly refinances consumers' loans when it is not in their best interest in order to maximize the loan balance and assess new fees and add-on products.

356. In its effort to renew or convert as many loans as possible—including loans that are delinquent—Mariner induces consumers into refinancing or renewing LBM or other existing loans without disclosing that it is often more expensive for them to refinance an existing loan than to simply make a payment or take out a new loan. This deprives them of an opportunity to make a meaningful informed decision.

357. These acts and practices materially interfere with the ability of consumers to understand a term or condition of the consumer financial products at issue—those being the add-on products and loan refinancings.

**COUNT IV – CFPA:**
**Mariner Engages in Abusive Acts and Practices that Take Unreasonable Advantage of a Lack of Understanding on the Part of the Consumer of the Material Risks, Costs, or Conditions of Add-On Products and by Loan Flipping**

358. Plaintiffs re-allege and incorporate by reference the allegations contained in the preceding paragraphs of this Complaint.

359. Section 1036(a)(1)(B) of the CFPA prohibits covered persons from engaging in "any unfair, deceptive, or abusive act or practice." 12 U.S.C. § 5536(a)(1)(B).

360. The CFPA defines an "abusive" act or practice as, *inter alia*, one that "takes unreasonable advantage of a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service." 12 U.S.C. § 5531(d).

361. Most of Mariner's victims whom it charges for hidden add-on products have no or little idea that their loans are saddled with fees for products that are supposed to be optional and which the consumers, when interviewed, almost universally say they would have declined to purchase.

362. Most of Mariner's customers have no reason to expect add-ons to be packed into the loan, and they therefore lack understanding of the cost of the hidden add-ons.

363. Moreover, since most Mariner customers do not know about the add-ons at all, most Mariner consumers lack understanding of the material risks of the add-ons, which include exclusions, waiting periods, and limitations that make the chances a consumer will successfully make a claim against some products as low as 1 in 1,607.

364. And yet other Mariner customers lack an understanding of the conditions of the add-on products. As described herein, Mariner falsely tells some consumers the add-ons are required as part of the loan. Mariner's rushed closing process then takes advantage of these consumers' lack of understanding about a key condition of the loan: that the add-ons are supposedly optional.

365. Mariner's practice of rushing consumers through loan closing and burying the disclosures in a flurry of electronic documents takes unreasonable advantage of this lack of understanding on the part of consumers.

366. Mariner employees scroll too fast through the paperwork and/or position the computer too far for the consumer to read and understand it.

367. In Pennsylvania, these hidden charges are costing consumers, on average, $1,085. In charging its customers for hidden add-on products, Mariner takes unreasonable advantage of a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service.

368. Yet other Mariner customers fail to understand the impact of refinancing their loans instead of obtaining a new loan or paying off the existing loan. Mariner's conduct related to loan flipping—refinancing consumers' loans where they do not understand, and Mariner fails to explain, that it is not in their interest to do so—constitutes an "abusive" act or practice.

369. Again, Mariner's policies emphasize repeatedly refinancing loans in order to maximize the loan balance and assess new fees and add-on products. In its effort to renew or convert as many loans as possible, Mariner induces consumers into refinancing or renewing LBM or other existing loans without disclosing that it is often more expensive for them to refinance an existing loan than to make a payment or take out a new loan. In its zeal to renew or convert as many loans as possible, Mariner takes unreasonable advantage of this lack of understanding on the part of consumers.

370. Therefore, Mariner's acts and practices as set forth herein constitute abusive acts or practices in violations of sections 1031 and 1036 of the CFPA, 12 U.S.C. §§ 5531, 5536(a)(1)(B).

**COUNT V – CFPA:**
**Mariner Violates TILA by Requiring Consumers to Pay for Add-On Products Incident to the Extension of Credit**

371. Plaintiffs re-allege and incorporate by reference the allegations contained in the preceding paragraphs of this Complaint.

372. Section 1036(a)(1)(A) of the CFPA prohibits covered persons from offering or providing consumer-financial products or services not in conformity with "Federal consumer financial law" or otherwise committing any act or omission in violation of a "Federal consumer financial law." 12 U.S.C. § 5536(a)(1)(A).

373. TILA and Regulation Z are each a "Federal consumer financial law." 12 U.S.C. § 5481(14) (defining "Federal consumer financial law" to include "enumerated consumer laws" and "any rule or order prescribed by the Bureau under this title"); 12 U.S.C. § 5481(12)(O) (defining "enumerated consumer law" to include TILA).

374. At all times relevant hereto, Mariner has regularly extended or offered consumer credit for which a finance charge is or may be imposed or which, by written agreement, is payable in more than four installments, making Mariner a creditor within the meaning of TILA, 15 U.S.C. § 1602(g) and Regulation Z, 12 C.F.R. § 1026.2(a)(17).

375. As described above, under the TILA and Regulation Z, in many cases the add-ons constitute a "finance charge" because Mariner requires the consumer to pay for them "as a condition of or an incident to the extension of credit." 12 C.F.R. § 1026.4(a)(1)(i).

376. But Mariner does not include the cost of the add-ons when it calculates the finance charge for the TILA disclosures. Instead, even in the many cases where Mariner requires consumers to pay for the add-ons, Mariner improperly includes the add-ons in the amount financed.

377. As a result of failing to include the add-ons in the finance charge, Mariner is disclosing inaccurate annual percentage rates (APRs), in violation of TILA and Regulation Z. If Mariner properly disclosed the cost of the add-ons as part of the finance charge, the disclosed APR would be far higher.

a. For example, as set out in paragraphs 302-303, above, Mariner disclosed an APR of 26.21% to a consumer. Given that Mariner required that consumer to pay $785 for add-on products that it told her were free and mandatory, Mariner should have disclosed that $785 as part of the finance charge, not the amount financed.

b. Properly disclosing the add-on charges as part of the finance charge would have reduced the amount finance on this loan to $2,950 (the amount the consumer thought she was borrowing). And it would have increased the finance charge to $2,485.

c. Properly disclosing the add-on charges on this loan would have increased the APR to 45.2%.

378. The disclosures Mariner provides to its customers fail to disclose the finance charge and APR, and therefore they do not comply with the requirements of Regulation Z, 12 C.F.R. § 1026.18(d) and (e).

379. Mariner's violations of TILA and Regulation Z constitute violations of the CFPA, 12 U.S.C. § 5536(a)(1)(A).

**COUNT VI – CFPA:**
**Mariner Violates TILA by Failing to Provide Required Disclosure**

380. Plaintiffs re-allege and incorporate by reference the allegations contained in the preceding paragraphs of this Complaint.

381. At all times relevant hereto, Mariner has regularly extended or offered consumer credit for which a finance charge is or may be imposed or which, by written agreement, is payable in more than four installments, making Mariner a creditor within the meaning of TILA, 15 U.S.C. § 1602(g) and Regulation Z, 12 C.F.R. § 1026.2(a)(17).

382. TILA requires lenders to provide a meaningful disclosure of credit terms so that consumers will be able to compare more readily the various credit terms available to them and avoid the uninformed use of credit, and to protect consumers against inaccurate and unfair lending practices. 15 U.S.C. § 1601(a).

383. Under TILA, when a lender provides written disclosures and an itemization of the amount financed to consumers it must accurately disclose "each amount that is or will be paid to third persons by the creditor on the consumer's behalf." 15 U.S.C. § 1638(a)(2)(A)(iii).

384. The written disclosures and itemization of amount financed that Mariner provided and regularly provides to consumers violate the requirements of TILA by failing to disclose the

amounts that Mariner pays to the credit insurers for the insurance products Mariner adds to consumers' loans.

385. By failing to disclose to consumers in its written disclosures the substantial commissions it retains and deducts from each insurance premium amount identified in the disclosures it provides to consumers, while falsely stating that the entire premium is paid "To Ins. Company," Mariner has systematically misled consumers and has not accurately disclosed the amounts it paid to third-party insurers on consumers' behalf in violation of TILA, 15 U.S.C. § 1638(a)(2)(A)(iii).

386. Mariner's violations of TILA and Regulation Z constitute violations of the CFPA, 12 U.S.C. § 5536(a)(1)(A).

**COUNT VII – PA CPL:**
**Mariner Charges Consumers for Add-On Products Without their Consent and Engages in Loan Flipping**
**(Asserted by Commonwealth of Pennsylvania)**

387. Plaintiff Commonwealth of Pennsylvania re-alleges and incorporates by reference the allegations contained in the preceding paragraphs of this Complaint.

388. As described above, Mariner misrepresents, either expressly or by implication, that the consumer is getting a loan with no add-on products, or that the add-on products are free, required, or both.

389. In fact, Mariner charges consumers hundreds or thousands of dollars in premiums, fees, and interest for add-on products without their consent.

390. Mariner rushes the consumer through the closing process in hopes that he or she will not notice the unauthorized charges.

391. Charging consumers for unwanted and duplicative credit property insurance also violates the Pennsylvania CDCA Regulations, which require that credit property "insurance may

be sold by a licensee only when similar coverage is not carried by a consumer or when the consumer has similar coverage but is *unable or unwilling* to offer the insurance to secure a loan transaction." 10 Pa. Code § 41.3(k). Mariner has no policy or procedure that ensures it sells property insurance only to consumers who lack similar homeowners or renter's coverage or who are unwilling or unable to use that to cover their property. As a result, and as demonstrated by consumer interviews, Mariner frequently charges consumers for credit property in violation of this regulation.

392. Mariner continues to hide the add-ons from consumers after loan origination and obstructs consumers' attempts to cancel the add-ons when consumers do discover them.

393. Mariner also misleads consumers through its practice of loan flipping: refinancing consumers' loans when it is not in their interest. Mariner induces consumers to refinance or renew LBM and other existing loans in order to maximize the loan balance and assess new fees and add-on products without disclosing that it is often more expensive for them to refinance an existing loan than to simply make a payment or take out a new loan.

394. Mariner executes it loan flipping scheme by taking advantage of consumers' lack of understanding that refinancing or renewing their loans is more expensive than paying off the existing loan or taking out a new loan. This deprives them of an opportunity to make a meaningful informed decision with regard to their refinancing options.

395. The aforesaid methods, acts and practices constitute unfair methods of competition and unfair acts or practices in the conduct of trade or commerce prohibited by Section 201-3 of the PA CPL, as defined by Section 201-2 of said Law, including, but not limited to, the following:

a. Section 201-2(4)(ii), by causing likelihood of confusion or of misunderstanding as to the source, sponsorship, approval or certification of goods or services;

b. Section 201-2(4)(iii), by causing likelihood of confusion or of misunderstanding as to affiliation, connection or association with, or certification by, another;

c. Section 201-2(4)(v), by representing that goods or services have sponsorship, approval, characteristics, ingredients, uses, benefits or quantities that they do not have; and

d. Section 201-2(4)(xxi), engaging in any other fraudulent or deceptive conduct which creates a likelihood of confusion or of misunderstanding.

73 P.S. §§ 201-3, 201-2(4)(ii), (iii), (v), (xxi).

396. The Commonwealth alleges that all of the practices described herein are performed willfully. Accordingly, and pursuant to Section 201-8 of the PA CPL, 73 P.S. § 201-8, the Commonwealth seeks the imposition of civil penalties of One Thousand Dollars ($1,000) for each violation of the PA CPL, including enhanced civil penalties of Three Thousand Dollars ($3,000) for each violation involving victims age sixty (60) or older, in addition to other relief sought, as appropriate.

## COUNT VIII – NJ CFA:
## Unconscionable Commercial Practices Related to the Extension of Loan and Insurance Products to New Jersey Consumers
## (Unconscionable Commercial Practices)
## (Asserted by the State of New Jersey)

397. Plaintiff, the State of New Jersey re-alleges and incorporates by reference the allegations contained in the preceding paragraphs of this Complaint.

398. The NJ CFA, N.J.S.A. 56:8-2, prohibits:

> The act, use or employment by any person of any unconscionable commercial practice, deception, fraud, false pretense, false promise, misrepresentation, or the knowing[] concealment, suppression, or omission of any material fact with intent that others rely upon such concealment, suppression or omission, in connection with the sale or advertisement of any merchandise or real estate, or with the subsequent performance of such person as aforesaid, whether or not any person has in fact been misled, deceived or damaged thereby . . . .

399. The NJ CFA defines "merchandise" as including "any objects, wares, goods, commodities, services, or anything offered, directly or indirectly to the public for sale." N.J.S.A. 56:8-1(c).

400. At all relevant times in the course and conduct of offering and extending loans to New Jersey consumers, Mariner has engaged in the advertisement and sale of merchandise within the meaning of N.J.S.A. 56:8-1(c).

401. In operating its business, Mariner has engaged in the use of unconscionable commercial practices and/or acts of deception.

402. Mariner has engaged in unconscionable commercial practices and/or acts of deception including, but not limited to, the following:

a. Refusing to provide New Jersey consumers the opportunity to read, understand, raise questions, or make objections to the cost, terms, or other obligations pertaining to add-on products during loan closings;

b. Charging New Jersey consumers for add-ons without ever mentioning them;

c. Failing to disclose to New Jersey consumers the cost and material terms of credit insurance and/or other add-on products including: (i) that the entire premium for such products is financed up-front; (ii) that the consumer is paying interest on the premium for such products; and (iii) that Mariner, not the consumer, is the primary beneficiary on credit insurance policies;

d. Requiring New Jersey consumers to purchase ancillary and credit insurance to significantly increases the cost of installment loans and then continuing to charge interest on those add-ons after they were cancelled by the consumers;

e. Failing to timely refund New Jersey consumers either in whole or in part and/or respond at all to consumer inquiries regarding cancelling one or more add-on products;

f. Refusing to name New Jersey consumers as a second beneficiary to credit life and credit disability insurance policies' that consumers have paid and are continuing to paying for;

g. Providing inadequate written disclosures during loan closings that do not correct misleading, material oral representations concerning the terms, price and/or optionality of the add-on(s); and

h. Mailing unsolicited "Live Checks" to consumers, exposing them to identity theft risks.

403. Each unconscionable commercial practice and/or act of deception by Mariner constitutes a separate violation under the NJ CFA, specifically N.J.SA. 56:8-2.

**COUNT IX – NJ CFA:**
**False Promises and/or Misrepresentations Related to the Extension of Loan and Insurance Products to New Jersey Consumers**
**(False Promises, Misrepresentations)**
**(Asserted by the State of New Jersey)**

404. Plaintiff, the State of New Jersey re-alleges and incorporates by reference the allegations contained in the preceding paragraphs of this Complaint.

405. Mariner's conduct in violation of the NJ CFA includes, but is not limited to, the following false promises and/or misrepresentations:

a. Representing to New Jersey consumers that premium payments were paid "To Ins. Company" when, in fact, Mariner deducts and retains a substantial portion of the premium as commission for each insurance add-on product;

b. Representing to New Jersey consumers that Mariner "may" receive benefits when, in fact, Mariner knows it is contractually entitled to receive a substantial commission on each insurance product it sells;

c. Representing to New Jersey consumers, directly, indirectly, expressly, or by implication that in order to obtain a loan, New Jersey consumers are required to purchase add-on products, when such is not the case;

d. Representing to New Jersey consumers, directly, indirectly, expressly, or by implication that it is in their financial interest to refinance or renew existing loans, when such is not the case; and

e. Representing to New Jersey consumers that monies are paid to The American Traveler Motor Club, LLC, and Home Benefits, LLC (or other provider for the Auto Club product) as "Cash to Borrower," when such is not the case.

406. Each false promise and/or misrepresentation by Mariner constitutes a separate violation under the NJ CFA, specifically N.J.SA. 56:8-2.

**COUNT X – WA Consumer Protection Act: Unfair and Deceptive Acts and Practices Related to the Extension of Loans and Insurance, Including Charging for Add-Ons Without Consumers' Consent, Concealing Commissions, and Loan Flipping (Asserted by State of Washington)**

407. Plaintiff State of Washington re-alleges and incorporates by reference the allegations contained in the preceding paragraphs of this Complaint.

408. Pursuant to the WA CPA, RCW 19.86.020, "[u]nfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful."

409. At all relevant times in the course and conduct of offering and extending loans to Washington consumers, Mariner engaged in "trade or commerce" as those terms are defined by RCW 19.86.010(2).

410. In the course of operating its business, including offering and extending loans and associated insurance products to Washington consumers, Mariner engaged in unfair and/or deceptive acts and practices including, but not limited to, the following:

a. Refusing to provide consumers the opportunity to read, understand, raise questions, or make objections to the cost, terms, or other obligations pertaining to add-on products during loan closings;

b. Charging consumers for add-ons without ever mentioning them;

c. Concealing from consumers the substantial commission it earns from credit insurers;

d. Affirmatively representing to Washington consumers that premium payments were paid "To Ins. Company" when, in fact, Mariner deducts and retains a substantial portion of the premium for each insurance add-on product as a commission;

e. Affirmatively representing to Washington consumers that Mariner "may" receive benefits when Mariner knows it *will* receive a substantial commission on each insurance product;

f. Representing, directly or indirectly, expressly or by implication, that in order to obtain a loan, consumers are required to purchase add-on products;

g. Failing to disclose the cost and material terms of credit insurance and/or other add-on products including: (i) that the entire premium for such products is financed up-front; (ii) that the consumer is paying interest on the premium for such products; and (iii) that Mariner, not the consumer, is the primary beneficiary on credit insurance policies;

h. Requiring consumers to purchase ancillary and credit insurance to significantly increases the cost of installment loans and then continuing to charge interest on those add-ons after they were cancelled by the consumers;

i. Failing to timely refund consumers either in whole or in part and/or respond at all to consumer inquiries regarding cancelling one or more add-on products;

j. Refusing to name Washington consumers as a second beneficiary to credit life and credit disability insurance policies that consumers have paid and are continuing to paying for;

k. Repeatedly refinancing consumer installment loans in order to assess new fees and add-on products resulting in an increase in the cost of the loan and compounding consumers' terms of indebtedness;

l. Misleading consumers into believing that add-on products provide more coverage than they actually provide; and

m. Providing inadequate written disclosures during loan closings that do not correct misleading, material oral representations concerning the terms, price and/or optionality of the add-on(s);

n. Mailing unsolicited "Live Checks" to tens of thousands of Washington consumers each year, exposing them to identity theft risks;

o. Misrepresenting monies paid to providers of Auto Club products as "Cash to Borrower" without corresponding itemization on the Note; and

p. Misleading consumers by inducing them into refinancing or renewing LBM and other existing loans without disclosing that it is often more expensive for them to refinance an existing loan than to simply make a payment or take out a new loan ("loan flipping").

411. Mariner's aforesaid unfair and deceptive methods, acts, and practices have affected the public interest in that they impacted numerous Washington consumers. These practices constituted a pattern of conduct that Mariner committed in the course of business and are likely to continue without relief from this Court.

412. The conduct described in Counts I and II herein in violation of the CFPA's prohibition of "any unfair, deceptive, or abusive act or practice" pursuant to 12 U.S.C. § 5536(a)(1)(B) also constitutes unfair and/or deceptive acts or practices in trade or commerce in violation of the WA CPA, RCW 19.86.020. These practices constitute a pattern of conduct impacting the public interest and are likely to continue without relief from this Court.

413. The conduct described in Count V herein that constitutes a violation of the CFPA's prohibition on covered persons offering or providing consumer-financial products or services not in conformity with "Federal consumer financial law" or otherwise committing any act or omission in violation of a "Federal consumer financial law" pursuant to 12 U.S.C. § 5536(a)(1)(A) also constitutes unfair and/or deceptive acts or practices in trade or commerce in violation of the WA CPA, RCW 19.86.020. These practices constitute a pattern of conduct impacting the public interest and are likely to continue without relief from this Court.

414. The conduct described in Count VI herein in violation of the TILA's requirement that lenders provide meaningful disclosure of credit terms, pursuant to 15 U.S.C. § 1601(a), and that written disclosures and itemizations of the amount financed to consumers must accurately disclose "each amount that is or will be paid to third persons by the creditor on the consumer's

behalf" pursuant to 15 U.S.C. § 1638(a)(2)(A)(iii), also constitute unfair and/or deceptive acts or practices in trade or commerce in violation of the WA CPA, RCW 19.86.020. These practices constitute a pattern of conduct impacting the public interest and are likely to continue without relief from this Court.

415. Based on the above described unfair acts and practices, Washington is entitled to relief under the WA CPA, including injunctive relief and restitution pursuant to RCW 19.86.080, civil penalties pursuant to RCW 19.86.140 for each and every violation of RCW 19.86.020, and reimbursement of the costs of this action, including reasonable attorneys' fees, pursuant to RCW 19.86.080.

**COUNT XI – WA Consumer Protection Act:**
**Unfair and Deceptive Non-Disclosure of Commissions**
**(Asserted by State of Washington)**

416. Plaintiff State of Washington re-alleges and incorporates by reference the allegations contained in the preceding paragraphs of this Complaint.

417. As a licensed insurance producer in the State of Washington, Mariner is required to disclose to consumers, in writing, the full amount of each commission it receives from credit insurers for the credit insurance products it adds to consumer loans in Washington.

418. Under the Washington Insurance Code, RCW 48.17.270, if the compensation Mariner receives on the sale of credit insurance includes a fee, it is required as an insurance producer to disclose in writing "the full amount of any commission paid to the insurance producer, if one is received."

419. Mariner charges Washington consumers a "Prepaid Finance Charge (Loan Origination Fee)" on all loans made in Washington, which is a fee that is tied to the total amount

financed, and includes a fee for all credit insurance premiums added by Mariner which are financed as part of the loan.

420. In the course of operating its business, including offering and extending loans and associated insurance products to Washington consumers, Mariner violated RCW 48.17.270 including, but not limited to, the following acts and practices:

a. Failing to disclose to consumers that Mariner deducts and retains a substantial portion of the premium for each insurance add-on product as a commission;

b. Failing to disclose to consumers that Mariner only pays a portion of insurance premiums to the insurer while deducting and retaining a substantial portion for itself as a commission; and

c. Failing to disclose to consumers that Mariner deducts a commission of 25% to 75% of the net written premium charged to the consumer for each insurance product.

421. The conduct described in this Count XI in violation of RCW 48.17.270 also constitute unfair and/or deceptive acts or practices in trade or commerce in violation of the WA CPA, RCW 19.86.020. These practices constitute a pattern of conduct impacting the public interest and are likely to continue without relief from this Court.

422. Based on these unfair acts and practices, Washington is entitled to relief under the WA CPA including injunctive relief and restitution pursuant to RCW 19.86.080, civil penalties pursuant to RCW 19.86.140 for each and every violation of RCW 19.86.020, and reimbursement of the costs of this action, including reasonable attorneys' fees, pursuant to RCW 19.86.080.

**Count XII - PA CPL:**
**Failure to Make Required Disclosures Prior to Consummation of the Loan**
**(Asserted by Commonwealth of Pennsylvania)**

423. Plaintiff Commonwealth of Pennsylvania re-alleges and incorporates by reference the allegations contained in the preceding paragraphs of this Complaint.

424. Under the TILA and Regulation Z, in many cases the add-ons constitute a "finance charge" because Mariner requires consumers to pay for them "as a condition of or an incident to the extension of credit." 12 C.F.R. § 1026.4(a)(1)(i).

425. In many cases, therefore, the disclosures Mariner provides to its customers fail to disclose the finance charge and APR as defined in Regulation Z, 12 C.F.R. § 1026.18(d) and (e).

426. As described above, Mariner has every consumer sign an E-Sign Agreement as part of the electronic closing process that takes place using Mariner's far-away hard-to-read computer screen. However, this process does not comply with the E-Sign Act's requirement that, "[T]he consumer ... consents electronically, or confirms his or her consent electronically, *in a manner that reasonably demonstrates that the consumer can access information in the electronic form* that will be used to provide the information that is the subject of the consent." 15 U.S.C. § 7001(c)(1)(C)(ii) (emphasis added).

427. When the consumer signs the E-Sign Agreement using Mariner's computer, this signature does not reasonably demonstrate that the consumer can access the information in electronic form. (Some consumers have provided such demonstration by signing an E-Sign Agreement from their home computer when they first applied for the loan – but Mariner skips this step with many consumers).

428. Mariner has no way of knowing whether every one of its consumer has access to a computer, internet, or even a smart phone at home.

429. As described in Count V Mariner also violates TILA's requirement that lenders provide meaningful disclosure of credit terms, pursuant to 15 U.S.C. § 1601(a), and that written disclosures and itemizations of the amount financed to consumers must accurately disclose "each amount that is or will be paid to third persons by the creditor on the consumer's behalf" pursuant to 15 U.S.C. § 1638(a)(2)(A)(iii).

430. The aforementioned acts and practices constitute unfair methods of competition and/or unfair acts or practices as prohibited by Section 201-3 of the PA CPL, as defined by Section 201-2(4) of said Law, including without limitation:

a. Section 201-2(4)(ii), by causing likelihood of confusion or of misunderstanding as to the source, sponsorship, approval or certification of goods or services;

b. Section 201-2(4)(iii), by causing likelihood of confusion or of misunderstanding as to affiliation, connection or association with, or certification by, another;

c. Section 201-2(4)(v), by representing that goods or services have sponsorship, approval, characteristics, ingredients, uses, benefits or quantities that they do not have; and

d. Engaging in any other fraudulent or deceptive conduct which creates a likelihood of confusion or of misunderstanding, in violation of Section 201-2(4)(xxi).

73 P.S. §§ 201-3, and 201-2(4)(ii), (iii), (v), (xxi).

431. The Commonwealth alleges that all of the practices described herein are performed willfully. Accordingly, and pursuant to Section 201-8 of the PA CPL, 73 P.S. § 201-8, the Commonwealth seeks the imposition of civil penalties of One Thousand Dollars ($1,000) for each

violation of the PA CPL, including enhanced civil penalties of Three Thousand Dollars ($3,000) for each violation involving victims age sixty (60) or older, in addition to other relief sought, as appropriate.

**COUNT XIII – NJ CFA:**
**Requesting or Requiring Consumers Execute Insurance and Loan Agreements without Simultaneously Providing Consumers a Print Copy of Same**
**(Failure to Provide a Copy)**
**(Asserted by State of New Jersey)**

432. Plaintiff State of New Jersey re-alleges and incorporates by reference the allegations contained in the preceding paragraphs of this Complaint.

433. The NJ CFA, specifically N.J.S.A. 56:8-2.22, prohibits:

> a person in connection with a sale of merchandise to require or request the consumer to sign any document as evidence or acknowledgment of the sales transaction, of the existence of the sales contract, or of the discharge by the person of any obligation to the consumer specified in or arising out of the transaction or contract, unless he shall at the same time provide the consumer with a full and accurate copy of the document so presented for signature but this section shall not be applicable to orders placed through the mail by the consumer for merchandise.

434. At all relevant times in the course and conduct of offering and extending loans to New Jersey consumers, Mariner has engaged in the advertisement and sale of merchandise within the meaning of N.J.S.A. 56:8-1(c).

435. At all relevant times, Mariner uses computer monitors to display the terms of insurance and loan agreements during loan closings.

436. When describing the terms of insurance and loan agreements, Mariner exercises exclusive control over the action of moving the computer's displayed text of the insurance and loan agreement terms up, down, or across the computer screen.

437. Mariner requires or requests consumers momentarily use a computer mouse or digital signature pad only to digitally acknowledge acceptance of the insurance and loan agreements.

438. Mariner does not simultaneously provide a printed copy of the loan documents when it requests or requires consumers to digitally acknowledge insurance and loan agreements.

439. Mariner's conduct constitutes a violation of the NJ CFA, specifically N.J.S.A. 56:8-2.22.

**COUNT XIV – PA CPL:**
**Charging Interest Rates in Excess of the Usury Limit**
**(Asserted by Commonwealth of Pennsylvania)**

440. Plaintiff Commonwealth of Pennsylvania re-alleges and incorporates by reference the allegations contained in the preceding paragraphs of this Complaint.

441. In Pennsylvania, lenders such as Mariner that are licensed under the Consumer Discount Company Act (CDCA), 7 P.S. §§ 6201-6219 are permitted to charge an annual interest rate up to approximately 24-27%. See *Pa. Dept. of Banking v. NCAS of Delaware, LLC*, 948 A.2d 752 (Pa. 2008). (The CDCA provides a discount rate and service charge limit, which is why the maximum permissible rate fluctuates depending on the loan term and size.) The CDCA's usury limit applies to all credit-related charges, however labeled, and applies to credit lines as well as fixed-amount loans. *Id*.

442. In many cases Mariner charges consumers interest that is at or near the maximum interest under state law.

443. As described above, in many cases Mariner is disclosing inaccurate finance charges and APRs to consumers.

444. As shown in the example above, with the add-ons properly included in the finance charge, the disclosed APR on the loan can exceed 40%.

445. Therefore the interest rates on many of Mariner's loans in Pennsylvania exceed the CDCA's usury limit.

446. These practices constitute unfair methods of competition and unfair acts or practices in the conduct of trade or commerce prohibited by Section 201-3 of the PA CPL, as defined by Section 201-2 of said Law, including, but not limited to, the following:

a. Section 201-2(4)(ii), by causing likelihood of confusion or of misunderstanding as to the source, sponsorship, approval or certification of goods or services;

b. Section 201-2(4)(iii), by causing likelihood of confusion or of misunderstanding as to affiliation, connection or association with, or certification by, another;

c. Section 201-2(4)(v), by representing that goods or services have sponsorship, approval, characteristics, ingredients, uses, benefits or quantities that they do not have; and

d. Section 201-2(4)(xxi), engaging in any other fraudulent or deceptive conduct which creates a likelihood of confusion or of misunderstanding.

73 P.S. §§ 201-3, and 201-2(4)(ii), (iii), (v), (xxi).

447. The Commonwealth alleges that all of the practices described herein are performed willfully. Accordingly, and pursuant to Section 201-8 of the PA CPL, 73 P.S. § 201-8, the Commonwealth seeks the imposition of civil penalties of One Thousand Dollars ($1,000) for each violation of the PA CPL, including enhanced civil penalties of Three Thousand Dollars ($3,000)

for each violation involving victims age sixty (60) or older, in addition to other relief sought, as appropriate.

**COUNT XV – PA CPL:**
**Sale of AD&D in Violation of CDCA Regulation**
**(Asserted by Commonwealth of Pennsylvania)**

448. Plaintiff Commonwealth of Pennsylvania re-alleges and incorporates by reference the allegations contained in the preceding paragraphs of this Complaint.

449. Under the Pennsylvania CDCA regulations, 10 Pa. Code § 41.3(*l*), sales of accidental death and dismemberment insurance (AD&D), service club memberships, or association-type membership policies shall be "completely voluntary." In order to prevent lenders from adding such services to a consumer's loan without the consumer's consent, Pennsylvania law explicitly prohibits lenders from "initiat[ing]" an effort to sell these types of add-ons to a borrower until *after* the lender has given the borrower the loan proceeds: "the disbursement of the loan proceeds to the borrower, shall be concluded before the licensee may initiate an effort to sell the services to the borrower." *Id.*

450. As described above, Mariner, as a licensed consumer discount company, has been violating this regulation since at least 2015. In the course of its business and as described in its policies and procedures, Mariner routinely initiates the effort to sell AD&D and auto club to Pennsylvania borrowers *before* it disburses the loan funds to them.

451. Mariner's policy and practice require consumers to sign the AD&D and/or auto club paperwork on the electronic closing system *before* any check is handed over.

452. Mariner caused a likelihood of confusion or misunderstanding by misrepresenting, explicitly or implicitly, that it was legal for Mariner to initiate an effort to sell AD&D and Auto Club to consumers prior to the disbursement of loan funds. In fact, such conduct explicitly violates

the CDCA regulations' prohibition on selling such add-ons prior to disbursement of funds. 10 Pa. Code § 41.3(*l*).

453. The aforementioned acts and practices constitute unfair methods of competition and/or unfair acts or practices as prohibited by Section 201-3 of the PA CPL, as defined by Section 201-2(4) of said Law, including without limitation:

a. Section 201-2(4)(ii), by causing likelihood of confusion or of misunderstanding as to the source, sponsorship, approval or certification of goods or services;

b. Section 201-2(4)(iii), by causing likelihood of confusion or of misunderstanding as to affiliation, connection or association with, or certification by, another;

c. Section 201-2(4)(v), by representing that goods or services have sponsorship, approval, characteristics, ingredients, uses, benefits or quantities that they do not have; and

d. Section 201-2(4)(xxi), by engaging in any other fraudulent or deceptive conduct which creates a likelihood of confusion or of misunderstanding.

73 P.S. §§ 201-3, and 201-2(4)(ii), (iii), (v), (xxi).

454. The Commonwealth alleges that all of the practices described herein are performed willfully. Accordingly, and pursuant to Section 201-8 of the PA CPL, 73 P.S. § 201-8, the Commonwealth seeks the imposition of civil penalties of One Thousand Dollars ($1,000) for each violation of the PA CPL, including enhanced civil penalties of Three Thousand Dollars ($3,000) for each violation involving victims age sixty (60) or older, in addition to other relief sought, as appropriate.

**PRAYER FOR RELIEF**

**WHEREFORE**, the Plaintiffs respectfully request that this Honorable Court issue an Order:

A. Declaring Mariner's conduct as described herein above to be in violation of the CFPA, the PA CPL, the NJ CFA, and the WA CPA.

B. Permanently enjoining Mariner and all other persons acting on its behalf, directly or indirectly, from violating the CFPA, the PA CPL, the NJ CFA, the WA CPA, or any other provision of Federal consumer financial law, as defined by 12 U.S.C. § 5481(14), and any amendments thereto;

C. Directing Mariner to make full restitution to all borrowers who have suffered losses as a result of the acts and practices alleged in this complaint and any other acts or practices proved by the Plaintiffs;

D. Permanently enjoining Mariner from selling, assigning, transferring, conveying, collecting or causing to be collected (including but not limited to through litigation or judgments) any portion of a loan (including principal and interest) that resulted from charges for add-on products;

E. Directing Mariner to withdraw any judgments, liens, garnishments, claims in bankruptcy, or other legal proceedings that Mariner have been initiated or entered against consumers relating to any loans that included charges for add-on products;

F. Directing Mariner to cease and desist furnishing any negative credit information to a consumer reporting agency with respect to any loans that included charges for add-on products;

G. If Mariner has furnished such negative credit information to a consumer reporting agency with respect to any loans that included charges for add-on products, directing Mariner to instruct the consumer reporting agency to delete all such negative credit information;

H. Directing Mariner to disgorge and forfeit all money it has derived as a result of the conduct alleged herein;

I. For those loans where required add-ons cause the interest rate to exceed a state usury limit, invalidating any beneficial interest in consumer debt purportedly owed by consumers and declaring that those balances were void *ab initio*;

K. Directing Mariner to pay to Plaintiffs appropriate civil penalties pursuant to the CFPA, the PA CPL, the NJ CFA, and/or the WA CPA;

L. Directing the rescission or reformation of contracts where necessary to redress injury to borrowers;

M. Directing Mariner to pay the Plaintiffs' investigative and litigation costs in this matter;

N. For any loans with add-ons that are secured by a motor vehicle, directing Mariner to, within thirty (30) days: (1) provide the state department of motor vehicles with all documents necessary to mark as satisfied and released any related liens, and (2) convey proper and rightful vehicle title to the owners of such vehicles; and

O. Granting such other general, equitable, and/or further relief as the Court deems just and proper.

[Signature Pages Follow]

Dated: August 16, 2022

Respectfully submitted,

**FOR THE COMMONWEALTH OF PENNSYLVANIA:**

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_/s/ Nicholas Smyth_________________
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# EXHIBIT A

# Tell Us About Yourself

| | |
|---|---|
| Name | First Name / Last Name |
| | Please provide your full legal name. |
| Email | Personal Email Address |
| Home Address | Street Address |
| Location | Zip Code / City / State |
| | If your state is not listed it means that loans are not offered in your state. More information |
| Date of Birth | Month / Day / Year |
| Phone | Personal Phone Number / Phone Type |
| Citizenship | Citizenship Status |
| SSN | Social Security Number |
| | Your SSN is required to pull your credit information. |
| Personal Annual Income | Personal Annual Income (Pre-Tax) |
| | Do not include income from others in your household. Stated income will be verified on every application. Your personal income must be verifiable via pay stubs, bank statements, or other records. Alimony, child support, or separate maintenance income need not be revealed if you do not wish to have it considered as a basis for repaying this loan. |
| Household Annual Income | Household Annual Income (Pre-Tax) |
| Employment Status | Employment Status |
| Employer Phone | Employer Phone Number |
| Years at Employer | Years at Employer |
| Rent or Own Home | Rent or Own Home |
| Monthly Rent / Mortgage Payment | Monthly Payment Amount |
| Loan Purpose | Loan Purpose |
| Password | |
| | You will need a security code to confirm your identity. This extra step shows it is really you trying to sign in. |
| Confirm Password | Confirm Your Password |

By clicking this box you acknowledge that you have received, reviewed and agree to the E-Signature Disclosure and Consent, Credit and Contact Authorization, Terms of Use, and Privacy Statement.

I'm not a robot

reCAPTCHA
Privacy - Terms

Checking your offers will not impact your credit score.*

Continue >

*The process uses a "soft" credit inquiry to determine whether a loan offer is available, which does not impact your credit score. If you continue with the application process online and accept a loan offer, or are referred to a branch and continue your application there, we will pull your credit report and credit score again using a "hard" credit inquiry. This "hard" credit inquiry may impact your credit score.

Credit Contact Version 14

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Credit and Contact Authorization

By clicking the "submit" button or otherwise providing responses to application questions, I understand that I am making application to Mariner Finance, LLC or one of its affiliated companies ("Mariner") for a loan for the purpose described in the application. If the application is submitted through one or more third parties to Mariner, I authorize such third parties to share any information that I have provided with Mariner. I authorize Mariner to order credit reports on me from time to time and to make whatever credit inquiries Mariner deems necessary in connection with this credit application or in the course of review, refinance or collection of any credit extended in reliance on this application. I authorize any person or consumer reporting agency to complete, compile and furnish to Mariner any information that Mariner may request. I certify that all information I have provided in connection with this application and request for credit is true, accurate and complete. I authorize Mariner (and any financial service provider that Mariner may ask to evaluate my request) to verify the information I have given and obtain information about me from a consumer reporting agency or other sources. I agree that all information that I provide or that Mariner obtains in connection with my application or otherwise: (i) may be used by Mariner to process my request and that Mariner may contact me using any telephone number and/or email address that I have provided; (ii) will remain Mariner's property whether or not credit is extended; and (iii) may be disclosed by Mariner to any of Mariner's subsidiaries, affiliates, and assigns.

By providing my mobile and/or home number (including any phone number that I later convert to a mobile phone number) or email through this application or otherwise, I consent to receive informational calls, text messages (including by auto dialers and/or with pre-recorded messages) by or on behalf of Mariner regarding the processing of my request and, if approved, for other transactional purposes, such as the collection and servicing of my account(s). I understand that my consent for non-marketing, informational calls and messages applies to each phone number that I voluntarily provide to Mariner now or in the future.

I understand that any text messages Mariner sends to me may be accessed by anyone with access to my text messages. I acknowledge that my mobile phone service provider may charge me fees for text messages that Mariner sends to me, and I agree that Mariner shall have no liability for the cost of any such text messages. I understand that I may unsubscribe from text messages by replying "STOP" to any text message that I receive from Mariner or on Mariner's behalf.

As of October 4, 2018

Terms of Use Version 11

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**Website Terms of Use**

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**By Mail**
Mariner Finance, LLC
8211 Town Center Dr
Baltimore, MD 21236
Attn: Webmaster

**By Email**
marketing@marinerfinance.com
(Please include "Notice of Infringement" in the subject line.)
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Mariner Finance, LLC
8211 Town Center Dr
Baltimore, MD 21236
Attn: Webmaster

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**14. VIOLATIONS**

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Privacy Statement Version 10

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Mariner Finance Website Privacy Statement

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**JUMP TO ADDITIONAL PRIVACY INFORMATION FOR CALIFORNIA RESIDENTS**

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As permitted by law, Mariner reserves the right to disclose your personally identifiable information to third parties in accordance with our Privacy Notice (located at the bottom of this page), to assist in administering our services and marketing activities, as required by law, as necessary to protect our rights (such as if you fail to repay a loan), as necessary in order to detect, investigate, prevent, or take action against illegal activities, fraud, or situations involving potential threats to the rights, property, or personal safety of any person, to comply with a judicial proceeding, court order, or legal process served on us, and/or as specifically consented to by you. If Mariner were to merge with or be acquired by another company or if it were to cease operations, your information may be transferred to the surviving or acquiring company. At that point, any use and sharing of your information will be subject to that company's privacy policy which may be different from that of Mariner. In addition to this Privacy Statement and Mariner's website Terms of Use, our use of your personal information collected is described in the Privacy Notice.

Third parties may also collect personally identifiable information about your online activities through the Site in order to assist Mariner in offering its services and products, marketing, and administration of the same.

## 2. COLLECTION, USE AND DISCLOSURE OF OTHER INFORMATION

The Site may gather non-personal information about you depending on how your browser is configured. That information may include the Internet Protocol (IP) address(es) used to access the Site, the number of times you visit the Site, the time and length of the visit, the operating system and browser type used to access the Site, your screen resolution, the particular web pages viewed right before and while visiting the Site, how long you remain on specific pages, your navigation patterns, where you go upon leaving the Site, or similar details.

The Site may use cookies and other tracking technologies (such as clear GIFs, web beacons, log files, and the like) to track unique visitors and pages viewed by users, both to understand how the Site is being used and to improve users' experiences on the Site. For example, cookies (small, unique text files that a website can deposit on your computer hard drive when you visit a website) may be used to allow repeat visitors to be served more quickly and efficiently or to provide information on the pages viewed by a given user. Since cookies reside on a user's hard drive, they may be deleted by a user after they are deposited by a site. You may also configure your browser to reject cookies, although if you do, some or all of the features on the Site may not be available to you.

Non-personal information collected as a result of your visit to the Site may be disclosed to third parties, but will not be associated with you personally. In other words, the Site may disclose that a unique user accessed the Site a particular number of times and spent specific amounts of time on different pages, but we will not disclose the identity of that user (and most likely would have no way of identifying who that user was unless the user voluntarily identified him or herself to us).

Some web browsers have a "Do Not Track" function that allows you to tell websites that you do not want to have your online activities tracked. The Site does not monitor or respond to "do not track" signals or similar mechanisms.

**3. SECURITY**

To prevent unauthorized access to your personal data, maintain data accuracy and integrity, and ensure the correct use of information, Mariner follows generally accepted industry standards to protect the personal information submitted to us, both during transmission and once we receive it. No method of transmission over the Internet, or method of electronic storage, is 100% secure, however. Therefore, while we strive to use commercially acceptable means to protect your personal information, we cannot guarantee its absolute security.

**4. CHANGES TO YOUR INFORMATION**

You may request access to and/or to change your personally identifiable information by contacting us at the following phone number or postal address: 877-310-2373, Mariner Finance, LLC, 8211 Town Center Drive, Baltimore, MD 21236. If you currently have an account with Mariner, you may log into the Customer Account Center to review and/or edit your personal information.

**5. CHANGES TO PRIVACY STATEMENT**

Mariner reserves the right at any time and from time to time to modify this Privacy Statement with or without notice. You will be bound by the modifications if you use the Site after a modification has been made. You agree that Mariner shall not be liable to you or to any third party in any way as a result of any such modification. If you do not agree to any changes or terms, you should discontinue your use of the Site.

**6. MARINER FINANCE CONTACT INFORMATION**

If you have any questions or comments regarding this Privacy Statement, please contact Customer Service at 877-310-2373.

**7. ADDITIONAL PRIVACY INFORAMTION FOR CALIFORNIA RESIDENTS**

Pursuant to the California Consumer Privacy Act ("CCPA"), California residents have specificrights regarding their personal information, which are detailed below. This California-specific privacysection incorporates by reference Mariner's general Privacy Statement and provides a comprehensive description of our online and offline practices regarding the collection, use, and disclosure of personal information.

Note that the rights set forth under the CCPA do not apply to:

- Personal information collected, processed, sold, or disclosed pursuant to the federal Gramm-Leach-Bliley Act, and implementing regulations, or the California Financial Information PrivacyAct;
- An activity involving the collection, maintenance, disclosure, sale, communication, or use of anypersonal information bearing on a consumer's credit worthiness, credit standing, credit capacity,character, general reputation, personal characteristics, or mode of living by a consumer reportingagency by a furnisher of information who provides information for use in a consumer report andby a user of a consumer report; and
- Personal information that is collected by us about a natural person in the course of the naturalperson acting as a job applicant to, an employee of, owner of, director of, officer of, medical staffmember of, or contractor of us to the extent that the natural person's personal information iscollected and used by the business solely within the context of the natural person's role or formerrole as a job applicant to, an employee of, owner of, director of, officer of, medical staff memberof, or a contractor of Mariner.

| **Categories of Personal Information Collected**<br><br>**Marinermay collect the following categories of personal information from you:** | **Categories of Sources from which Personal Information was Collected**<br><br>**We obtain the categories of personal information from the following categories of sources:** | **Business or Commercial Purpose for the Collection**<br><br>**Your personal information is collected by us, used, and/or disclosed for one or more of the following business purposes:** | **Categories of Third Parties with whom We Share Personal Information**<br><br>**We may disclose your personal information to the following categories of third parties:** |
|---|---|---|---|
| Category A: Identifiers<br><br>Examples: Your real name, alias, postal address, unique personal identifier, online identifier, internet protocol address, email address, account name, social security number, driver's license number, passport number, or other similar identifiers. | 1. Directly from our customers or their agents.<br><br>Indirectly from our customers or their agents. For example, through information we collect in the course of providing services to our customers<br><br>Directly and indirectly from activity on the Site. For example, from submissions | For auditing purposes related to our customer relationships, including, but not limited to, verifying the quality of ad impressions and auditing our compliance with applicable law;<br><br>For detecting security incidents, protecting against malicious, deceptive, fraudulent, or illegal activity, and prosecuting those responsible for that activity;<br><br>For debugging activities to identify and repair errors that impair Site functionality;<br><br>For short-term use, provided that the personal information is not disclosed to another third party and is not used to build a profile about a consumer; | Our affiliates.<br><br>Our service providers.<br><br>Third parties to whom you or your agents authorize us to disclose your personal information in connection with products or services we provide to you. |

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| | through our online loan application, Customer Account Center, and/or website usage details collected automatically.<br><br>4.From third parties that interact with us in connection with the services we perform. | For performing services for Mariner or on behalf of a service provider, including maintaining or servicing accounts, providing customer service, processing or fulfilling orders and transactions, verifying customer information, processing payments, providing financing, providing advertising or marketing services, providing analytic services, or providing similar services on behalf of Mariner or a service provider;<br><br>For internal research for technological development; and/or<br><br>For use in activities to verify or maintain the quality or safety of Mariner's services, and to improve, upgrade, or enhance such services. | |
| Category B. Customer Records with Personal Information<br><br>Examples:<br><br>Note: Some personally identifiable information included in this category may overlap with other categories<br><br>Any information that identifies, relates to, describes, or is capable of being associated with, a particular individual, including, but not limited to, his or her name, signature, social security number, address, telephone number, passport number, driver's license or state identification card number, insurance policy number, education, employment, employment history, bank account number, credit card number, debit card number, or any other financial information, medical information, or health insurance information. | Same as Category A. | Same as Category A. | Same as Category A. |
| Category C. Protected classification characteristics under State or federal law.<br><br>Examples: Age (40 years or older), race, color, ancestry, national origin, citizenship, religion or creed, marital status, , sex (including gender, gender identity, veteran or military status) | Same as Category A. | For performing services for Mariner or on behalf of a service provider, including maintaining or servicing accounts, providing customer service, processing or fulfilling orders and transactions, verifying customer information, processing payments, providing financing, , or providing similar | Same as Category A. |

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| | | services on behalf of Mariner or a service provider; or<br><br>For use in activities to verify or maintain the quality or safety of Mariner's services, and to improve, upgrade, or enhance such services. | |
| Category D: Commercial information.<br><br>Examples: Information including, but not limited to, records of personal property, products or services purchased, obtained, or considered, or other purchasing or consuming histories or tendencies | Same as Category A. | For detecting security incidents, protecting against malicious, deceptive, fraudulent, or illegal activity, and prosecuting those responsible for that activity;<br><br>For short-term use, provided that the personal information is not disclosed to another third party and is not used to build a profile about a consumer;<br><br>For performing services for Mariner or on behalf of a service provider, including maintaining or servicing accounts, providing customer service, processing or fulfilling orders and transactions, verifying customer information, processing payments, providing financing, or providing similar services on behalf of Mariner or a service provider;<br><br>For internal research for technological development; and/or<br><br>For use in activities to verify or maintain the quality or safety of Mariner's services, and to improve, upgrade, or enhance such services. | Same as Category A. |
| Category E: Internet or other similar network activity.<br><br>Examples: Information including, but not limited to, browsing history, search history, information regarding a consumer's interaction with a website, application, or advertisement | Same as Category A. | Same as Category A. | Same as Category A. |
| Category F: Professional or employment-related information.<br><br>Examples: Current or past job history and/or performance evaluations. | Same as Category A. | For performing services for Mariner or on behalf of a service provider, including maintaining or servicing accounts, providing customer service, processing or fulfilling orders and transactions, | Same as Category A. |

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| | | verifying customer information, processing payments, providing financing, providing advertising or marketing services, providing analytic services, or providing similar services on behalf of Mariner or a service provider;<br><br>For use in activities to verify or maintain the quality or safety of Mariner's services, and to improve, upgrade, or enhance such services. | |
| Category G: Inferences drawn from other personal information.<br><br>Examples: Information that can be used to create a profile reflecting a person's preferences, characteristics, psychological trends, predispositions, behavior, attitudes, intelligence, abilities, and aptitudes. | Same as Category A. | 1. Same as Category A. | Same as Category A. |

Mariner does not offer any financial incentives for the collection, sale, or deletion of personal information.

Disclosure or Sale of Personal Information

In the preceding twelve (12) months, we have disclosed the following categories of personal information for a business purpose:

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| Category A: | Identifiers. |
| Category B: | Customer Records with personal information |
| Category C: | Protected classification characteristics under State or federal law. |
| Category D: | Commercial information |
| Category E: | Internet or other similar network activity. |
| Category F: | Professional or employment-related information. |
| Category G: | Inferences drawn from other personal information. |

In the preceding twelve (12) months, we have not sold any personal information.
We do not sell the Personal Information of minors under 16 years of age without affirmative authorization.

Access to Specific Information

California residents have the right to request that we disclose certain information about our collection and use of your personal information over the past 12 months. Once we receive and confirm your verifiable consumer request, we will disclose to you:

- The categories of personal information we collected about you.
- The categories of sources for the personal information we collected about you.
- Our business purpose for collecting or selling that personal information.
- The categories of third parties with whom we share that personal information.
- The specific pieces of personal information we collected about you.
- If we sold or disclosed your personal information for a business purpose, two separate lists disclosing:
    - For sales of personal information, the personal information categories that each category of recipient purchased; and

- For disclosures of personal information for a business purpose, the personal information categories that each category of recipient obtained.

Deletion Request Rights

You have the right to request that we delete any of your personal information that we collected from you and retained, subject to certain exceptions. Once we receive and confirm your verifiable consumer request, we will delete (and direct our service providers to delete) your personal information from our records, unless an exception applies.

Please note, however, that we may deny your deletion request if retaining the information is necessary for us or our service providers to:

1. Complete the transaction for which we collected the personal information, provide a good or service that you requested, take actions reasonably anticipated within the contextof our ongoing business relationship with you, or otherwise perform our contract with you.
2. Detect security incidents, protect against malicious, deceptive, fraudulent, or illegal activity, or prosecute those responsible for such activities.
3. Debug products to identify and repair errors that impair existing intended functionality.
4. Exercise free speech, ensure the right of another consumer to exercise their free speech rights, or exercise another right provided for by law.
5. Comply with the California Electronic Communications Privacy Act (Cal. Penal Code § 1546 *seq.*).
6. Engage in public or peer-reviewed scientific, historical, or statistical research in the public interest that adheres to all other applicable ethics and privacy laws, when the information's deletion may likely render impossible or seriously impair the research's achievement, if you previously provided informed consent.
7. Enable solely internal uses that are reasonably aligned with consumer expectations based on your relationship with us.
8. Comply with a legal obligation.
9. Make other internal and lawful uses of that information that are compatible with the context in which you provided it.

Right to Opt-Out of Sales:

You have the right, at any time, to direct us not to sell your personal information to a third party. This right may be referred to as the right to opt-out. Once we have received direction from you not to sell your personal information, we will not sell your personal information unless you subsequently provide express authorization for the sale of your personal information.

Exercising Your Rights:

To exercise your access and deletion rights described above, please submit a verifiable consumer request to us by either:

- Calling us at 877-310-2373, select option 3. Available Monday through Friday, 8:30 am EST to 5:00 pm EST, excluding observed holidays.

Filling out an online request at any time available at:

To opt- out of the sale of your personal information to a third party, please call us at 877-310-2373, select option 3or click the following link:

Do Not Sell My Personal Information LINK TO OPT OUT

Only you or a person registered with the California Secretary of State that you authorize to act on your behalf, may make a verifiable consumer request related to your personal information. If you are opting out on behalf of a California resident, please attach a written authorization signed by the California resident and authorizing you to make this request on their behalf. You may also make a verifiable consumer request on behalf of your minor child.

You may only make a verifiable consumer request for access or data portability twice within a 12-month period. The verifiable consumer request must:

- Provide sufficient information that allows us to reasonably verify you are the person about whom we collected personal information or an authorized representative.
- Describe your request with sufficient detail that allows us to properly understand, evaluate, and respond to it.

We cannot respond to your request or provide you with personal information if we cannot verify your identity or authority to make the request and confirm the personal information relates to you. Making a verifiable consumer request does not require you to create an account with us. We will only use personal information provided in a verifiable consumer request to verify the requestor's identity or authority to make the request.

Response Timing and Format

We endeavor to respond to a verifiable consumer request within 45 days of its receipt. If we require more time (up to 90 days), we will inform you of the reason and extension period in writing. If you have an account with us, we will deliver our written response to that account. If you do not have an account with us, we will deliver our written response by mail or electronically, at your option. Any disclosures we provide will only cover the 12-month period preceding the verifiable consumer request's receipt. The response we provide will also explain the reasons we cannot comply with a request, if applicable. For data access requests, we will select a format to provide your personal information that is readily useable and should allow you to transmit the information from one entity to another entity without hindrance.

We do not charge a fee to process or respond to your verifiable consumer request unless it is manifestly unfounded or excessive, for example, because of a repetitive nature. If we determine that the request warrants a fee, we will tell you why we made that decision and provide you with a cost estimate before completing your request.

Non-Discrimination

We will not discriminate against you for exercising any of your CCPA rights.

Accessibility

We are committed to ensuring this Privacy Policy is accessible to individuals with disabilities. If you wish to access this Privacy Policy in an alternative format, please contact us as described above

Revised 12/19.

Print This Page

**Please read this E-Signature Disclosure and Consent carefully and keep a copy for your records.**

**E-Signature Disclosure and Consent**

As used in this E-Signature Disclosure and Consent ("Consent"), the words "we," "us," or "our" refer to Mariner Finance, LLC (and its affiliates and subsidiaries); and the words "you," "your," and "yours" refer to each person in whose name a loan application is submitted and/or a loan is maintained. "Communication" means any application forms, loan agreements or amendments thereto, customer agreements or amendments thereto, disclosures, notices, responses to claims, transaction history, monthly statements, privacy policies, and all other information related to a loan application or your loans, or the services we offer, including, but not limited to, information that we are required by law to provide to you in writing.

You confirm that you can access and read and agree to all of the terms and conditions herein. You agree that your electronic signature will have the same force and effect, and will bind you to the all terms and conditions in the same manner and to the same extent as a physical signature would do. You also agree that any documents that you electronically sign are electronic records that may be transferred, authenticated, stored, and transmitted by electronic means. If you are accessing Communications through a device that we provide, a copy of the referenced Communications will be emailed to you to the email address that you provide so that you can print, save, or send them to a place where they may be printed/saved/viewed for future reference.

**What Communications Will be Provided to You in Electronic Format**

You agree that we may provide you with all disclosures and notices required by law or the Automated Clearing House System in connection with your loans with Mariner, including Communications in electronic format. Your consent to receive electronic Communications and conduct electronic transactions includes, but is not limited to, the execution and receipt of loan documents and the receipt of our privacy policies/notices and other notices/disclosures. By providing your electronic signature for a given loan document, you agree that you are legally bound by such document and you are solely and fully responsible for fulfilling all duties and obligations set forth in such document just as though you had signed in ink a paper copy of such document. If your loan is not for the purchase of goods or services and you are to receive any loan proceeds directly, you authorize us to electronically credit your designated checking or savings account with applicable loan proceeds.

**How to Withdraw Your Consent**

To withdraw your consent to receive future electronic Communications, you may contact us in any of the ways described below. We will not impose any fee to process the withdrawal of your consent, but your access to receive future Communications in electronic format will be terminated. Any withdrawal of your consent to receive electronic Communications will be effective only after we have a reasonable period of time to process your withdrawal.

**System Requirements**

To be able to access, view, and retain electronic Communications that we make available to you, you must have the following equipment and software:

- A personal computer or other device that is capable of accessing the Internet.
- A current Internet web browser that is capable of supporting 128-bit SSL encrypted communications, with cookies and java script enabled, such as the current major release of Microsoft Internet Explorer, Mozilla Firefox, Google Chrome or Apple Safari.
- Software that permits you to receive and access Portable Document Format or "PDF" files, such as the current version of Adobe Acrobat Reader.
- An email account with an Internet service provider and email software to permit you to participate in the Online Account services.

- To retain a copy of electronic Communications your device must have the ability to print, download and store PDF files.
- Sufficient electronic storage capacity on your device's hard drive or other data storage unit.

You will be notified if there are any significant changes in system requirements in order to confirm that you still meet the minimum system requirements to access and receive Communications in electronic format.

**Requesting Paper Delivery of Disclosures and Notices**

You can obtain a paper copy of an electronic Communication by printing it yourself or by requesting that we mail you a paper copy. To receive a paper copy of any Communication provided by Mariner Finance, LLC at no charge, please request it in one of the following ways:

- Send an email message with your name and mailing address to: websupport@marinerfinance.com
- Call our Corporate Offices at 443-438-2056
- Send a letter to: 8211 Town Center Dr., Nottingham, MD 21236

Attn: Web Support

Be sure to request the specific Communication you want in a paper format.

**No Fees for Electronic Communications**

There is no charge for electronic delivery of the Communications.

**Communications in Writing; Updating Contact Information**

All Communications in either electronic or paper format from us to you will be considered "in writing." You should print or download for your records a copy of this Consent and any other Communication that is important to you. You agree to update any contact information that you provide to us, including any email address, by contacting us through one of the above methods.

**Federal Law**

You acknowledge and agree that your consent to electronic Communications is being provided in connection with a transaction affecting interstate commerce that is subject to the federal E-Signature Act, and that you and we both intend that the E-Signature Act apply to the fullest extent possible to validate our ability to conduct business with you by electronic means.

**<u>Please read the below information carefully and keep a copy for your records.</u>**

As used in the following consents and disclosures, the words "we," "us," "our," or "Company" refer to Mariner Finance, LLC, Personal Finance Company LLC, and their affiliates and subsidiaries; and the words "you," "your," and "yours" refer to the person acknowledging these consents and disclosures. "Communication" means any application forms, loan agreements or amendments thereto, customer agreements or amendments thereto, disclosures, notices, responses to claims, transaction history, monthly statements, privacy policies, and all other information related to a loan application or your loans, or the services we offer, including, but not limited to, information that we are required by law to provide to you in writing.

**<u>E-Signature Disclosure and Consent</u>**

You confirm that you can access, read, and agree to all of the terms and conditions herein. You agree that your electronic signature will have the same force and effect and will bind you to the all terms and conditions in the same manner and to the same extent as a physical signature would do. You also agree that any documents that you electronically sign are electronic records that may be transferred, authenticated, stored, and transmitted by electronic means. If you are accessing Communications through a device that we provide, a copy of the referenced Communications will be provided to you in hardcopy or emailed to you to the email address that you provide so that you can print, save, or send them to a place where they may be printed/saved/viewed for future reference.

**What Communications Will be Provided to You in Electronic Format.** You agree that we may provide you with all disclosures and notices required by law or by the Automated Clearing House System in connection with your loan(s) with Company, including Communications, in electronic format. Your consent to receive electronic Communications and conduct electronic transactions includes, but is not limited to, the execution and receipt of loan documents, and the receipt of our privacy policies/notices, and of any other notices/disclosures. By providing your electronic signature for a given loan document, you agree that you are legally bound by such document, and you are solely and fully responsible for fulfilling all duties and obligations set forth in such document just as though you had signed in ink a paper copy of such document. If your loan is not for the purchase of goods or services and you are to receive any loan proceeds directly, you authorize us to electronically credit your designated checking or savings account with applicable loan proceeds.

**How to Withdraw Your Consent.** To withdraw your consent to receive future electronic Communications, you may contact us in any of the ways described below. We will not impose any fee to process the withdrawal of your consent, but your access to receive future Communications in electronic format will be terminated. Any withdrawal of your consent to receive electronic Communications will be effective only after we have a reasonable period of time to process your withdrawal.

**System Requirements**. To be able to access, view, and retain electronic Communications that we make available to you, you must have the following equipment and software:

- A personal computer or other device that is capable of accessing the Internet.
- A current Internet web browser that is capable of supporting a minimum of 128-bit SSL encryption using the TLS 1.1 standard, with cookies and java script enabled, such as the current major release of Microsoft Internet Explorer, Mozilla Firefox, Google Chrome or Apple Safari.
- Software that permits you to receive and access Portable Document Format or "PDF" files, such as the current version of Adobe Acrobat Reader.
- An email account with an Internet service provider and email software to permit you to participate in the Online Account services.

- To retain a copy of electronic Communications your device must have the ability to print, download and store PDF files.
- Sufficient electronic storage capacity on your device's hard drive or other data storage unit.

You will be notified if there are any significant changes in system requirements in order to confirm that you still meet the minimum system requirements to access and receive Communications in electronic format.

**Requesting Paper Delivery of Disclosures and Notices.** You can obtain a paper copy of an electronic Communication by printing it yourself or by requesting that we mail you a paper copy. To receive a paper copy of any Communication provided by Company at no charge, please request it in one of the following ways and be sure to include the specific Communication you would like in paper format:

- Send an email message with your name and mailing address:
  - For Mariner Finance, LLC: contactus@marinerfinance.com, or
  - For Personal Finance Company LLC: contactus@personalfinancecompany.com
- Call our Corporate Offices at 443-438-2056
- Send a letter to:
  8211 Town Center Dr.,
  Nottingham, MD 21236
  Attn: Web Support

**No Fees for Electronic Communications.** There is no charge for electronic delivery of Communications.

**Communications in Writing; Updating Contact Information.** All Communications in either electronic or paper format from us to you will be considered "in writing." You should print or download for your records a copy of this E-Signature Disclosure and Consent and any other Communication that is important to you. You agree to update any contact information that you provide to us, including any email address, by contacting us through one of the above methods.

**Federal Law.** You acknowledge and agree that your consent to electronic Communications is being provided in connection with a transaction affecting interstate commerce that is subject to the federal E-Signature Act, and that you and we both intend that the E-Signature Act apply to the fullest extent possible to validate our ability to conduct business with you by electronic means.

By signing below, you hereby give your affirmative consent to the terms and conditions of our E-Sign Consent and Disclosure Policy and for us to provide electronic Communications to you as described in the Policy above. You further agree that you have provided us with a current email address at which we may send electronic Communications to you. This E-Sign Disclosure and Consent replaces any previous E-Sign Disclosure and Consent.

| | |
|---|---|
| December 04, 2020<br>Date | [redacted]<br>Borrower |
| Date | Borrower |
| Date | Borrower |
| Date | Borrower |

**Texting Terms of Use**

By providing your mobile number (including any mobile number provided in the future or other phone number later converted to a mobile phone number), you consent to be contacted by Mariner Finance, LLC, or an affiliated company (hereinafter "Company"), Company's agents, employees, attorneys, subsequent creditors, loan servicing companies, and third-party collectors, through the use of SMS text messages sent from an automatic telephone dialing system (or any other means) regarding the loan and services for which you have applied. You agree and acknowledge that you have provided your consent to be contacted by text message in exchange for the loan or services you received from Company and that these Terms of Use shall be incorporated into any concurrent or subsequent agreements entered into between you and the Company.

You understand that your cellular provider's message and data rates may apply to text messages sent from Company and that Company has no liability for the cost of any such text messages. You certify that you are the subscriber or non-subscribing customary user and are authorized to consent to receive text messages on the mobile phone number provided and that you are authorized to incur any message or data charges that may apply. Company is not responsible for incomplete, lost, late, or misdirected messages, including (but not limited to) undelivered messages resulting from any form of filtering by your mobile carrier or service provider or otherwise.

You acknowledge that text messages sent to your phone may be seen by anyone with access to your phone. As such, you agree to take steps to safeguard your phone and text messages so long as you would like any such messages to remain private. You acknowledge and agree that you want to receive text messages even though there is a risk another person could access those messages. You agree to notify Company immediately of any change of address, if you change mobile numbers, or if you plan to provide your phone to another person.

Company's Texting Terms of Use can be modified at any time. The current version of the Terms of Use will be posted on the Company's website. Company may terminate the text message program at any time.

Opt-Out or STOP

You understand that if you wish to stop receiving all text messages from Company, you must reply to any text messages from Company with the word STOP.

If at any time you need Company's contact information or information on text messages, you can reply to any text message from Company by typing HELP. Some of the text messages Company sends may include links to websites. To access these websites, you will need a web browser and Internet access.

For questions about these Terms of Use, requests for a paper copy of these Terms of Use, or any other requests regarding these Terms of Use, the following contact information may be used:

8211 Town Center Drive

Nottingham, MD 21236

Tel. Number: 877-310-2373

Email Address: **customersupport@marinerfinance.com**

# CREDIT AND CONTACT AUTHORIZATION FORM

By providing responses to application questions, I understand that I am making application to Mariner Finance, LLC, Personal Finance Company LLC, an affiliated company, and/or its agent(s) (hereinafter collectively referred to as "Company") for a loan for the purpose described in the application. If the application is submitted through one or more third parties to Company, I authorize such third parties to share any information that I have provided with Company. I authorize Company to order credit reports on me from time to time and to make whatever credit inquiries Company deems necessary in connection with this credit application or in the course of review, refinance or collection of any credit extended in reliance on this application. I authorize any person or consumer reporting agency to complete, compile and furnish to Company any information that Company may request. I certify that all information I have provided in connection with this application and request for credit is true, accurate and complete. I authorize Company (and any financial service provider that Company may ask to evaluate my request) to verify the information I have given and obtain information about me from a consumer reporting agency or other sources. Further, by signing my name below and by providing my mobile number, home number (including any phone number that I later convert to a mobile phone number), or email address to Company, I understand that in conjunction with my application to and request for services from Company as described in my application, I agree that all information that I provide or that Company obtains in connection with my application or otherwise: (i) may be used by Company to process my request and that Company may contact me via telephone, text message, or email using any telephone number and/or email address that I have provided; (ii) will remain Company's property whether or not credit is extended; and (iii) may be disclosed by Company to any of its subsidiaries, affiliates, and assigns.

Further, in exchange for Company's processing of this request and any potential loan or service provided to me by Company, I expressly consent and agree to receive phone calls, text messages, and emails by or on behalf of Company regarding the processing of my request and, if approved, for other transactional purposes, such as the collection and servicing of all of my accounts with Company. Such consent includes, but is not limited to, manual calling methods, prerecorded or artificial voice messages, text messages, emails and/or calls placed using an automatic telephone dialing system. I understand that my consent for non-marketing, informational calls and messages applies to each phone number and email address that I provide to Company now or in the future.

I understand that any text messages Company sends to me may be accessed by anyone with access to my text messages. I acknowledge that my mobile phone service provider may charge me fees for text messages that Company sends to me, and I agree that Company shall have no liability for the cost of any such text messages. I understand that I may unsubscribe from text messages by replying "STOP" to any text message that I receive from Company or on Company's behalf.

Finally, by signing below, I acknowledge that I have been provided a copy of and agree to the terms and conditions set forth in Company's Texting Terms of Use.

[redacted]
Applicant Signature

[redacted]
Applicant Name (Please Print)

12/04/2020
Date

[redacted]
Mobile Phone number

Applicant Signature

Applicant Name (Please Print)

Date

Mobile Phone number

AGREEMENT TO RECEIVE MARKETING TEXT MESSAGES

By signing this Agreement to Receive Marketing Text Messages, I authorize Mariner Finance, LLC, Personal Finance Company LLC, any affiliated company, and/or its agent(s) (hereinafter collectively referred to as "Company") to send marketing text messages using an automatic telephone dialing system to the mobile number I have provided and that is listed below. I understand that I am not required to authorize marketing text messages to obtain credit or other services from Company. I acknowledge that if I do not wish to receive, sales or marketing text messages from Company, I should not sign this section. I further understand that any messages Company sends to me may be accessed by anyone with access to my text messages. I acknowledge that my mobile phone service provider may charge me fees for text messages that Company sends to me, and I agree that Company shall have no liability for the cost of any such text messages. I understand that I may unsubscribe from marketing text messages by replying "STOP" to any text message that I receive from Company or on Company's behalf.

Mobile Telephone Number: [redacted]

Customer Name: [redacted]

Signature: [redacted]

Date: 12/04/2020

Mobile Telephone Number: ______________________

Customer Name: ______________________

Signature: ______________________

Date: ______________________

**Mariner Finance, LLC**

Lender Number: **6007-0000024925** Date: **12/04/2020**

| Applicant Name and Address | Office Address and Phone Number |
|---|---|
| [redacted] | **1380 HANOVER AVE**<br>**ALLENTOWN, PA 18109**<br>**(484) 550-6958** |

# Your Credit Score and the Price You Pay for Credit

| **Your Credit Score** | |
|---|---|
| **Your Credit Score** | 623<br>Source: **Equifax** Date: **12/03/2020** |

| **Understanding Your Credit Score** | |
|---|---|
| **What you should know about credit scores** | Your credit score is a number that reflects the information in your credit report.<br>Your credit report is a record of your credit history. It includes information about whether you pay your bills on time and how much you owe to creditors.<br>Your credit score can change, depending on how your credit history changes. |
| **How we use your credit score** | Your credit score can affect whether you can get a loan and how much you will have to pay for that loan. |
| **The range of scores** | Scores range from a low of **299** to a high of **850**.<br>Generally, the higher your score, the more likely you are to be offered better credit terms. |
| **How your score compares to the scores of other consumers** | Your credit score ranks higher than **25** percent of U.S. consumers. |

| **Checking Your Credit Report** | |
|---|---|
| **What if there are mistakes in your credit report?** | You have a right to dispute any inaccurate information in your credit report. If you find mistakes on your credit report, contact the consumer reporting agency.<br>It is a good idea to check your credit report to make sure the information it contains is accurate. |
| **How can you obtain a copy of your credit report?** | Under federal law, you have the right to obtain a free copy of your credit report from each of the nationwide consumer reporting agencies once a year.<br>To order your free annual credit report—<br>*By telephone*: Call toll-free: 1-877-322-8228<br>*On the web*: Visit www.annualcreditreport.com<br>*By mail*: Mail your completed annual credit report Request Form (which you can obtain from the Federal Trade Commission's web site at http://www.ftc.gov/bcp/conline/include/requestformfinal.pdf) to:<br>Annual Credit Report Request Service<br>P.O. Box 105281<br>Atlanta, GA 30348-5281 |
| **How can you get more information?** | For more information about credit reports and your rights under federal law, visit the Federal Reserve Board's web site at www.federalreserve.gov, or the Federal Trade Commission's web site at www.ftc.gov. |

Date: 12/03/2020
Amount Requested $ 2,250.00
Application Taken:
( ) In person ( ) By telephone
( ) By mail (X) E-mail, Web-site or electronically
Proceeds of Credit To be Used for
Unexpected Expenses/Bills
Lender # 6007-0000024925

MARINER FINANCE
1380 HANOVER AVE
ALLENTOWN, PA 18109
(484) 550-6958
Fax: (610) 439-1730

# LOAN APPLICATION

APPLICANT – Please read he following before completing this form: Married applicants may apply for an individual account. I am applying for ( X ) INDIVIDUAL CREDIT or ( ) JOINT CREDIT

## APPLICANT INFORMAITON

| | | | |
|---|---|---|---|
| Name (Last, First, Middle I.) [redacted] | Home Phone | Cell Phone [redacted] | Date of Birth [redacted] |
| Street Address [redacted] | City, State, Zip [redacted] | | How Long? [redacted] |
| Social Security Number [redacted] | Drivers License Number [redacted] | E-mail Address [redacted]@[redacted] | |
| Former Address (if current address is less han 3 years) [redacted] | Second Former Address (if current address is less han 3 years) [redacted] | | |
| Employer Name and Address [redacted] A | Marital Status – Do not complete if this is an application for individual unsecured Credit ( ) Married ( ) Unmarried ( ) Separated | | |
| Phone Number ([redacted] / Posi ion/Department [redacted] / Leng h of Employment | Former Employer ( if less than 3 years) | | |
| Gross Monthly Income $4,704.27 / Net Mon hly Income (Take Home Pay) $2,803.93 | Second Former Employer ( if less than 3 years) | | |
| Additional Income Name | Re irement Pension Amount $ | Social Security Benefit Amount $0.00 | |
| Gross Additional Income $ / Net Mon hly Income (Addi ional Income) $ | Dividends Amount $ | Rental Property Income Amount $ | |
| O her Income Source(s): **Income from alimony, child support, or separate maintenance payments need not be revealed if you do not wish to have it considered as a basis for repaying this obligation.** $ | Receiving Child Support Amount $ | Receiving Alimony Amount $ | |

## CO-APPLICANT INFORMATION

| | | | |
|---|---|---|---|
| Name (Last, First, Middle I ) | Home Phone | Cell Phone | Date of Birth |
| Street Address | City, State, Zip | | How Long? years |
| Social Security Number / Drivers License Number | E-mail Address | | |
| Former Address (if current address is less han 3 years) | Second Former Address (if current address is less than 3 years) | | |
| Employer Name and Address | Marital Status – Do not complete if this is an applica ion for individual unsecured Credit ( ) Married ( ) Unmarried ( ) Separated | | |
| Phone Number / Posi ion/Department / Leng h of Employment | Former Employer ( if less than 3 years) | | |
| Gross Monthly Income $ / Net Monthly Income (Take Home Pay) $ | Second Former Employer ( if less than 3 years) | | |
| Addi ional Income Name | Retirement Pension Amount $ | Social Security Benefit Amount $0.00 | |
| Gross Addi ional Income $ / Net Monthly Income (Additional Income) $ | Dividends Amount $ | Rental Property Income Amount $ | |
| Other Income Source(s) **Income from alimony, child support, or separate maintenance payments need not be revealed if you do not wish to have it considered as a basis for repaying this obligation.** $ | Receiving Child Support Amount $ | Receiving Alimony Amount $ | |

## Assets

| | Amount | |
|---|---|---|
| Home [redacted] | $ 0.00 | |
| 2nd Home / Vacation Property | $ 0.00 | |
| Rental Property | $ 0.00 | |
| Land | $ 0.00 | |
| Total Real Estate | $ 0.00 | |
| Auto 1 Description Auto - Year Make Model 2008 Honda Civic | $ 1,975.00 | [A] Applicant |
| Auto 2 Description Year Make Model | $ | |
| Auto 3 Description Year Make Model | $ | |
| Other Motor Vehicles or Equipment | $ 0.00 | |
| Life Insurance Policies | $ 0.00 | |
| Bank/ Credit Union Accounts Checking | $ 0.00 | |
| Bank/Credit Union Accounts - Savings/ Certificates of Deposit/ 401K | $ 0.00 | |
| Trust accounts/ Annuities/ Stocks & Bonds | $ 0.00 | |
| Other | $ 0.00 | |
| | Total Assets $ | 1,975.00 |

MARINER FINANCE

## Liabilities

| Mortgage or Contract Holder | | Address | Monthly Payment | | Amount |
|---|---|---|---|---|---|
| 1st Mortgage | | | $ | | $ 0.00 |
| 2nd Mortgage | | | $ | | $ 0.00 |
| Other Mortgages- Land, rental property, vacation or 2nd home | | | $ | | $ 0.00 |
| Mobile Home Payment/ Land payment | | | $ | | $ 0.00 |
| Rent / Lot Rent | | | $ | | $ 0.00 |
| Other Mortgages | | | $ | | $ 0.00 |
| Declared Monthly Pmt – rent / mortg | Renting | | $ 600.00 | [redacted] | |
| Declared Monthly Pmt – rent / mortg | | | $ 0.00 | | |
| | | **Total Real Estate** | $ 600.00 | | $ 0.00 |
| **Creditors** | | **Nature of Debt** | **Monthly Payment** | | **Amount** |
| Auto 1 | | NET FCU | $ | [A] Applicant | $ |
| Auto 2 | | CREDITACPT | $ | [A] Applicant | $ |
| Auto 3 | | | $ | | $ |
| Ti le Pawn/ Rent to Own/ Check Cashers | | | $ | | $ 0.00 |
| Co-signed Debts | | | $ | | $ 0.00 |
| Finance Companies | | KASHABLELL BMGMONEYIN BMGMONEYIN | $ 825.00 | [A] Applicant | $ 13,761.00 |
| Job related expenses (other than daycare & childcare) | | | $ | | $ 0.00 |
| All Medical/Drugs | | | $ | | $ 0.00 |
| Alimony/Child Support Court ordered ( ) Yes ( ) No | | | $ | | $ 0.00 |
| Bank Loans | | NET FCU DPT ED/NAV NET FCU | $ 321.79 | [A] Applicant | $ 15,098.00 |
| Credit Cards | | SYNCB/QVC CAP ONE KOHLS/CAP1 SYNCB/AMAZ | $ 212.00 | [A] Applicant | $ 3,710.00 |
| Other | | | $ | | $ 0.00 |
| | | **Total of Recurring Debts (other than Real Estate)** | $ 1,358.79 | | $ 32,569.00 |
| | | | | | |
| | | **Total Debts** | $ 1,958.79 | | $ 32,569.00 |
| Job related expenses: Daycare & Childcare | | | $ 0.00 | | $ 0.00 |

* Asterisk indicates that this amount will be paid with the proceeds from this loan. **Total Monthly Payments** $ 1,958.79 **Total Outstanding Debts** $ 32,569.00

| | |
|---|---|
| **Total Net Income** | $ 2,803.93 |
| **Net Debt Ratio** | % 69.85 |

## Declarations

By signing below, you authorize us to make whatever credit inquiries and obtain such credit reports as we deem necessary in connection with this credit application or in the course of review or collection of any credit extended in reliance on this application. You authorize and instruct any person to complete and furnish to us any information that we may request and agree that such information, along with this application, shall remain our property whether or not credit is extended. You authorize us to disclose any information in or relating to this application and loan account if approved (including information received from third persons) to any applicant for, or guarantor of, this credit, to financial service providers we select to provide you with financial products and services we do not offer ourselves, and to any potential assignee, transferee, or participant in the credit to which this application relates. You represent that this application lists all debts and obligations you have, including those upon which you are jointly obligated, and that all information provided is true.

[redacted] Applicant Signature — 12/4/2020 Date — Co-Applicant Signature — Date


Distribution Instructions – File Copy

10134-2

**First Payment Date Request Form (PA.)**

Loan #: [redacted]

I request the following first payment date in connection with my loan from Mariner Finance, LLC for my convenience:

**Requested First Payment Date:** 01/08/2021

I acknowledge that interest begins to accrue in connection with my loan on the loan date.

[redacted]
Borrower

12/04/2020
Date

Co-Borrower

Date

# NOTE, SECURITY AGREEMENT & ARBITRATION AGREEMENT (Pennsylvania)

| Name & Mailing Address of Borrower(s) | Co-Borrower(s) | Maturity Date | Account No. |
|---|---|---|---|
| [redacted] | CO-BORROWER ADDRESS IF NOT THE SAME | 12/08/2024 | [redacted] |
| | | Loan Date 12/4/2020 | Loan Type 10 |

The borrower(s) who sign this Note, Security Agreement & Arbitration Agreement (*note*) are called *you* or *your*. The **lender/creditor, Mariner Finance, LLC**, whose address is 1380 HANOVER AVE, ALLENTOWN, PA 18109, is called *we, us,* or *our*. Each borrower is responsible for individually repaying the loan in full.

These disclosures are required by law and are part of this note:

| **ANNUAL PERCENTAGE RATE** The cost of your credit as a yearly rate. | **FINANCE CHARGE** The dollar amount the credit will cost you. | **Amount Financed** The amount of credit provided to you or on your behalf. | **Total of Payments** The amount you will have paid after you have made all payments as scheduled. |
|---|---|---|---|
| 27.68 % | $ 3,124.72 | $ 4,680.97 | $ 7,805.69 |

Your payment schedule will be:

| Number of Payments | Amount of Payments | When Payments Are Due |
|---|---|---|
| 1 | $ 176.18 | 01/08/2021 First Payment Date |
| 47 | $ 162.33 | Other payments are due on the same date each following month until paid in full. |

**Security**: You are giving a security interest in: ☐ the goods or property being purchased. ☒ PP ("PP" means certain household items)

**Late Payment**: If a payment is not received within 10 days after it is due, you will pay a late charge of 1.5% per month of such payment, but no less than $1.00.

**Prepayment**: If you pay off early, you will not have to pay a penalty and you may be entitled to a refund of part of the finance charge.

See the rest of this note for additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment refunds and penalties. *e means an estimate*

**Itemization of Amount Financed**

1. $ 534.72 Net Balance-Prior Account
2. $ NONE Plus Accrued Interest
3. $ 480.94 Unpaid Balance-Prior Account
4. $ 126.45 To Insurance Company for Life Ins.*
5. $ 308.56 To Insurance Company for Dis. Ins.*
6. $ 520.88 To Insurance Company for Household Property Ins.*
7. $ NONE To Insurance Company for Non-Filing Ins.*
8. $ 384.14 To Insurance Company for Invol. Unemp. Ins.*
9. $ NONE To us for Auto Physical Damage Ins.*
10. $ NONE To Public Officials for Recording Fees
11. $ 2,860.00 Cash to Borrower(~~s~~)
12. $ 4,680.97 Amount Financed (Sum of 3-11)
13. $ 150.00 Service Charge (Prepaid Finance Charge)

*We or our affiliates may receive benefits from your purchase of these items.

If you do not meet your contract obligation, you may lose the Property that secures this loan.

At your direction and request, on your behalf and for your benefit, we will disburse the following (including any items described on Schedule B):

a) $ 2,500.00 To [redacted]
b) $ 360.00 To [redacted]
c) $ NONE To N/A
d) $ NONE To N/A
e) $ NONE To N/A
f) $ NONE To N/A
g) $ NONE To N/A
h) $ NONE To N/A

$ 2,974.72 Discount
$ 13.85 First Payment Extension Charge

**You promise to pay us** the Total of Payments, which includes interest at the rate of 25.80 % per year (the *Interest Rate*), in monthly payments as scheduled above. Each payment is applied first to late charges, then to Finance Charge and then to principal, or in any order we decide. The late charge will continue to be charged on amounts unpaid after maturity (including after any judgment) until paid in full. You may prepay this note without penalty. If you prepay in full, we will refund any unearned interest portion of the Finance Charge using the Rule of 78's refund method for notes with an original term of 61 months or less. We will use the Actuarial refund method for notes with an original term of greater than 61 months. No refund of less than $1.00 will be made. If you prepay between scheduled payment dates, the refund is computed as of the next payment due date. The Service Charge is earned when the loan is made and will not be refunded. Partial prepayments will be applied against the unpaid balance and you must still make each scheduled monthly payment until the entire balance is paid.

**Credit life, credit disability and involuntary unemployment insurance are not required to get credit, and won't be provided unless you sign and agree to pay the additional cost.**

| | | | |
|---|---|---|---|
| Credit Life ☒ Single ☐ Joint Coverage | $ 126.45 | You want credit life insurance. You also want joint credit life insurance. | Signature [redacted] Signature |
| Credit Disability ☒ Single ☐ Joint Coverage | $ 308.56 | You want credit disability insurance You also want joint credit disability insurance. | Signature [redacted] Signature |
| Involuntary Unemployment | $ 384.14 | You want involuntary unemployment insurance. | Signature [redacted] |

**Property Insurance**. If the Property (as defined below) is a motor vehicle, you agree to buy and maintain primary automobile physical damage insurance consisting of comprehensive and collision coverage, covering loss or damage to the Property. **You may buy property insurance (automobile physical damage insurance and household property insurance) from anyone you want**. If you get dual interest primary automobile physical damage insurance through us for a term of N/A months you will pay $ NONE. If you get dual interest household property insurance through us for a term of 48 months you will pay $ 520.88.

*You want* ☐ *dual interest primary automobile physical damage insurance* ☒ *dual interest household property insurance through us.*
*Signature* [redacted]

**You grant us a security interest in the following property**, all parts, accessories, and equipment now or later added to the property, and all proceeds (collectively, the *Property*). We give up any right we have (now or later) to consider collateral you give us for another obligation as collateral for this note unless it is described in this note.

☐ Motor Vehicle(s) described as follows

| NEW OR USED | YEAR AND MAKE | NO. CYL | SERIES NAME (Also No. if applicable) | BODY, TYPE & MODEL NO. (If truck, tons capacity) | IDENTIFICATION NO. (Serial or Motor No.) |
|---|---|---|---|---|---|
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |

☒ Personal Property. See attached Schedule A, which is part of this note, for more detail.

**You promise that**: you are the owner of the Property and, if there is a certificate of title to the Property, you will promptly deliver the certificate to us; you will not sell, lease or otherwise dispose of the Property without our prior written consent; you will keep the Property in this state, unless the Property is a motor vehicle, in which case you only will use it outside this state in the course of your normal use of the Property; you will not use the Property in violation of any law or in any manner inconsistent with any insurance policy; you will pay all taxes, assessments and other fees payable on the Property when they are due and payable; only we have a security interest in the Property unless you have told us in writing about another security interest; you will not permit any other security interest to be on the Property without our prior written consent; and you will keep the Property in good condition and repair and you will not permit anything to be done to the Property that would impair its value.

**ADDITIONAL TERMS AND CONDITIONS**

1. If you make a payment with a check that is dishonored, you agree to pay us a bad check fee of $50.00.
2. We may inspect the Property at any reasonable time. You will show us the Property or give us a written statement showing the location of the Property whenever we ask. You authorize us to file all financing statements, continuation statements and security interest filing statements with respect to the Property and you agree to sign such statements at our request.
3. You will keep the Property insured for its full value against loss or damage. If the Property is a motor vehicle, your physical damage insurance policy must insure the Property for its full replacement value with a deductible amount of no more than $500. Your insurance policies must say that the insurance is payable to us to the extent of what you owe us and you must give us a loss payable clause satisfactory to us. You assign any returned or unearned insurance premiums due upon cancellation of any insurance policy to us. You direct the insurance companies to pay us all insurance proceeds and returned or unearned premiums.
4. You will be in default if: you do not make a payment on time; you are (or any other person puts you) in bankruptcy, insolvency or receivership; any credit information you gave to us or any representation you make to us in this note is materially wrong; you do not fulfill any obligation of yours in this note; or you die.
5. When you are in default, we may require you to pay this loan plus accrued charges less a refund of interest computed in the same way as if you had made payment in full in advance, at once, in addition to any other remedies we have. If we place this note in the hands of an attorney, not our salaried employee, for collection, you agree to pay our attorney fees. You also agree to pay all court costs and actual reasonable expenses of repossessing, storing and selling the Property.
6. When you are in default, we have the rights and remedies of a secured party under Pennsylvania law, including the right to repossess the Property. If we repossess the Property other than by legal process, we will send you a repossession notice. The notice will inform you that the Property will be sold at a public or private sale, and that you may get the Property back by paying the full amount owed under the note (redeem) within 15 days of the date of mailing of the notice. In our discretion, we may also allow you to get the Property back by paying all past due payments and default charges (reinstate) within 15 days of the date of mailing of the notice. We will tell you how much you must pay to redeem the Property or (if we allow it) reinstate the note. The repossession notice may be sent to your address last shown on our records. We may require you to assemble and make the Property available to us at any place convenient to both of us. If any of your possessions are in or attached to the Property at the time it is repossessed, you authorize us to take them without any liability. We will store them for you safely. We will tell you where they are stored and you may redeem them. If you do not claim your possessions within 30 days after the Property is repossessed, we may dispose of them in any manner we deem appropriate without notice to you, unless required otherwise by applicable law. You agree to pay any deficiency after the sale of the Property.
7. We can waive or delay enforcing any of our rights without losing them. We can waive or delay enforcing a right against one of you without losing it as to the other. We can release one of you without releasing the other. You consent to extensions of time without notice.
8. Pennsylvania law and federal law govern this note. If any part of this note is unenforceable, this will not make any other part unenforceable (subject to the paragraph below titled **Other Agreements**). You won't be required to pay interest or charges in excess of those permitted by law. In addition, if any provision of this note is contrary to the rights and protections afforded to any "covered borrower" as defined in the Military Lending Act, such contrary provision of this note shall be inoperative and shall have no force or effect in connection with such "covered borrower;" however all remaining provisions of this note shall remain in full force and effect.

<u>Military Lending Act Disclosures</u>: **THE FOLLOWING DISCLOSURES APPLY IF YOU ARE AN ACTIVE DUTY MEMBER OF THE MILITARY OR A DEPENDENT OF AN ACTIVE DUTY MILITARY MEMBER.**
Mariner Finance appreciates your and your family's service to our country. As an active duty member of the military (or dependent of an active duty military member), the Federal Military Lending Act ("MLA") provides you with certain protections. Please see below for important information about your loan.
**Federal law provides important protections to members of the Armed Forces and their dependents relating to extensions of consumer credit. In general, the cost of consumer credit to a member of the Armed Forces and his or her dependents may not exceed an annual percentage rate of 36 percent. This rate must include, as applicable to the credit transaction or account: The costs associated with credit insurance premiums, fees for ancillary products sold in connection with the credit transaction; any application fee charged (other than certain application fees for specified credit transactions or accounts); and any participation fee charged (other than certain participation fees for a credit card account).**

Please also call 1-877-299-3124 to receive your MLA disclosures over the phone.

**READ THE BELOW ARBITRATION AGREEMENT CAREFULLY. IT PROVIDES, AMONG OTHER TERMS:**

- **YOU OR WE MAY ELECT TO HAVE DISPUTES BETWEEN US RESOLVED BY BINDING ARBITRATION INSTEAD OF IN COURT.**
- **IN ARBITRATION YOU GIVE UP THE RIGHT TO SUE IN COURT AND DISCOVERY AND RIGHTS OF APPEAL ARE LIMITED. A NEUTRAL ARBITRATOR RESOLVES THE DISPUTE INSTEAD OF A JUDGE OR JURY.**
- **YOU MAY NOT PARTICIPATE AS A CLASS REPRESENTATIVE OR MEMBER IN ARBITRATION OR IN ANY OTHER CONSOLIDATED PROCEEDING.**
- **YOU MAY REJECT THE BELOW ARBITRATION AGREEMENT FOR A CERTAIN AMOUNT OF TIME AFTER THE NOTE DATE.**

***The below Arbitration Agreement does not apply to any "covered borrower" as defined in the Military Lending Act.***

By signing this note, you agree to this Arbitration Agreement (Agreement). This Agreement is part of your note. In this Agreement, "you," "we," "us," and "our" include subsidiaries, affiliates, agents, employers, successors, and assigns.

**Arbitration Agreement**. You or we may elect to have any Claim (defined below) resolved by neutral binding arbitration instead of in court. You waive any right you have to resolve a Claim between you and us in court. You waive any right you have to participate as a class representative or class member.

**Claim.** Claim means any claim or dispute, whether arising in law, equity, or otherwise, and regardless of the type of relief sought involving your application for credit, the note, the origination, servicing and enforcement of the obligation, any insurance contract or warranty or other product or service you buy, the validity, enforceability and scope of this Agreement and the note, and any relationship that results from the note or underlying obligation. Claim includes initial claims, counterclaims, cross-claims, and third-party claims.

**Small Claims**. You and we retain the right to seek individual relief in small claims court so long as the Claim is only in that court and is within that court's jurisdiction. Filing or pursuing a Claim in small claims court does not waive any right to seek arbitration for Claims outside the court's jurisdiction or if the Claim is transferred, removed, or appealed to a different court.

**Excluded Claims**. The following claims, called Excluded Claims, are excluded from the arbitration process: self-help remedies (such as repossession), foreclosure, replevin, garnishment, and/or individual injunctive relief. Pursuing an Excluded Claim in court does not waive any right to seek arbitration for Claims outside the court's jurisdiction, or if an Excluded Claim is transferred, removed, or appealed to a different court.

**Non-Waiver**. Even if a Claim is brought in court, you or we may choose to arbitrate any Claim made by a new party or any Claim later asserted by a party in that action or any related or unrelated lawsuit.

**Arbitration Process.** Arbitrations will be conducted by the American Arbitration Association ("AAA") or, if the AAA is not available, another arbitration organization, subject to agreement by both you and us. You can find the rules of the AAA by visiting its website at www.adr.org. Arbitrators must be attorneys or retired judges with at least 15 years of experience practicing law. Arbitrators must be selected according to rules of the AAA or any other agreed arbitration organization. Arbitrators must apply substantive governing law and applicable statutes of limitation.

The arbitration hearing will be conducted in the federal district where you live. The arbitration may take place somewhere else more convenient to you if required by the rules of the AAA or any other agreed arbitration organization. If you and we agree, the arbitration can be conducted by telephone. We will advance and/or pay any fees and costs required by the rules of the AAA or any other agreed arbitration organization to ensure this arbitration agreement is enforceable. You and we will each pay our own attorney's fees and witness and experts' expenses, except as otherwise required by law or this Agreement. The arbitration award must be in writing. Any award must be kept confidential. The arbitrator's decision is final and binding. You and we have a limited right to appeal as permitted under the Federal Arbitration Act.

**30 Days to Resolve Claims.** Before you start an arbitration, you agree to write to us at our address at the top of the note (or any changed address that we have provided to you in writing) and give us a reasonable opportunity to resolve your Claim. Your letter must tell us your name and account number, describe your Claim, including the dollar amount of your Claim, and describe any other information you need from us.

Before we start an arbitration, we must write to you at your address at the top of the note (or any changed address that you have told us about in writing), describe our Claim, including the dollar amount of our Claim, and give you a reasonable opportunity to resolve the Claim.

We each have 30 days from receipt of notice to resolve the Claim before starting an arbitration.

**Limitations.** The arbitrator may award punitive damages if allowed under similar circumstances in a state court in the state where the arbitration occurs. The arbitrator must follow applicable state and federal laws regarding the amount of punitive damages. The arbitrator must state the exact amount of the punitive damages award. The arbitrator must allow you and us the same procedural rights and use the same standards and guidelines that would apply in a lawsuit in the state where the arbitration occurs. The arbitrator may award individual injunctive relief for the benefit of either party to the arbitration. The arbitrator may not award injunctive relief for the benefit of other persons.

**Applicable Law**. This Agreement relates to a credit transaction involving interstate commerce. Any arbitration under this Agreement is governed by the Federal Arbitration Act (9 U.S.C. § 1 *et seq.*), and only in the event and to the limited extent that the Federal Arbitration Act does not apply, the law of the state governing your note will apply.

**CLASS ACTION WAIVER.** ***Other than as expressly provided in this Agreement, you and we agree that only an arbitrator may resolve Claims. You agree not to bring or participate as a class representative or a class member in any class action in arbitration or in any other consolidated proceeding. Any Claim between you and us must be resolved on an individual basis. Arbitration is not available and will not be conducted on a class-wide basis.***

**Other Agreements**. If any part of this Agreement, other than the Class Action Waiver, is found by a court or arbitrator to be unenforceable, the remainder is enforceable. If the Class Action Waiver is found by a court or arbitrator to be unenforceable, the remainder of this Agreement is unenforceable. This Agreement will survive the termination of the note, regardless of reason for termination. Either you or we can compel arbitration in any court proceeding, regardless of which party filed suit. Either you or we can enforce an arbitration award. This Agreement does not stop you from filing a complaint with a federal, state, or local regulator.

**Rejection of Agreement**. ***You may reject this Agreement by sending us a rejection notice at our address at the top of the note (and no other location) within 60 days after the date of the note. The notice must include a statement that you reject the Agreement, and your name address, telephone number, and note number. You must sign the rejection notice in order for it to be effective.***

You received a completely filled in copy of this note before you signed it. **All 3 pages of this note and Schedules A and B (if any) are specifically incorporated in this note by reference.** This note (all 3 pages) and Schedules A and B (if any) is your entire agreement with us and cannot be changed except in writing signed by us. **Pages 2 and 3 contain an arbitration agreement that is part of this note. By signing below, you agree to all of the terms of this note and you authorize us to order credit reports on you from time to time.** You ask us to make the payments listed above and on Schedule B (if any).

| | |
|---|---|
| ______________________ (WITNESS) | [redacted]__________(SEAL) (BORROWER) |
| ______________________ (WITNESS) | ______________________(SEAL) (BORROWER) |
| ______________________ (WITNESS) | ______________________(SEAL) (BORROWER) |
| ______________________ (WITNESS) | ______________________(SEAL) (BORROWER) |

Any individuals that sign this note as non-obligor below sign solely for the purpose of granting us a security interest in the Property and such individuals are not obligated for the payment of any monies.

| | |
|---|---|
| ______________________ (WITNESS) | ______________________(SEAL) (NON-OBLIGOR) |
| ______________________ (WITNESS) | ______________________(SEAL) (NON-OBLIGOR) |

**☐ The following notice applies if this box is checked: NOTICE: A HOLDER OF THIS AGREEMENT IS SUBJECT TO ALL CLAIMS AND DEFENSES THAT THE BUYER COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED WITH THE PROCEEDS OF THIS AGREEMENT. RECOVERY UNDER THIS AGREEMENT BY THE BUYER MAY NOT EXCEED THE AMOUNT PAID BY THE BUYER UNDER THE AGREEMENT.**

The within instrument or agreement is pledged as collateral to Wells Fargo Bank, N.A.

**Life of the South Insurance Company**
**10151 Deerwood Park Blvd., Bldg. 100, Ste. 500**
**Jacksonville, Florida 32256**

**GROUP POLICY NUMBER**
**CERTIFICATE NO.** [redacted]

**SCHEDULE OF INSURANCE**

| | | | | |
|---|---|---|---|---|
| Insured Debtor [redacted] | S.S. # [redacted] | [redacted] | Age [redacted] | Customer Acct. # [redacted] |
| Insured Co-Debtor (if any) | S.S. # | Address: | Age | Interest Rate 25.80 % |
| First Beneficiary – Creditor Mariner Finance, LLC | | Address 1380 HANOVER AVE ALLENTOWN, PA 18109 | | Maximum Amount of Life Insurance $50,000.00 |
| Debtor's Second Beneficiary (if none, to the estate) [redacted] | | Co-Debtor's Second Beneficiary (if none, to the estate) | | |

| Effective Date 12/04/2020 / Original Scheduled Maturity Date of the Loan 12/08/2024 | Life Term | Disability Term | 1st Payment Due Date | Amortized Term | Issue Ages: |
|---|---|---|---|---|---|
| | 48 Mos. | 48 Mos. | 01/08/2021 | 48 Mos. | Life: 18-71 Disability: 18-67 |

| COVERAGES | | PREMIUMS |
|---|---|---|
| ☒ Single Gross Decreasing Life on Debtor<br>☐ Single Gross Decreasing Life on Co-Debtor<br>☐ Single Gross Decreasing Life with TPD on Debtor<br>☐ Single Gross Decreasing Life with TPD on Co-Debtor<br>☐ Joint Gross Decreasing Life<br>☐ Joint Gross Decreasing Life with TPD | Original Amount of Life Insurance<br>$ 7,805.69 | $ 126.45 |
| ☒ Single Disability on Debtor<br>☐ Single Disability on Co-Debtor<br>☒ Retro<br>14 -day waiting period | Monthly Disability Benefit<br>$ 162.33 | $ 308.56 |
| Maximum Terms: Gross Decreasing Life 75 months; Disability 75 months | Maximum Disability Benefit of $50,000.00 divided by the Loan Term not to exceed $750.00 per month. Disability Coverage commences on the effective date of the Certificate as shown in the Schedule. | |

**You will be covered for Total and Permanent disability if offered by your Creditor and elected by you.**
**Disability coverage excludes preexisting conditions. If you have a preexisting condition resulting from an Illness, disease, or physical condition, you could be ineligible for benefits. Please read the disability pre-existing exclusion section of your Certificate for details.**

**DEBTOR'S GROUP CREDIT INSURANCE APPLICATION**

WAIVED Representations 1 & 2 for $25,000 or less

| **Answer the following questions if applying for life and/or disability coverage:** | **DEBTOR YES** | **DEBTOR NO** | **CO-DEBTOR YES** | **CO-DEBTOR NO** |
|---|---|---|---|---|
| 1a. Have you been diagnosed, treated (including medication), consulted or received advice from a physician within the past twenty four (24) months for any of the following: a heart disease, condition or disorder; cancer (excluding basal cell carcinoma); respiratory illness (excluding bronchitis)? | ☐ | ☐ | ☐ | ☐ |
| 1b. Have you received medical diagnosis or treatment for Acquired Immune Deficiency Syndrome (AIDS) or Aids Related Complex (ARC); or tested positive for HIV virus? | ☐ | ☐ | ☐ | ☐ |
| **In addition to the above, answer the following questions if applying for disability coverage:** | | | | |
| 2. Have you been diagnosed, treated (including medication), consulted or received advice from a physician within the past twenty four (24) months for conditions, disease or disorders of the following: neck or back? | ☐ | ☐ | ☐ | ☐ |
| 3. Are you currently employed and working at least thirty (30) hours per week? | ☒ | ☐ | ☐ | ☐ |

What is your age [redacted] years (Debtor) ____________ years (Co-Debtor)

**The life insurance coverage will not be issued if you or your co-debtor answer "Yes" to questions 1 (a) and 1 (b). The disability** insurance coverage will not be Issued If you or your co-debtor answers "Yes" to questions 1 (a), 1 (b), or 2, or "No" to question 3.

I (We) understand that the Company may void this Certificate or deny a claim if the Company finds at any time during the contestable period even when a claim occurs, that I (we) have concealed or misrepresented any material fact in the application.
I (We) understand that the insurance applied for herein is not compulsory, nor a condition precedent to any loan or credit transaction. I (We) hereby state that I (we) have been given the option to purchase such credit insurance or other insurance from any insurer or agent of my (our) choice and that I (we) freely choose Life of the South Insurance Company and I (we) understand that commissions may be paid to someone or some entity who is connected to this credit transaction and who is acting as an agent for the Company. I (We) acknowledge that I (we) have received a copy of the Certificate or Notice of Proposed Insurance for my (our) records as part of this loan transaction.

**INSURANCE FRAUD WARNING:** Any person who, with intent to defraud any insurance company or other person, files an application for insurance or statement of claim containing any materially false information or conceals, for the purpose of misleading, information concerning any fact material thereto, commits a fraudulent insurance act, which is a crime and subjects such person to criminal and civil penalties.
I (We) understand that these representations will be the basis for the Company's acceptance or denial of this application for the insurance applied for.
**I (We) have answered the above questions to the best of my (our) knowledge and belief.**
**Do not sign this application if any spaces applicable to the debtor electing coverage and to the coverage being elected have not been completed. This application will not be used in a contest if the debtor(s) has not answered the questions applicable to the coverage being applied for and/or If the debtor(s) has not signed and dated the application.**

Dated this 4th day of December, 2020.

President

[redacted]
Signature of Debtor

Signature of Co-Debtor

Signature of Witness: ____________________

Date: 12/04/2020

**Life of the South Insurance Company**
**10151 Deerwood Park Blvd., Bldg. 100, Ste. 500**
**Jacksonville, Florida 32256**

**GROUP POLICY NUMBER**
**CERTIFICATE NO.** [redacted]

**SCHEDULE OF INSURANCE**

| | | | | |
|---|---|---|---|---|
| Insured Debtor [redacted] | S.S. # [redacted] | [redacted] | Age [redacted] | Customer Acct. # [redacted] |
| Insured Co-Debtor (if any) | S.S. # | Address: | Age | Interest Rate 25.80 % |
| First Beneficiary – Creditor Mariner Finance, LLC | | Address 1380 HANOVER AVE ALLENTOWN, PA 18109 | | Maximum Amount of Life Insurance: $50,000.00 |
| Debtor's Second Beneficiary (if none, to the estate) [redacted] | | Co-Debtor's Second Beneficiary (if none, to the estate) | | |

| Effective Date | Life Term | Disability Term | 1st Payment Due Date | Amortized Term | Issue Ages: |
|---|---|---|---|---|---|
| 12/04/2020<br>Original Scheduled Maturity Date of the Loan 12/08/2024 | 48 Mos. | 48 Mos. | 01/08/2021 | 48 Mos. | Life: 18-71<br>Disability: 18-67 |

| COVERAGES | | PREMIUMS |
|---|---|---|
| ☒ Single Gross Decreasing Life on Debtor<br>☐ Single Gross Decreasing Life on Co-Debtor<br>☐ Single Gross Decreasing Life with TPD on Debtor<br>☐ Single Gross Decreasing Life with TPD on Co-Debtor<br>☐ Joint Gross Decreasing Life<br>☐ Joint Gross Decreasing Life with TPD | Original Amount of Life Insurance<br>$ 7,805.69 | $ 126.45 |
| ☒ Single Disability on Debtor<br>☐ Single Disability on Co-Debtor<br>☒ Retro<br>14 -day waiting period | Monthly Disability Benefit<br>$ 162.33 | $ 308.56 |
| Maximum Terms: Gross Decreasing Life 75 months<br>Disability 75 months | Maximum Disability Benefit of $ 50,000.00 divided by the Loan Term not to exceed $ 750.00 per month. Disability Coverage commences on the effective date of the Certificate as shown in the Schedule. | |

**You will be covered for Total and Permanent disability if offered by your Creditor and elected by you. Disability coverage excludes pre-existing conditions. If you have a pre-existing condition resulting from an illness, disease, or physical condition, you could be ineligible for benefits. Please read the disability pre-existing exclusion section of your Certificate for details.**

**RIGHT TO RESCIND**: Within the first 15 days after this certificate is received, an Insured Debtor may surrender it and receive a full refund of premiums paid. Please return the Certificate to us if you wish to rescind coverage.

**LIFE INSURANCE BENEFIT**

**WHO IS INSURED**: This coverage is issued on the life of the Debtor indicated in the Schedule. Either debtor may elect single coverage, however, both debtors must elect joint coverage.

**WHAT YOU GET**: We certify that if we have been paid the premium shown in the schedule, you and the Insured Co-Debtor, if any, are insured for the coverage shown in the Schedule, subject to the terms of the Group Policy issued to the Policyholder and this Certificate.

**WHO GETS PAID**: Immediately upon proof of death or disability, including total and permanent disability, we will pay the benefits provided under this Certificate to the Creditor. The Creditor will apply such payment(s) to pay off or reduce the insured debt. If the amount of insurance exceeds the balance of the insured debt, the excess will be paid to the appropriate debtor, if living, otherwise to the appropriate second beneficiary in the Schedule, or if no second beneficiary is named, then to the appropriate estate.

**SINGLE LIFE INSURANCE BENEFIT**: If you or the Insured Co-Debtor dies or becomes totally and permanently disabled while insured for single life coverage, we will pay the amount of life insurance in force at the time of death or total permanent disability.

**JOINT LIFE INSURANCE BENEFIT**: If you or the Insured Co-Debtor dies or becomes totally and permanently disabled while insured for joint life coverage, we will pay the amount of insurance in force at the time you or the Insured Co-Debtor dies or becomes totally and permanently disabled. If both die or become totally and permanently disabled simultaneously, or under such circumstances that it is impossible to determine who died or became totally disabled first, only one benefit will be paid. Any excess amount will be paid equally to the appropriate Debtor, if living, otherwise to the appropriate second beneficiaries or the estates of both Insured Debtors.

**AMOUNT OF LIFE INSURANCE:**

**GROSS DECREASING TERM COVERAGE (Loan Terms of 75 Months or Less Only):**
The amount of life insurance decreases each month throughout the term of the coverage. On the effective date, the Original Amount of Life Insurance is the lesser of the original amount of the indebtedness (the sum of the payments) or the Maximum Amount of Life Insurance. Thereafter, the amount of insurance decreases each month by an equal amount. That amount is the Original amount of Life Insurance divided by the term of the indebtedness. The benefit will be increased to include no more than two delinquent payments. If the Original Amount of Life Insurance is less than the Original Amount of indebtedness, the benefit will not completely pay off the debt.

**TOTAL PERMANENT DISABILITY**: If elected by the Creditor and by an Insured Debtor, we will pay an amount equal to the life insurance in force on the date of loss if you become totally and permanently and continuously unable to engage in any occupation, employment or activity for compensation or profit, for which you are suited by education, training or experience, according to the certification of a Physician or Podiatrist. This certification may be waived by us if you have suffered permanent loss of sight of both eyes, or severed both hands, both feet or one hand and one foot.

**CERTIFICATE OF CREDIT LIFE AND DISABILITY INSURANCE**
**SINGLE PREMIUM TERM WITH TOTAL AND PERMANENT DISABIILTY**
**SINGLE AND JOINT COVERAGE**
**GROSS DECREASING LIFE COVERAGE WITH TOTAL AND PERMANENT DISABILITY**
**DISABILITY COVERAGE**

**LIFE EXCLUSIONS**

**Suicide Exclusion:** If the Insured Debtor or the Insured Co-Debtor die as a result of suicide while sane or insane within twelve (12) months after the effective date of coverage, our liability will be limited to the refund of premiums paid for single coverage, plus any unearned A and H insurance premiums, or where one debtor's coverage is terminated, our liability will be limited to that portion of the premium outlined under Termination of Joint Coverage, plus any unearned A and H insurance premiums, of this Certificate. Single life coverage on the surviving Insured Debtor will continue unless cancellation is requested in writing.

**TOTAL DISABILITY INSURANCE BENEFIT**

**THIS BENEFIT IS AVAILABLE ONLY IF YOUR INSTALLMENTS ARE PAID ON A MONTHLY BASIS**.

**SINGLE DISABILITY INSURANCE BENEFIT:** Either Debtor may elect single coverage. If you or the Insured Co-Debtor become totally disabled during the term of coverage and continue to be totally disabled for more than the number of days as stated in the Waiting Period as indicated in the Schedule, then you or the Insured Co-Debtor will become eligible for benefits under this Certificate.

**JOINT DISABILITY INSURANCE BENEFIT:** Both Debtors must elect joint coverage. If you or the Insured Co-Debtor becomes totally disabled within the terms of coverage and continues to be for more than the number of days stated in the Waiting Period as indicated in the Schedule, then you or the Insured Co-Debtor will become eligible for benefits under this Certificate. If you and the Insured Co-Debtor become totally disabled at the same time, only one benefit will be paid. However, benefit payments will continue until you or the Insured Co-Debtor are no longer disabled, or when the insurance terminates or expires, whichever occurs first.

**DISABILITY BENEFIT COVERAGE:** If indicated in the Schedule, and you or the Insured Co-Debtor, if applicable, become totally disabled within the term of coverage and such total disability continues uninterrupted for more than the number of days as stated in the Waiting Period, we will pay the Creditor a disability benefit equal to 1/30th of the **MONTHLY DISABILITY BENEFIT** for each day of continuous total disability during your benefit period.

**BENEFIT BASIS:** Any disability benefits payable under this Certificate will be calculated based on one of the following methods which is indicated in your Certificate Schedule.

(a) Retroactive Coverage: This plan provides benefits after the Waiting Period has been satisfied, retroactive to the first day.

(b) Non Retroactive Coverage: This plan is also known as Elimination Coverage and provides benefits beginning with the first day after the Waiting period. Benefits are not retroactive to the first day.

**BENEFIT LIMITATIONS:** The following items are benefit limitations which apply under this Certificate. Regardless of the specific limitation which may apply, the Insured Debtor(s) will be responsible for the payment of all installment payments and/or deficiency amounts required to keep the insured debt from becoming delinquent.

(a) After the first benefit month, each subsequent benefit month will begin on the same day as the first benefit month. If the last day of total disability for which benefits are payable falls on a date which does not equal a full benefit month, we will pay to the Creditor, a daily benefit of 1/30th of the **MONTHLY DISABILITY BENEFIT** for each day.

(b) In the months when the insured loan payment exceeds the **MONTHLY DISABILITY BENEFIT** shown in the Schedule, coverage will be only for an amount equal to the **MONTHLY DISABILITY BENEFIT**.

(c) Benefits will end when an Insured Debtor is no longer disabled, the term of disability insurance expires or the coverage terminates, which ever occurs first. We reserve the right to require evidence of total disability from a licensed doctor of medicine or osteopathy other than yourself, at monthly or at reasonable intervals as determined by us in order to justify the continuing payment of benefits. We will cease to pay benefits if the required proof is not given to us at our Administrative Office. If the amount of insurance qualified and payable under the terms and conditions exceeds the unpaid indebtedness, such excess will be paid to you, if living, otherwise to the second beneficiary named in this Certificate, or to the estate.

**Total Disability** is disability which: (1) begins while you and the Insured Co-Debtor, if applicable, are covered by this Certificate; (2) results directly from accidental bodily injury or sickness as defined below; (3) continues uninterrupted for more than the number of days of the Waiting Period shown in the Certificate Schedule; (4) prevents you or the Insured Co-Debtor during the first twelve (12) months of total disability from performing the important or significant duties of your occupation (or previous occupation if unemployed or retired) at the time disability occurs; and (5) prevents you or the Insured Co-Debtor after the initial twelve (12) months of total disability from performing any occupation for which you are qualified by education, training or experience. **Injury** means accidental bodily injury which causes total disability. **Sickness** means illness or disease which causes total disability.

**RECURRENT DISABILITY**: If a period of total disability has ended and the Insured Debtor again becomes disabled within 30 days from the same cause, no new Waiting Period will be required. If the second period of disability begins after 30 days, or from a different cause, a new Waiting Period will apply.

**RULES FOR FILING A DISABILITY CLAIM**

**NOTICE OF CLAIM:** You or the Insured Co-Debtor must write to us or our agent about a total disability claim within thirty (30) days after such disability begins or as soon after that as possible.

**CLAIM FORMS:** Upon receipt of written notice of claim, by the Administrative Office, we will send claim forms within fifteen (15) days. If we do not send the claim forms within fifteen (15) days you or the Insured Co-Debtor may simply send us written proof of your disability. The proof must show the date and the cause of the total disability, how serious it is, and must be signed by a licensed doctor of medicine or osteopathy other than the disabled Debtor.

**PROOF OF LOSS DISABILITY:** Written proof of disability must be sent to us no later than ninety (90) days after total disability ends. If proof cannot be filed within ninety (90) days, you must file as soon as possible. No claim will be reduced or denied if it is filed as soon as possible. In no event, except in the absence of legal capacity, can proof be filed later than one (1) year from the time proof is normally required.

**TIMELY PAYMENT OF CLAIMS:** Benefits payable under this Certificate for any loss other than the loss for which this Certificate provides any periodic payment will be paid immediately upon receipt of due written proof of such loss. Subject to due written proof of loss, all accrued Indemnities for loss for which this Certificate provides periodic payment will be paid monthly and any balance remaining unpaid upon termination of liability will be paid immediately upon receipt of due written proof.

**PHYSICAL EXAMINATION:** We, at our own expense, will have the right and opportunity to have you or the Insured Co-Debtor examined when and as often as we reasonably require during the pendency of a claim hereunder.

**EXCEPTIONS OF DISABILITY COVERAGE:** We do not cover disabilities resulting from:

1) normal pregnancy; (2) intentionally self-inflicted injury; (3) flight in a non-scheduled aircraft; or (4) a preexisting condition as defined below.

**PRE-EXISTING EXCLUSION:** A pre-existing condition is a disease, injury or condition of health for which you or the Insured co-debtor were hospitalized or received medical treatment (including medication), consultation or advice within the six (6) months preceding the effective date of the Certificate and which caused disability within the six (6) months following the effective date of this Certificate. If the original term of coverage is less than six (6) months, this time period is equal to the term of coverage. Disability commencing after the pre-exisiting period will be covered.

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**LEGAL ACTION (Disability Coverage Only):** No action at law or equity shall be brought to recover on this Certificate sooner than sixty (60) days after written proof of loss has been furnished in accordance with the requirements of the Certificate and Group Policy. No such action shall be brought later than three (3) years after the date of loss or after three (3) years from the date the cause of action accrues, whichever occurs first.

## GENERAL PROVISIONS

The amount charged by the Policyholder for this coverage will not exceed the premium paid by the Policyholder to us.

**WHO WE PAY:** Immediately upon proof of death or disability of you or the Insured Co-debtor, if applicable, we will pay benefits provided under this Certificate to the Creditor. The Creditor will apply such payment(s) to pay off or reduce the insured debt. If the amount of insurance exceeds the balance of the debt, the excess will be paid to you or the Insured Co-Debtor, if living, or to the Second Beneficiary named in the Schedule, if living, otherwise to the estate.

**LIMITS OF COVERAGE:** At no time will the amount of coverage issued under this Certificate be afforded to anyone for a term, an original amount of life insurance or original amount of disability insurance (sum of all monthly disability benefits payable), or a monthly benefit in excess of the maximum indicated in this Certificate or permitted by law. If the maximum limits are exceeded, we will terminate the excess coverage as outlined below under **EXCESS COVERAGE**.

**EXCESS COVERAGE:** All premiums paid for coverage in excess of the maximum amount allowed will be returned within sixty (60) days of the effective date of coverage while the debtor is alive (for life coverage and for life with TPD coverage) and not disabled and not met the waiting period (for disability). We will return the excess premium to the Creditor for refund or credit to the insured account.

**ELIGIBILITY:** You and the Insured Co-Debtor, if applicable, are eligible for life and for life with TPD coverage because: (a) you are a natural person (not a partnership, corporation or association); (b) you did not exceed the maximum age requirement for life and for life with TPD coverage as stated in the Group Policy and the Certificate Schedule; (c) you provided satisfactory evidence of insurability. You and the Insured Co-debtor, if applicable, are eligible for disability coverage because: (a) you met the requirement for life and for life with TPD coverage; (b) you did not exceed the maximum age requirement for disability coverage stated in the Group Policy and the Certificate Schedule; and (c) you were gainfully employed working at least thirty (30) hours per week on the effective date of coverage. If you are ineligible for coverage and a Certificate is issued to you in error, we will terminate the coverage as soon as we discover it and refund or credit the entire premium charged to your account. If you are ineligible, and we do not terminate the coverage and refund the premium paid within sixty (60) days of the effective date of coverage, while the debtor is alive (for life and for life with TPD coverage) and not disabled and not met the waiting period (for disability coverage), then the insurance will remain in force. Nothing in this provision will preclude the Incontestability Clause or the Misstatement of Age Provision.

**MISSTATEMENT OF AGE:** If your or the Insured Co-Debtor's, if applicable, true age would render that Insured Debtor ineligible for coverage under this Certificate, then our liability will be limited to a return of premium paid for such coverage, as long as we refund the premium within sixty (60) days from the effective date of coverage and while the Debtor is alive (for life coverage and for life with TPD coverage) and not disabled and not met the waiting period (for disability). In the event of a claim, if it is determined that an Insured Debtor was ineligible for coverage and the true age was correctly stated on the application, we cannot deny or change the benefit or the amount of insurance. If the true age of an Insured Debtor was not stated in the application, our liability will be limited to a return of the premium paid for such coverage, as long as we refund the premium within the two (2) year contestable period. If joint coverage is elected, the remaining Insured Debtor's coverage will continue as provided under **TERMINATION OF JOINT COVERAGE**.

**RENEWAL OR REFINANCED INDEBTEDNESS:** If the indebtedness issued under this Certificate is discharged prior to the scheduled maturity date due to renewal or refinancing, the effective date for the renewed or refinanced indebtedness will be the first date on which you became insured under the Group Policy. Disability for the renewed or refinanced indebtedness is limited to the remaining term and conditions of the original indebtedness outstanding at the time of renewal or refinancing. Any period of exclusion will be reduced by any period that insurance was in force in connection with the prior indebtedness which was renewed or refinanced. Any portion of the new debt which was not renewed or refinanced is not covered by this renewal and refinancing provision. Nothing in this provision shall preclude the Incontestability Clause. Any claim for benefits occurring prior to the debt being paid off, renewed or refinanced shall not be prejudiced by the termination of coverage.

**INCONTESTABILITY:** All statements made by you or the Insured Co-Debtor, if any, will be deemed representations and not warranties. We cannot contest the insurance evidenced by the Certificate after it has been in force two (2) years during your or the Insured Co-Debtor's lifetime. This does not prevent us from legally terminating the insurance under this Certificate if premiums are not paid. If joint coverage is elected, the remaining Insured Debtors coverage will continue as provided under **TERMINATION OF JOINT COVERAGE.**

**ENTIRE CONTRACT:** The Group Policy, together with the group application and endorsements, if any, make up the entire contract between the parties. Only an Officer of the Administrative Office may waive or otherwise change any provision of the Group Policy or our rights thereunder. No action, statement or agreement by any person or persons other than an Officer of the Administrative Office in writing shall in any way bind or estop us from enforcing the provisions of the Group Policy or our rights thereunder. No agreement in conflict with, modifying or extending the Group Policy shall be valid unless in writing signed by an Officer of the Administrative Office and made part of the Group Policy.

**PROOF OF DEATH:** Upon the death of an Insured Debtor, we must receive proof of death satisfactory to the Company as soon as reasonably possible. Such proof must include, but may not be limited to, a death certificate and a statement from the Creditor certifying the amount due.

**AUTOPSY:** We have the right to have an autopsy performed, at our expense, unless forbidden by law.

**REPRESENTATIONS:** All statements made by you or the Insured Co-debtor, if any, shall be deemed representations and not warranties. No statement made for the purpose of effecting insurance shall void or reduce benefits unless contained in a written instrument signed by you or the Insured Co-Debtor, a copy of which has been furnished to you or the Insured Co-Debtor, or the designated beneficiary. If joint coverage is elected, the remaining Insured Debtors coverage will continue as provided under **TERMINATION OF JOINT COVERAGE**.

**TERMINATION OF INDIVIDUAL COVERAGE:** This insurance will terminate on the earliest of the following dates: (1) the date the debt is discharged by renewal or refinancing; (2) the scheduled maturity date of the loan for full term coverage; (3) the date the debt is transferred to another Debtor; (4) the date the debt has been in default for more than ninety (90) days; (5) the date that the collateral, if any, which is security for the debt, or upon which the debt is based, has been repossessed; (6) the date the debt becomes the subject of a judicial proceeding for collection, bankruptcy or a court judgment; (7) the date the death benefit becomes due under the Group Policy; (8) the date we receive written request to end the coverage; (9) the date the debt is discharged by prepayment.

We shall provide that in the event of termination of the policy, insurance coverage with respect to the Debtor shall continue with either the original insurer or the new insurer for the entire period for which the single premium has been paid.

**TERMINATION OF JOINT COVERAGE:** If joint coverage is terminated for any reason specified in this Certificate, with respect to one of the Insured Debtors, coverage on the remaining Insured Debtor will continue and a refund will be made. The joint coverage Certificate will be replaced by a single coverage Certificate for the remaining Insured Debtor. The refund will equal the difference between the premium actually charged for the joint coverage and the premium charge that would have been charged if only single coverage on the remaining insured Debtor had been issued originally. If death is due to suicide any refund will also include any unearned disability premium.

**PENDENCY OF A CLAIM:** In the event of a life claim originating prior to such termination, the claim will be processed as if such termination had not occurred. Any refund may be withheld or if previously credited or paid, the death claim minus the premium refund will be paid.

In the event of a disability claim originating prior to such termination, the claim will be processed as if such termination had not occurred. Any refund may be withheld or if previously credited or paid, we will contact you and give you the option of returning the refund and receiving the disability benefit or keeping the refund and pursuing the termination.

In the event of a continuing accident and health claim prior to the termination date of coverage, the refund may be withheld until you are no longer considered to be totally disabled. This statement will apply provided it does not conflict with any state law. However, if you are no longer considered totally disabled as required, you will be entitled to a refund of unearned premiums as of the date you are no longer disabled. You retain the right to cancel coverage as of any date upon receipt of written notice of the request by the Administrative Office. If you elect to cancel the coverage, benefits will cease.

**WHEN INSURANCE STOPS - REFUNDS:** If your insurance stops before the end of the term of coverage shown in the Schedule, you will be given a refund or credit to your account of the unearned premiums within 10 days of the Creditor receiving from us. If termination is due to death, the life premium will be considered fully earned where allowed by law, and no refund will be made. A refund of unearned disability premium, if applicable, will be paid, calculated as of the date of death. If death is due to suicide any refund will also include any unearned disability premium. The unearned premium is computed by subtracting the premium earned from the original premium charged. This refund will be calculated for gross decreasing coverage, according to the Rule of 78's (also known as the Sum of Digits); for disability coverage, according to the Rule of 78's method.

The period between the effective date of coverage and the premature termination date will be computed in whole months using the 15/16 day rule. Refunds of less than $5.00 will not be made.

**Life of the South Insurance Company**
**10151 Deerwood Park Blvd., Bldg. 100, Ste. 500**
**Jacksonville, Florida 32256**

**GROUP POLICY NUMBER**
**CERTIFICATE NO.** [redacted]

**SCHEDULE OF INSURANCE**

| | | | | |
|---|---|---|---|---|
| Insured Debtor [redacted] | S.S. # [redacted] | [redacted] | Age [redacted] | Customer Acct. # [redacted] |
| Insured Co-Debtor (if any) | S.S. # | Address: | Age | Interest Rate 25.80 % |
| First Beneficiary – Creditor Mariner Finance, LLC | | Address 1380 HANOVER AVE ALLENTOWN, PA 18109 | | Maximum Amount of Life Insurance: $50,000.00 |
| Debtor's Second Beneficiary (if none, to the estate) | | Co-Debtor's Second Beneficiary (if none, to the estate) | | |

| Effective Date | Life Term | Disability Term | 1st Payment Due Date | Amortized Term | Issue Ages: |
|---|---|---|---|---|---|
| 12/04/2020<br>Original Scheduled Maturity Date of the Loan<br>12/08/2024 | 48 Mos. | 48 Mos. | 01/08/2021 | 48 Mos. | Life: 18-71<br>Disability: 18-67 |

| COVERAGES | | PREMIUMS |
|---|---|---|
| ☒ Single Gross Decreasing Life on Debtor<br>☐ Single Gross Decreasing Life on Co-Debtor<br>☐ Single Gross Decreasing Life with TPD on Debtor<br>☐ Single Gross Decreasing Life with TPD on Co-Debtor<br>☐ Joint Gross Decreasing Life<br>☐ Joint Gross Decreasing Life with TPD | Original Amount of Life Insurance<br>$ 7,805.69 | $ 126.45 |
| ☒ Single Disability on Debtor<br>☐ Single Disability on Co-Debtor<br>☒ Retro<br>14 -day waiting period | Monthly Disability Benefit<br>$ 162.33 | $ 308.56 |
| Maximum Terms: Gross Decreasing Life 75 months<br>Disability 75 months | Maximum Disability Benefit of $ 50,000.00 divided by the Loan Term not to exceed $ 750.00 per month. Disability Coverage commences on the effective date of the Certificate as shown in the Schedule. | |

REFUND OF UNEARNED INSURANCE PREMIUM TO BE PAID TO: ______________________

Date of Cancellation: ____/____/____

Date of Issue:

Total Elapsed: ______________________

AMOUNT OF REFUND
Life: $ ______________
Disability: $ ______________
TOTAL: ______________
(No refund under $5.00)

I hereby request cancellation of the above-numbered Certificate as of 12:00 noon Standard Time, on the Date of Cancellation noted above:

Signature(s) of Insured Debtor(s):

______________________ ______________________

THIS FORM IS TO BE RETAINED BY POLICYHOLDER AND SENT TO COMPANY AT TIME OF CANCELLATION

# LYNDON SOUTHERN INSURANCE COMPANY

Administrative Office: 10151 Deerwood Park Blvd. Bldg. 100, Suite 500
Jacksonville, Florida 32256 (800) 888-2738

(Called "Company," "We," "Us" or "Our")

**CERTIFICATE NUMBER**

## APPLICATION FOR INVOLUNTARY UNEMPLOYMENT INSURANCE

**SCHEDULE**

**ACCOUNT NUMBER** [redacted]

| | | | |
|---|---|---|---|
| **NAME OF DEBTOR (called "You" or "Your")** [redacted] **Second Beneficiary** | **ADDRESS** [redacted] | | **EFFECTIVE DATE OF DEBT:** 12 (MO.) 04 (DAY) 2020 (YR.) 12:01 A.M. Standard Time |
| **NAME OF CO-DEBTOR (called "You" or "Your")** **Second Beneficiary** | **ADDRESS** | | |
| **Beneficiary (Creditor) Name and Address** Mariner Finance, LLC 1380 HANOVER AVE ALLENTOWN, PA 18109 | **MONTHLY DEBT PAYMENT** $ 162.33 **MONTHLY BENEFIT** $ 162.33 **MAXIMUM MONTHLY BENEFIT - $1000 Per Month** | **PREMIUM** $ 384.14 | **SCHEDULED MATURITY DATE OF THE DEBT:** 12 (MO.) 04 (DAY) 2024 (YR.) |
| | **TERM OF DEBT:** 48 **MAXIMUM TERM OF DEBT – 60 MONTHS** | | |

**I want Involuntary Unemployment Insurance Coverage** ☒ Debtor or ☐ Co-Debtor
**I understand that if my debt has more than one Debtor, only one individual may apply for Involuntary Unemployment Insurance:** ☒ Yes ☐ No

## APPLICATION FOR GROUP CREDIT INVOLUNTARY UNEMPLOYMENT INSURANCE

1. Are you self-employed, an independent contractor or on full-time military duty? ☐ Yes ☒ No
   **PLEASE NOTE:** If you have answered "Yes" you are ineligible for coverage.
2. Do you request to apply for Lyndon Southern Insurance Company's Involuntary Unemployment Insurance group policy based on the information shown above? ☒ Yes ☐ No
3. Are you working for salary, wages or other employment income at least thirty (30) hours a week? ☒ Yes ☐ No
4. Have you received written notice of a layoff or employment termination within 60 days of the termination notice? ☐ Yes ☒ No
5. Is your debt for a term of 60 months or less? ☒ Yes ☐ No
6. The Creditor is authorized to deduct the premium shown above from the proceeds of my debt and pay it to the Company.

I hereby make application to Lyndon Southern Insurance Company for Involuntary Unemployment Insurance to provide protection on the debt which is the subject of the extension of credit to me. I fully understand that the purchase of this insurance is voluntary and not a requirement for extension of credit.

**The purchase of this insurance is completely voluntary and has not been made a condition of the debt.**
**30-Day Right to Examine Certificate**: You may surrender your certificate at anytime for cancellation. However, within the first thirty (30) days after receipt of the certificate, you may cancel it for any reason by returning it to the Creditor at the address shown above. Upon cancellation, a full premium will be refunded or credited to your account at the option of the Creditor.

**FRAUD WARNING:**
**"Any person who knowingly and with intent to defraud any insurance company or other person files an application for insurance or statement of claim containing any materially false information or conceals for the purpose of misleading information concerning any fact material thereto commits a fraudulent insurance act, which is a crime and subjects such person to criminal and civil penalties."**

**DO NOT SIGN THIS APPLICATION IF ANY SPACES APPLICABLE TO THE DEBTOR ELECTING THE COVERAGE AND TO THE COVERAGE BEING ELECTED HAVE NOT BEEN COMPLETED. THE APPLICATION WILL NOT BE USED IN A CONTEST IF THE DEBTOR(S) HAS NOT ANSWERED THE QUESTIONS APPLICABLE TO THE COVERAGE BEING APPLIED FOR AND/OR IF THE DEBTOR(S) HAS NOT SIGNED AND DATED THE APPLICATION.**

**I represent to the best of my knowledge and belief that the above answers are true and correct.**

Co-Debtor's Signature________ Date______ Debtor's Signature [redacted] Date 12/4/2020
Witness/Agent Signature________ Date 12/4/2020

# LYNDON SOUTHERN INSURANCE COMPANY

Administrative Office: 10151 Deerwood Park Blvd. Bldg. 100, Suite 500
Jacksonville, Florida 32256 (800) 888-2738
(Called "Company," "We," "Us" or "Our")

**CERTIFICATE NUMBER**

**SCHEDULE**

**ACCOUNT NUMBER** [redacted]

| | | | |
|---|---|---|---|
| **NAME OF DEBTOR (called "You" or "Your")** [redacted] **Second Beneficiary** | **ADDRESS** [redacted] | | **EFFECTIVE DATE OF DEBT:** 12 MO. 04 DAY 2020 YR. 12:01 A.M. Standard Time |
| **NAME OF CO-DEBTOR (called "You" or "Your")** **Second Beneficiary** | **ADDRESS** | | |
| **Beneficiary (Creditor) Name and Address** Mariner Finance, LLC 1380 HANOVER AVE ALLENTOWN, PA 18109 | **MONTHLY DEBT PAYMENT** $ 162.33 **MONTHLY BENEFIT** $ 162.33 **MAXIMUM MONTHLY BENEFIT - $1000 Per Month** | **PREMIUM** $ 384.14 | **SCHEDULED MATURITY DATE OF THE DEBT:** 12 MO. 04 DAY 2024 YR. |
| | **TERM OF DEBT:** 48 **MAXIMUM TERM OF DEBT – 60 MONTHS** | | |

**I want Involuntary Unemployment Insurance Coverage** ☒ Debtor or ☐ Co-Debtor
**I understand that if my debt has more than one Debtor, only one individual may apply for Involuntary Unemployment Insurance:** ☒ Yes ☐ No

**Group Credit Single Premium - Closed-End-**
**Involuntary Unemployment Insurance Single Coverage Only**
**Maximum of 12 Monthly Benefits Per Occurrence**
**Non-Participating**

**In consideration of the payment of the premium,** in reliance upon the statements made by you in the Application for Involuntary Unemployment Insurance, and subject to the terms of the Master Policy and the Creditor's Application, Lyndon Southern Insurance Company agrees as follows:

**NOTICE: THE BENEFITS PROVIDED BY THIS COVERAGE ARE LIMITED. Benefits are limited to a total of 12 monthly benefits per occurrence or the remaining term of the debt, whichever is less, during the continued Involuntary Unemployment of either Debtor. If you plan to retire or no longer plan to work you are no longer eligible for benefits under this certificate. You should contact us or the Creditor immediately to cancel your insurance coverage and to request a refund of the unearned insurance premium.**

**I. PAYMENT OF BENEFIT**

The Company will pay the Creditor the Monthly Benefit upon Involuntary Unemployment of you. Any benefits in excess of the amount paid to the Creditor will be paid to you.

**II. INVOLUNTARY UNEMPLOYMENT**

Involuntary Unemployment means loss of employment income (salary, wages or other employment income) caused by:

A. Layoff - meaning a temporary or permanent suspension of employment, other than seasonal layoff, as the result of an action of the employer.
B. General Strike - meaning a strike against all the employers in an industry or a territory; simultaneous cessation or quitting of work by a body of employees acting in combination for the purpose of obtaining for themselves more desirable terms of employment.
C. Termination by Employer - meaning a complete severance of the relationship of employer and employee by the employer for reasons other than willful or criminal misconduct.
D. Unionized Labor Dispute - meaning a trade or labor union, through the coalition of its members, authorizing a strike to obtain higher wages, shorter hours of employment, better working conditions or some other concession from an employer by the employees stopping work at a preconcerted time, and it involves a combination of persons and not a single individual.
E. Lockout - meaning the discharge of employees by their employer because of: 1.) a labor dispute; 2.) the employer's dislike of employees' activities as a union; or 3.) the temporary closing of the place of employment by the employer without formally discharging the employees to: a.) discourage union activities; b.) gain acceptance of the employer's views; or c.) effect a compromise which is more favorable to the employer than the demands made by the employees.
F. Non-voluntary termination of your full-time job.

## III. BENEFIT LIMITS

A. **Amount of Insurance –** The Monthly Benefit payable will be the lesser of: 1.) the Monthly Debt Payment; or 2.) the Maximum Monthly Benefit shown in the Schedule. For a portion of a month the monthly benefit payment for each day of Involuntary Unemployment will be 1/30th of the Monthly Benefit.

B. The Monthly Benefits will cease on the earliest of the following:
   1. Your return to full-time work (30 hours or more);
   2. Payment of debt in full; or
   3. Payment of 12 consecutive monthly benefits. (per occurrence).

C. To automatically re-qualify for 12 monthly benefits per occurrence, you must return to full-time work (30 hours or more) for a period of 120 days.

D. If you have not received 12 consecutive monthly benefits per occurrence, you are automatically re-eligible from the first day you return to full-time work (30 hours or more) for any remaining benefits.

In no event will Monthly Benefits be paid after the Scheduled Maturity Date of the Debt. The maximum term of the debt is 60 months.

## IV. ELIGIBILITY FOR COVERAGE

When there are two Debtors on a debt, either may elect the single coverage.

Coverage was written based on the following eligibility requirements:

A. You have a debt agreement with the Creditor which provides for equal monthly installments;

B. You are working for salary, wages at least thirty (30) hours a week in a non-seasonal, non-temporary occupation.

C. You have not received notice of a layoff or employment termination within 60 days of the termination notice or plant closing.

D. You are not self-employed (including independent contractors) or a member of the military full time.

E. The maximum term of the debt is 60 months.

## V. ELIGIBILITY FOR BENEFITS

Debtors may name Second Beneficiaries which are shown in the schedule.

To be eligible for benefits under this certificate, you must:

A. Have been unable to work for salary, wages or other employment income as a result of Involuntary Unemployment for at least thirty (30) consecutive days;

B. 1. Have a loss of salary, wages or other employment income occurred as the result of either Layoff or Termination by Employer; or
   2. Provide the Company with Union or Employer verification of loss of salary, wages or other employment income, which occurred as the result of a General Strike, Unionized Labor Dispute or Lockout; or
   3. Provide the Company other reasonable proof of unemployment.

Eligibility for Monthly Benefits will begin on the thirty-first (31) day of Involuntary Unemployment. Thereafter, the Company will pay retroactively, beginning with the first day of Involuntary Unemployment, the Amount of Insurance to the Creditor. Upon our request, you must complete and return to us the continuing claim form as proof of continuing Involuntary Unemployment. We will not accept proof of loss resulting from Involuntary Unemployment more than one year after you became involuntarily unemployed.

## VI. EXCLUSIONS

The insurance described in this certificate does not apply to:

A. Resignation;

B. Retirement;

C. Loss of income due to disability caused by accident, sickness, disease, or pregnancy; or

D. Loss of income due to termination as the result of willful misconduct (a transgression of some established and definite rule of conduct, a forbidden act, or a willful dereliction of duty) or criminal misconduct (unlawful behavior as determined by local, State or Federal law).

## VII. CONDITIONS

A. **Debtor's Statements:** Statements made by the Debtor in the Application for Involuntary Unemployment Insurance shall be used to determine eligibility for coverage. If a Debtor who is not gainfully employed correctly stated employment status information in an application signed by the Debtor, and if a group certificate is issued, the Company or its authorized representative must pay a benefit if due, unless the Company had discovered its error, terminated coverage, and refunded the premium all within 60 days of the effective date of the Debt and while the Debtor is not involuntary unemployed and not met the waiting period.

B. **Payment of Benefit:** Monthly Benefits shall be paid directly to the Creditor to reduce or pay off your account.

C **Incontestability:** This Certificate is not contestable after it has been in force during your lifetime for a period of two years. No statement relating to insurability shall be used to contest the insurance unless it is contained in a written Application signed by you. A copy of the Application must have been provided to you or your estate.

D. **Conformity with State Statutes:** Terms of this certificate which are in conflict with the statutes of the state wherein the Group Policy is delivered are hereby amended to conform with the minimum standards of such statutes.

E. **Payment of Premium:** The single premium is due and payable on the Effective Date of the debt shown in the certificate Schedule. The premium for Involuntary Unemployment insurance will be calculated by multiplying the premium rate applicable to the term of the debt by the Initial Amount of Insurance. The Initial Amount of Insurance is the Monthly Benefit times the term of the debt.

F. **Term of Debtor's Certificate:** The insurance will end on the earliest of:
   1. the Scheduled Maturity Date of the debt;
   2 the date that there is no longer a debt;
   3. upon prepayment, renewal or refinancing of the debt
   4. the date requested in writing by you; or
   5. the date on which 60 days have elapsed without a full contractual debt payment having been made to the Creditor.

G. **Cancellation of Coverage:** The coverage may be cancelled by the Debtor by prior written notice to the Creditor or the Company stating when such cancellation will become effective. The Company shall provide that in the event of termination of the Policy, insurance coverage with the respect to the Debtor shall continue with either the original Insurer or a new Insurer for the entire period for which the premium has been paid.

H. **Refund:** Any unearned premium will be: 1.) computed on a pro rata basis; and 2.) paid to you or credited to your account at the option of the Creditor. No refund or credit less than $1.00 will be made. Refund calculations for a portion of a debt month are: 1 - 14 days = the portion of the premium for that month will be considered unearned and a refund made; 15 days or more = the portion of the premium for that month will be considered fully earned and no refund will be made.

I. **Entire Contract:** The entire contract consists of the:
   1. Group Master Policy;
   2. Creditor's Application.

J. **Filing a Claim:**
   1. You must notify us at the start of your involuntary unemployment by written notice to us or the Creditor/Policyholder.
   2. We will send you a claim form within 15 days of receipt of your notice per the terms of this certificate.
   3. We will pay your debt payment per the terms of this certificate.
   4. If you do not receive a claim form within 15 days, your notice to us in step 1 completes this claim procedure and step 3 will begin without further notice to us.

K. **Changes to Contract:** No one can change the contract or alter its terms except by written amendment signed by our: 1) President; 2) Vice President; or 3) Secretary. Any changes made to the Group Policy will affect only those Debtors becoming insured after the date of the change.

**VIII. MANDATORY ARBITRATION**

It is understood and agreed that the transaction evidenced by this certificate takes place in and substantially affects interstate commerce. Any controversy or dispute arising out of or relating in any way to this certificate or the sale of this certificate, including for recovery of any claim under this certificate and including the applicability of this arbitration clause and the validity of this certificate, shall be resolved by neutral binding arbitration by the National Arbitration Forum ("NAF"), under the Code of Procedure in effect at the time the claim is filed. All preliminary issues of arbitration will be decided by the arbitrator(s).

1. The arbitration shall take place in the county of residence of the Insured before a single arbitrator or a panel of arbitrators selected in accordance with the NAF Code of Procedure. NAF rules and forms may be obtained and all claims shall be filed at any NAF office, www.arb-forum.com, or P.O Box 50191, Minneapolis, Minnesota 55405. The NAF may be reached at 651-631-1105 or 800-474-2371.
2. Except for the filing fee and costs any party other than us may incur to present its case, the cost of the arbitration shall be borne by us: unless the arbitrator(s) holds that a party is entitled to recover attorney's fees and other fees and expenses based upon applicable law.
3. It is understood and agreed that the arbitration shall be binding upon the parties, that the parties are waiving their right to seek remedies in court, including the right to a jury trial, and that an arbitration award may not be set aside in later litigation except upon the limited circumstances set forth in the Federal Arbitration Act.
4. All statues of limitation that would otherwise be applicable shall apply to any arbitration proceeding.

Neither party shall be precluded from instituting an action in court of competent jurisdiction to obtain a temporary restraining order, a preliminary injunction or other equitable relief to preserve the status quo or prevent irreparable harm pending the selection of the arbitrator(s) or the commencement and completion of the arbitration hearing.

In witness whereof, **LYNDON SOUTHERN INSURANCE COMPANY** has caused this certificate to be signed by two authorized officers at Jacksonville, FL.

Authorized Officer　　　　Authorized Officer

**For Policyholder Services:** **The Insured may contact the Company at:**
**Policyholder Service Department**
**Lyndon Southern Insurance Company**
**10151 Deerwood Park Blvd. Bldg. 100, Suite 500**
**Jacksonville, Florida 32256**
**(800) 888-2738**

# LYNDON SOUTHERN INSURANCE COMPANY

Administrative Office: 10151 Deerwood Park Blvd. Bldg. 100, Suite 500
Jacksonville, Florida 32256 (800) 888-2738

(Called "Company," "We," "Us" or "Our")

**CERTIFICATE NUMBER**

**SCHEDULE**

**ACCOUNT NUMBER** [redacted]

| | | | |
|---|---|---|---|
| **NAME OF DEBTOR (called "You" or "Your")** [redacted] **Second Beneficiary** | **ADDRESS** [redacted] | | **EFFECTIVE DATE OF DEBT:** 12 (MO.) 04 (DAY) 2020 (YR.) 12:01 A.M. Standard Time |
| **NAME OF CO-DEBTOR (called "You" or "Your")** **Second Beneficiary** | **ADDRESS** | | |
| **Beneficiary (Creditor) Name and Address** Mariner Finance, LLC 1380 HANOVER AVE ALLENTOWN, PA 18109 | **MONTHLY DEBT PAYMENT** $ 162.33 **MONTHLY BENEFIT** $ 162.33 **MAXIMUM MONTHLY BENEFIT - $1000 Per Month** | **PREMIUM** $ 384.14 | **SCHEDULED MATURITY DATE OF THE DEBT:** 12 (MO.) 04 (DAY) 2024 (YR.) |
| | **TERM OF DEBT:** 48 **MAXIMUM TERM OF DEBT – 60 MONTHS** | | |

**I want Involuntary Unemployment Insurance Coverage** ☒ Debtor or ☐ Co-Debtor
**I understand that if my debt has more than one Debtor, only one individual may apply for Involuntary Unemployment Insurance:** ☒ Yes ☐ No

I, the insured Debtor in the Certificate described above, certify that I am unable to surrender and deliver said Certificate to Lyndon Southern Insurance Company and I agree to indemnify and protect the said company against any claim or loss that may be asserted against said company under said Certificate by any person or persons and that I further request cancellation of said Certificate and accept receipt of the unearned portion of the premium calculated thereon; and that I further agree and understand that this Certificate shall terminate and cease to exist at 12:01 A.M., Standard Time at my address on the date show below.

DATE OF CANCELLATION ________________, ____________ RETURN PREMIUM $ ____________________

DEBTOR ______________________________________ WITNESS ______________________________

**LYNDON SOUTHERN INSURANCE COMPANY**
**(A Stock Company)**
**Administrative Office: 10151 Deerwood Park Blvd. Bldg. 100, Ste. 500, Jacksonville, Florida 32256**

**CERTIFICATE - SINGLE PREMIUM CREDIT PROPERTY INSURANCE**

**NOTICE: THE PURCHASE OF THIS INSURANCE IS VOLUNTARY. If YOU HAVE VALID AND COLLECTIBLE INSURANCE ON THE SAME COLLATERAL TO OFFER TO THE CREDITOR, PURCHASE OF THIS COVERAGE WOULD BE DUPLICATIVE AND UNNECESSARY.**

**Schedule of Insurance**

| | | |
|---|---|---|
| [redacted] | CREDITOR NAME: Mariner Finance, LLC 1380 HANOVER AVE ALLENTOWN, PA 18109 | CERTIFICATE/ACCOUNT NUMBER: [redacted] |
| EFFECTIVE DATE: 12/04/2020 | PREMIUM AMOUNT: $520.88 | |
| TERM IN MONTHS 48 | MAXIMUM AMOUNT OF INSURANCE: $3,339.00 | |

## GENERAL DEFINITIONS

**"WE", "US"** and **"OUR"** mean the Lyndon Southern Insurance Company.

**"HE", "HIS"** and **"HIM"** mean both genders.

**"YOU"** and **"YOUR"** mean the Insured.

## INSURING AGREEMENTS

In return for payment of premiums, **WE** agree to insure **YOU** and the Creditor with an interest in personal property you buy or pledge under a conditional sales contract, deferred payment contract, installment sales contract, security agreement of a direct consumer loan (herein called agreement). Coverage is provided for the kinds of insurance described in the Certificate of Insurance, subject to the provisions of the Master Policy **WE** issued to the Creditor. The Master Policy may be reviewed by **YOU** at the Creditor's place of business.

The insurance provided covers the interests of **YOU** and the Creditor up to the maximum stated on the Certificate Schedule. Coverage for any one account will be limited to the maximum amount per account as shown in the Certificate Schedule. If **YOU** have more than one account:

1. The maximum amount shown in the Certificate Schedule applies; and
2. The total insurance provided under all of **YOUR** accounts cannot exceed this amount.

Coverage begins on the effective date shown in the Certificate Schedule/Installment Sales Account Agreement and continue until the expiration date shown in the Certificate Schedule.

## PROPERTY INSURANCE

**Coverage:**
This insurance covers the interest of the Creditor and **YOUR** interest in personal property:

1. Purchased by **YOU;** and
2. Financed under an account agreement.
3. **YOUR** personal property held as collateral on direct consumer loan.

This coverage will:

1. Continue until the expiration date shown in the Certificate Schedule; and
2. Cover the insured property while anywhere within the United States of America, its territories or possessions; Canada, Puerto Rico or while being transported between their ports.

**Perils Insured:**
This coverage provides insurance against direct and accidental loss or damage to insured personal property by: Fire; Smoke; Lightning; Windstorm; Cyclone; Tornado; Flood; Hail; Earthquake; Explosion; Riot; Riot attending a strike; Civil Commotion; Marine Perils while on ferries and/or in cars or transfers in connection with land conveyances; Aircraft; Vehicles; Collision; Vandalism and Malicious Mischief; and Burglary from within a building, room or locked motor vehicle (of which there must be visible evidence of forced entry); Holdup or Robbery; and Theft. A $100 deductible applies to theft losses.

**Perils not Insured:**
We do not insure against;
1. Defective manufacture or materials, latent defect, rust, rot, mold contamination, vermin or inherent vice.
2. Wear and tear or abusive use.
3. Freezing or other extremes of temperature.
4. Misappropriation, secretion, conversion, infidelity or a dishonest or criminal act on the part of the debtor including his employees, agents or others to whom the covered property may by entrusted (except a hired carrier).
5. Neglect of the debtor to use reasonable means to save and preserve the property at the time of, during and after any loss or damage insured against.
6. War, including undeclared war, rebellion, revolution or warlike act by military personnel.
7. Nuclear action or reaction, radiation or radioactive contamination. We cover direct loss by fire resulting from the nuclear hazard.
8. Mechanical, electrical or utility failures unless the result of a covered loss.

**Limit of Liability:**
Our liability for loss will be the cost to repair or replace the property insured at the time of loss, not to exceed the maximum amount(s) shown on the Certificate Schedule.

## GENERAL PROVISIONS

**Premium Charged:**
The premium rate charged by the Creditor to **YOU** will not exceed the premium rate filed with the State Insurance Department for this insurance.

**Refunds:**
In the event this insurance is terminated before the term shown in the Schedule, the Creditor will promptly refund to **YOU** any unearned premium. This refund will be calculated by the "pro rata". Refunds of less than one dollar will not be made.

**Notice of Claim:**
Written proof of loss or damage must be filed:
1. With **US;** or
2. With one of **OUR** duly authorized representatives; and
3. Within 90 days from the date of loss.

If **YOU** do not notify **US** within 90 days, **WE** will not pay your claim.

**Claim Forms:**
The Creditor will report all notices and proof of loss to **US** on forms provided by **US.** If **WE** or the Creditor do not furnish **YOU** with notice of loss forms within 15 days after the notice of claim, then **YOU** will be deemed to have complied with the filing of "Notice of Loss"

**Conformity to Statute:**
The terms of this Certificate which are in conflict with the statutes of the state where it is issued are amended to comply with such statutes.

**Arbitration:**
It is understood and agreed that the transaction evidenced by this certificate takes place in and substantially affects interstate commerce. Any controversy or dispute arising out of or relating in any way to this certificate or the sale of this certificate, including for recovery of any claim under this certificate and including the applicability of this arbitration clause and the validity of this certificate, shall be resolved by neutral binding arbitration by the National Arbitration Forum ("NAF"), under the Code of Procedure in effect at the time the claim is filed. All preliminary issues of arbitration will be decided by the arbitrator(s).

1 The arbitration shall take place in the county of residence of the Insured before a single arbitrator or a panel of arbitrators selected in accordance with the NAF Code of Procedure. NAF rules and forms may be obtained and all claims shall be filed at any NAF office, www.arb-forum.com, or P.O Box 50191, Minneapolis, Minnesota 55405. The NAF may be reached at 651-631-1105 or 800-474-2371.

2 Except for the filing fee and costs any party other than us may incur to present its case, the cost of the arbitration shall be borne by us: unless the arbitrator(s) holds that a party is entitled to recover attorney's fees and other fees and expenses based upon applicable law.

3 It is understood and agreed that the arbitration shall be binding upon the parties, that the parties are waiving their right to seek remedies in court, including the right to a jury trial, and that an arbitration award may not be set aside in later litigation except upon the limited circumstances set forth in the Federal Arbitration Act.

4 All statues of limitation that would otherwise be applicable shall apply to any arbitration proceeding.

Neither party shall be precluded from instituting an action in court of competent jurisdiction to obtain a temporary restraining order, a preliminary injunction or other equitable relief to preserve the status quo or prevent irreparable harm pending the selection of the arbitrator(s) or the commencement and completion of the arbitration hearing.

Authorized Officer

Authorized Officer

**LYNDON SOUTHERN INSURANCE COMPANY**
**(A Stock Company)**
**Administrative Office: 10151 Deerwood Park Blvd. Bldg. 100, Ste. 500, Jacksonville, Florida 32256**

**CERTIFICATE - SINGLE PREMIUM CREDIT PROPERTY INSURANCE**

**NOTICE: THE PURCHASE OF THIS INSURANCE IS VOLUNTARY. If YOU HAVE VALID AND COLLECTIBLE INSURANCE ON THE SAME COLLATERAL TO OFFER TO THE CREDITOR, PURCHASE OF THIS COVERAGE WOULD BE DUPLICATIVE AND UNNECESSARY.**

**Schedule of Insurance**

| | | |
|---|---|---|
| [redacted] | CREDITOR NAME: Mariner Finance, LLC 1380 HANOVER AVE ALLENTOWN, PA 18109 | CERTIFICATE/ACCOUNT NUMBER: [redacted] |
| EFFECTIVE DATE: 12/04/2020 | PREMIUM AMOUNT: $520.88 | |
| TERM IN MONTHS 48 | MAXIMUM AMOUNT OF INSURANCE: $ 3,339.00 | |

I, the insured Debtor in the Certificate described above, certify that I am unable to surrender and deliver said Certificate to Lyndon Southern Insurance Company and I agree to indemnify and protect the said company against any claim or loss that may be asserted against said company under said Certificate by any person or persons and that I further request cancellation of said Certificate and accept receipt of the unearned portion of the premium calculated thereon; and that I further agree and understand that this Certificate shall terminate and cease to exist at 12:01 A.M., Standard Time at my address on the date shown below.

DATE OF CANCELLATION: ______________________ RETURN PREMIUM $______________

DEBTOR SIGNATURE: ____________________________________________

WITNESS SIGNATURE: ____________________________________________

Group Master Policy No.____________

# Life of the South Insurance Company

Administrative Office: 10151 Deerwood Park Blvd. Bldg. 100, Suite 500
Jacksonville, Florida 32256 - 1-800-888-2738

**(HEREIN CALLED THE COMPANY)**

## ACCIDENTAL DEATH, DISMEMBERMENT, & LOSS OF SIGHT INSURANCE CERTIFICATE APPLICATION

**FRAUD WARNING:**
**ANY PERSON WHO KNOWINGLY AND WITH INTENT TO DEFRAUD ANY INSURANCE COMPANY OR OTHER PERSON FILES AN APPLICATION FOR INSURANCE OR STATEMENT OF CLAIM CONTAINING ANY MATERIALLY FALSE INFORMATION OR CONCEALS FOR THE PURPOSE OF MISLEADING, INFORMATION CONCERNING ANY FACT MATERIAL THERETO COMMITS A FRAUDULENT INSURANCE ACT, WHICH IS A CRIME AND SUBJECTS SUCH PERSON TO CRIMINAL AND CIVIL PENALTIES.**

We agree to insure the Covered Person(s) named below (herein called You and Your) against specified Loss resulting from accidental bodily injuries. If the accidental bodily injuries are the direct and independent cause of the loss and occur while this Certificate is in force, payment of the benefits are subject to the provisions, conditions, limitations, and exclusions of this Certificate.

**THIS IS APPLICATION IS FOR AN ACCIDENT ONLY CERTIFICATE AND IT DOES NOT PAY BENEFITS FOR LOSS FROM SICKNESS**

| NAME OF APPLICANT | | | AGE | CERTIFICATE NUMBER |
|---|---|---|---|---|
| [redacted] | | | [redacted] | [redacted] |
| ADDRESS (NUMBER, STREET) [redacted] | | | EFFECTIVE DATE 12/04/2020 | TERM (MOS.) 48 |
| CITY, STATE, ZIP CODE [redacted] | | | EXPIRATION DATE 12/04/2024 | MAXIMUM COVERAGE $100,000 |
| **COVERED PERSONS** | **AGE** | **BENEFICIARY'S NAME & RELATIONSHIP** | **PRINCIPAL SUM** | **PREMIUM** |
| The Applicant designated above. | 41 | [redacted] | $15,000.00 | $ 360.00 |
| | | | $ | $ |
| | | | $ | $ |
| | | | $ | $ |
| | | | **TOTAL PREMIUM PAID** | $ 360.00 |

I acknowledge and declare that I have voluntarily purchased this insurance, and said purchase has not been compulsory. I also acknowledge that this insurance is offered neither as a condition nor as a part of a credit transaction.

| [redacted] | 12/04/2020 | Signature on File |
|---|---|---|
| APPLICANT SIGNATURE | DATE | AGENT'S SIGNATURE |

**IN CONSIDERATION OF THE ADVANCE PAYMENT OF THE PREMIUM STATED ABOVE THE COMPANY DOES HEREBY INSURE YOU** (herein called the Insured) and promises to indemnify for loss resulting from injury; subject to the provisions of this policy.

**RIGHT TO FREE LOOK:** Within the first ten days after this policy is received you may surrender it by delivering or mailing it to the Company's Administrative Office at Jacksonville, Florida or to the agent through whom it was purchased. Your premium will be refunded upon this surrender.

**WHILE THIS CERTIFICATE IS IN EFFECT:** During the term of this Certificate, if an Injury suffered by You shall result in any of the losses described in the Schedule of Benefits, We will pay the amount determined from the Schedule of Benefits. We will pay for only one Loss for any one accident. If more than one Loss is sustained as the result of the accident, payment will be made for the Loss for which the greatest amount is payable. The total amount payable will not exceed the full results in a one-half benefit being paid, the Certificate will continue in force for one-half the amount of benefit shown in the Schedule of Benefits until such time as the full amount has been paid or to expiration date.

**SCHEDULE OF BENEFITS:**

Full Amount of Benefit Payable For:
- Loss of Life
- Loss of Both Hands
- Loss of Both Feet
- Loss of Sight of Both Eyes
- Loss of One Hand and One Foot
- Loss of One Hand and Sight of One Eye
- Loss of One Foot and Sight of One Eye

One-Half Amount of Benefit Payable For:
- Loss of One Hand
- Loss of One Foot
- Loss of Sight of One Eye

**THIS CERTIFICATE PROVIDES INDEMNITY FOR LOSS OF LIFE, LIMB, SIGHT, RESULTING FROM ACCIDENTAL BODILY INJURIES TO THE EXTENT HEREIN PROVIDED.**

**SINGLE PREMIUM. NON-PARTICIPATING. NON RENEWABLE.**

**EXCLUSIONS:**
This benefit will not pay for any Loss due to:

A. Disease, bodily or mental infirmity or medical or surgical treatment thereof; or
B. Primary or secondary bacterial infections, except infections accidentally sustained or whose primary cause resulted from medical or surgical treatment related to an accidental injury; or
C. Suicide or intentionally self-inflicted injury, while sane or insane; or
D. Injury, caused by flight in, descending or descending from a non-scheduled aircraft; or
E. Injury sustained while on duty with the Armed Forces of any country; or
F. Injury incurred during the commission of a felony, or a subsequent confinement directly related to the commission of a felony. This limitation will not apply to a public official who is present at the commission of the felony in his official capacity; or
G. Participating in an insurrection, or participation in a riot. This limitation will not apply to a public official who is present at the insurrection or riot in his official capacity;
H. Injury sustained due to any loss sustained or contracted in consequence of the Insured's being intoxicated or under the influence of narcotics unless administered on the advice of a physician; or
I. A preexisting illness, disease or physical condition for which medical advice, consultation or treatment was required or recommended within ninety (90) days immediately preceding the Effective Date of the debtor's coverage and for which medical advice consultation or treatment was required or recommended within the six months following the Effective Date of coverage.

**WORLD WIDE COVERAGE:** This Certificate will cover Loss from an accident (except as defined herein) with no restrictions as to the country or territory in which it occurs.

**SINGLE PREMIUM CONSIDERATION:** The Consideration for issuing this policy is the application and the payment of the single premium. This insurance begins at 12:01 A.M., Standard Time on the Effective Date, and ends at the same time on the Expiration Date shown above.

**DEFINITIONS:**

A. Whenever the words "we", "us" and "our" are used in this Certificate they shall refer to the company shown above.
B. Whenever the words "you" and "your" are used in this Certificate they shall refer to the Insured.
C. "Loss" as used in this Certificate with reference to hand, foot, or eye, means:
   1. Severance of a hand at or above your wrist; or
   2. Severance of a foot at or above your ankle; or
   3. Entire and irrevocable loss of your sight.
D. "Injury" as used in this Certificate means bodily injury as evidenced by a visible contusion or wound on the exterior of the body (except for internal injuries revealed by autopsy) caused by accident occurring while this policy is in force.
E. "Covered Person" as herein defined may be (1) The Creditor Customer; (2) The lawful spouse of the Creditor Customer; and (3) each Unmarried dependent child or dependent grandchild of Creditor Customer spouse under 21 years of age. A dependent child or dependent grandchild who develops a mental or nervous condition, problem, or disorder may be covered to age 24 unless such child is and continues to be both 1) incapable of self sustaining employment, and 2) chiefly dependent upon the Certificate holder for support and maintenance, provided proof of such incapacity and dependency is furnished to Us within 31 days of the child's attainment of the limiting age. We may require subsequent proof, but not more frequently than annually after the two year period following the child's attainment of the limiting age. Such person must be named on the Schedule as a covered Person. Once coverage has been accepted and the premium paid, coverage cannot be terminated or voided, by Us for failure to qualify under the definition of Covered Person.

## CERTIFICATE PROVISIONS

**ENTIRE CONTRACT; CHANGES:** The Master Policy, including the application, endorsements and the attached papers, if any, make up the entire contract of insurance. No changes in this policy shall be valid until approved by an executive officer of the Company and endorsed or attached hereto. No agent has authority to change this policy or to waive any of its provisions.

**REPRESENTATIONS:** All statements in your application for this policy shall be deemed to be representations and not warranties. No statement made for the purpose of effecting insurance shall avoid such insurance or reduce benefits, unless contained in a written instrument signed by you, a copy of which has been furnished to you or your beneficiary.

**TIME LIMIT ON CERTAIN DEFENSES:** After two years from the date of issue of this Certificate, no statements you made in the application for such Certificate shall be used to void the Certificate or to deny a claim for loss incurred, as defined in the Certificate, after the expiration of such two-year period. After this Certificate has been in force for a period of two years during the Insured's lifetime, it shall become incontestable as to the statements contained in the application.

**OTHER INSURANCE WITH THE COMPANY:** If an accidental death and dismemberment policy or policies previously issued by the Company to you is in force at the same time as this policy, making the aggregate indemnity for accidental death or dismemberment in excess of $100,000, the excess insurance shall be void and all premiums paid for the excess shall be returned to you or your estate.

**NOTICE OF CLAIM:** Written notice of claim must be given to us within twenty days after the occurrence of any loss covered by this Certificate, or as soon thereafter as is reasonably possible. Notice given by you or on your behalf or on behalf of your Beneficiary to us at our Administrative Office in Jacksonville, Florida, or to any authorized agent of the Company shall be deemed notice to the Company.

**CLAIM FORMS:** We, upon receipt of a notice of claim, will furnish to the claimant forms to be used to file proof of loss. If such forms are not furnished within fifteen working days after we are so notified, the claimant shall be assumed to have complied with the requirements of the policy as to proof of loss upon submitting, within the time fixed in the policy for filing proofs of loss, written proof covering the occurrence, nature and extent of the loss for which claim is made.

**PROOFS OF LOSS:** Written proof of loss and a copy of this Certificate must be furnished to us at our Administrative Office within ninety days after the date of the loss for which the claim is made. Failure to furnish such proof within the time required shall not invalidate nor reduce any claim if it was not reasonably possible to give proof within such time; provided such proof is furnished as soon as reasonably possible and in no event, except in the absence of legal capacity, later than one year from the time proof is otherwise required.

**PAYMENT OF CLAIMS:** Benefits payable for loss of life will be paid to the designated beneficiary in accordance with the provisions prescribed in this Certificate. If no such designation or provision is effective at the time of payment, such benefits will be paid to your estate. Any other accrued indemnities unpaid at your death may, at our option, be paid either to such Beneficiary or to your estate. All other benefits payable under this Certificate shall be paid to you. All benefits payable under the Certificate will be payable immediately upon receipt of due written proof of loss. Should we fail to pay the benefits payable under our policy upon receipt of due written proof of loss, we shall have fifteen working days thereafter to mail you or your beneficiary a letter of notice which states the reasons we may have for failing to pay the claim, either in whole or in part; and which also gives a written itemization of any documents or other information needed to process the claim or any portions which are not being paid. When all of the listed documents or other information needed to process the claim has been received, we shall then have fifteen working days to process and either pay the claim or deny it, in whole or in part, giving the reasons we may have for denying such claim or any portion thereof. Should we fail to comply in a timely manner with the schedule as indicated above, we will pay you interest equal to 18 percent per annum on the proceeds or benefits due under the terms of the policy.

**TERMINATION OF INSURANCE:** The insurance automatically terminates on the earliest of the following dates: (1) the Expiration Date shown in the Schedule; (2) when you request cancellation by mailing written notice to Us; or 3) when you receive at least forty-five (45) days advance written notice of cancellation from us.

**REFUNDS:** Upon termination, any unearned premium will be paid to the Certificate holder within thirty (30) days following such termination. If the Certificate holder cancels, the earned premium shall be computed using the short-rate method. If We cancel, the earned premium shall be computed pro rata.

**PHYSICAL EXAMINATION AND AUTOPSY:** We at our own expense shall have the right to examine you when and as often as we may reasonably require in respect to a claim under this policy and to make an autopsy in case of death where it is not forbidden by law.

**LEGAL ACTIONS:** No action at law or in equity shall be brought to recover on the Master Policy or any Certificate of Insurance within sixty days after written proof of loss has been furnished in accordance with the requirements of this policy. No such action shall be brought after the expiration of three years after the time written proof of loss is required to be furnished.

**MISSTATEMENT OF AGE:** If your age has been misstated, all amounts payable under this Certificate shall be such as the premium paid would have purchased at the correct age.

**MAXIMUM AGE LIMITS:** No person will be eligible for insurance if the scheduled expiration date of his proposed insurance is later than his 76th birthday. If the Company accepts a premium for insurance past such maximum age, then the excess insurance shall not be valid provided the Company refunds the premium for such excess coverage during your lifetime and within sixty (60) days of the acceptance of such premium. If such refund is not made within that period, coverage will be continued in full force and effect.

**CHANGE OF BENEFICIARY:** The right to change a beneficiary is reserved to you and the consent of the beneficiary shall not be needed to assign this policy. No change of beneficiary under this policy shall be binding upon us unless and until the original or duplicate thereof is received at our Administrative Office.

**ASSIGNMENT:** This policy may be assigned as collateral to cover a loan. All of your rights and the rights of your beneficiary will be transferred only to the extent of the assignee's interest. No assignment of interest under this policy will be binding on the Company until a duplicate of the assignment is filed at our Administrative Office. We are not responsible for the validity of any assignment.

**CONFORMITY WITH STATE STATUTES:** Any provision of this policy which, on its effective date, is in conflict with the statutes of the state in which you reside is amended to conform to the minimum requirements of such statutes.

**MANDATORY BINDING ARBITRATION:**

**It is understood and agreed that the transaction evidenced by this certificate takes place in and substantially affects interstate commerce. Any controversy or dispute arising out of or relating in any way to this certificate or the sale of this certificate, including for recovery of any claim under this certificate and including the applicability of this arbitration clause and the validity of this certificate, shall be resolved by neutral binding arbitration by the National Arbitration Forum ("NAF"), under the Code of Procedure in effect at the time the claim is filed. All preliminary issues of arbitration will be decided by the arbitrator(s).**

1. **The arbitration shall take place in the county of residence of the Insured before a single arbitrator or a panel of arbitrators selected in accordance with the NAF Code of Procedure. NAF rules and forms may be obtained and all claims shall be filed at any NAF office, www.arb-forum.com, or P.O Box 50191, Minneapolis, Minnesota 55405. The NAF may be reached at 651-631-1105 or 800-474-2371.**

2. **Except for the filing fee and costs any party other than us may incur to present its case, the cost of the arbitration shall be borne by us: unless the arbitrator(s) holds that a party is entitled to recover attorney's fees and other fees and expenses based upon applicable law.**
3. **It is understood and agreed that the arbitration shall be binding upon the parties, that the parties are waiving their right to seek remedies in court, including the right to a jury trial, and that an arbitration award may not be set aside in later litigation except upon the limited circumstances set forth in the Federal Arbitration Act.**
4. **All statues of limitation that would otherwise be applicable shall apply to any arbitration proceeding.**

**Neither party shall be precluded from instituting an action in court of competent jurisdiction to obtain a temporary restraining order, a preliminary injunction or other equitable relief to preserve the status quo or prevent irreparable harm pending the selection of the arbitrator(s) or the commencement and completion of the arbitration hearing.**

**IN WITNESS WHEREOF,** we have caused this policy to be executed by our President and Secretary.

Secretary President

Group Master Policy No.____________

# Life of the South Insurance Company

**Administrative Office: 10151 Deerwood Park Blvd. Bldg. 100, Suite 500**
**Jacksonville, Florida 32256 - 1-800-888-2738**

**(HEREIN CALLED THE COMPANY)**

## ACCIDENTAL DEATH, DISMEMBERMENT, & LOSS OF SIGHT INSURANCE CERTIFICATE APPLICATION

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We agree to insure the Covered Person(s) named below (herein called You and Your) against specified Loss resulting from accidental bodily injuries. If the accidental bodily injuries are the direct and independent cause of the loss and occur while this Certificate is in force, payment of the benefits are subject to the provisions, conditions, limitations, and exclusions of this Certificate.

**THIS IS APPLICATION IS FOR AN ACCIDENT ONLY CERTIFICATE AND IT DOES NOT PAY BENEFITS FOR LOSS FROM SICKNESS**

| | | |
|---|---|---|
| NAME OF APPLICANT [redacted] | AGE [redacted] | CERTIFICATE NUMBER [redacted] |
| ADDRESS (NUMBER, STREET) [redacted] | EFFECTIVE DATE 12/04/2020 | TERM (MOS.) 48 |
| CITY, STATE, ZIP CODE [redacted] | EXPIRATION DATE 12/04/2024 | MAXIMUM COVERAGE $100,000 |

| COVERED PERSONS | AGE | BENEFICIARY'S NAME & RELATIONSHIP | PRINCIPAL SUM | PREMIUM |
|---|---|---|---|---|
| The Applicant designated above. | 41 | [redacted] | $ 15,000.00 | $ 360.00 |
| | | | $ | $ |
| | | | $ | $ |
| | | | $ | $ |
| | | | **TOTAL PREMIUM PAID** | $ 360.00 |

**CANCELLATION OF ABOVE POLICY**

I, the named Insured in the Policy described above certify that I am unable to surrender and deliver said Policy to the above Company and I agree to indemnify and protect the Life Insurance Company against any claim of loss that may be asserted against said Company and accept receipt by any person or persons and that I further request cancellation of said Policy and accept receipt of the unearned portion of the premium calculated thereon; and I further agree and understand that this Policy shall terminate and benefits thereon cease to exist at 12:00 noon, Standard Time, at my address on the date shown below.

DATE OF CANCELLATION________________REFUND $_______________TOTAL $_______________________

Signature of Witness___________________________ Signature of Insured_______________________________

**SCHEDULE A**
**Collateral List To Note & Security Agreement between**
**Mariner Finance , Creditor, and**
**[redacted]____________________________________, Borrower(s)**

**This Schedule A is part of the Note & Security Agreement identified below. The Borrower(s) grant the Creditor a security interest in the listed property according to the terms of the Note & Security Agreement.**

**Purchase Money Security Interest:**

| DESCRIPTION OF ITEM PURCHASED | PURCHASE PRICE |
|---|---|
| | |

**OTHER PERSONAL PROPERTY COLLATERAL**

**CAMERAS AND ELECTRONICS**

| # | ITEM | DESCRIPTION | VALUE |
|---|---|---|---|
| 3 | Home Computers/Laptops/Tablets | IPAD 1K, IPAD 1K, APPLE MACBOOK 1800 | $3,800.00 |
| 1 | Televisions (in excess of 1) | 65" LG | $1,500.00 |

| [redacted] | $5,300.00 | [redacted] | 12/4/2020 |
|---|---|---|---|
| **Loan Number** | **Total Value** | **Signature** | **Date** |
| | | | |
| | | **Signature** | **Date** |

[redacted]

# AUTO PAY AUTHORIZATION

As used in this authorization, the words, "I," "MY," and "ME" refer to the borrower agreeing to the terms of this authorization, and the word "YOU" refers to Mariner Finance, LLC (and its subsidiaries and affiliates) (collectively "Lender").

I hereby authorize and direct Lender to initiate periodic debit entries for my scheduled loan payments from the bank account information provided to Lender. I agree that debit entries will be made on my scheduled due date (as specified in my loan documents) unless a scheduled payment date falls on a weekend or holiday, in which case the debit entry will be made on the next business day. Changes made to my account or banking information must be received by Lender at least three (3) business days prior to the payment due date.

If the first scheduled payment is an extended due date payment, then the first drafted payment amount may differ from the contractually agreed upon amount due each month. If any scheduled debit amount is greater than the outstanding balance of the loan, the scheduled payment will be debited in full and a check in the amount of the overpayment will be issued and mailed to me.

Lender may cancel my automatic payment enrollment if any automatic payment is returned unpaid by my financial institution. Lender may also cancel the automatic payment service for any reason and will notify me if such an action takes place. The automatic payment amount will only be reduced or canceled to avoid creating a credit balance on the account.

Further, I understand and agree that if my account at the depository financial institution provided does not have sufficient funds to make my loan payment, Lender will not be responsible or liable for any penalties or charges assessed by any other financial institution as a result of such insufficiency. I acknowledge that, in the event Lender's additional attempts to collect my payment via EFT-ACH are unsuccessful, I must make my loan payment by other means. I understand that a fee may be assessed by Lender in accordance with the terms of my loan agreement as a result of my account at the depository financial institution listed below having insufficient funds.

Termination: I have the right to stop payment of preauthorized transfers from my account by notifying Lender, verbally or in writing at the mailing address or email address noted below; any such notification must be received by Lender at any time up to three (3) business days before the scheduled date of the transfer. If the debit item is resubmitted, Lender must continue to honor the stop payment order.

I may terminate this authorization at any time (i) through the Customer Account Center; (ii) by providing written notice to Lender at Mariner Finance, LLC, 8211 Town Center Drive, Nottingham, MD 21236, Attn: Servicing; or (iii) by providing written notice to the following email address: recurringpymtoptout@marinerfinance.com.

This authorization will remain in effect until the underlying obligation to you is satisfied OR you receive written notification from me of termination of this authorization and you have reasonable time to act upon it, whichever comes first.

| | |
|---|---|
| [redacted] | [redacted] |
| Applicant Signature | Applicant Name (Please Print) |
| | |
| Applicant Signature | Applicant Name (Please Print) |
| 12/04/2020 | |
| Date | |
| [redacted] | [redacted] |
| Account Number | Routing Number |

MARINER FINANCE

# IMPORTANT INFORMATION ABOUT PROCEDURES FOR OPENING A NEW ACCOUNT

To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions to obtain, verify, and record information that identifies each person who opens an account.

What this means for you: When you open an account, we will ask for your name, address, date of birth, and other information that will allow us to identify you. We may also ask to see your driver's license or other identifying documents.

DISCLOSURES REQUIRED UNDER AMENDMENTS TO THE FAIR CREDIT REPORTING ACT

1. REQUIREMENT TO DISCLOSE COMMUNICATIONS TO A CONSUMER REPORTING AGENCY.
   We may report information about your account to credit bureaus. Late payments, missed payments, or other defaults on your account may be reflected in your credit report.

2. PROCEDURES TO ENHANCE THE ACCURACY AND INTEGRITY OF INFORMATION FURNISHED TO CONSUMER REPORTING AGENCIES.
   If you seek to dispute the accuracy of information that Mariner Finance has provided to consumer reporting agencies you can notify the consumer reporting agency of your dispute. Should their investigation reveal that any information furnished by Mariner Finance was either incomplete, inaccurate, or can no longer be verified, the information will be corrected or removed from the consumer report, as appropriate.

3. ADDITIONAL RIGHTS TO REPORT DISPUTES DIRECTLY TO MARINER FINANCE
   Additionally, you have the right to report disputes directly to Mariner Finance at the following address:
   Mariner Finance, LLC
   8211 Town Center Drive
   Baltimore, Maryland 21236
   Your written notice to us should contain the following:
   a. identification of the specific information that is being disputed;
   b. explanation of the basis for the dispute; and
   c. include as an attachment copies of all supporting documentation required by Mariner Finance to substantiate the basis of the dispute.

4. VICTIMS OF IDENTITY THEFT
   If you believe that you have become the victim of identity theft, and that Mariner Finance has reported information to a consumer reporting agency that is the result of identity theft, you should submit an Identity Theft report to Mariner Finance. An Identity Theft Report is a report that:
   a. Alleges fraud as a result of identity theft;
   b. Includes a copy of an official, valid report that you have filed with the appropriate federal, state or local law enforcement agency; and
   c. Subjects you to criminal penalties if perjury is committed.
   You may request copies of application and business transaction records that are in our control that evidence any transaction alleged to be a result of identity theft. You can request that these records be sent to you, or any law enforcement agency or officer that you specify or authorize to receive these records. The Identity Theft Reports and any requests for records should be mailed to the same address indicated in 3. above.

Rev. 6/14

Rev. 01/2020

MARINER FINANCE

| FACTS | WHAT DOES MARINER FINANCE DO WITH YOUR PERSONAL INFORMATION? |
|---|---|
| Why? | Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some, but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do. |
| What? | The types of personal information we collect and share depend on the product or service you have with us. This information can include:<br>▪ Social Security number and income<br>▪ account balances and payment history<br>▪ transaction history and credit history |
| How? | All financial companies need to share customers' personal information to run their everyday business. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons Mariner Finance chooses to share; and whether you can limit this sharing. |

| Reasons we can share your personal information | Does Mariner Finance share? | Can you limit this sharing? |
|---|---|---|
| **For our everyday business purposes —** such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or report to credit bureaus | Yes | No |
| **For our marketing purposes —** to offer our products and services to you | Yes | No |
| **For joint marketing with other financial companies** | Yes | No |
| **For our affiliates' everyday business purposes —** information about your transactions and experiences | Yes | No |
| **For our affiliates' everyday business purposes —** information about your creditworthiness | Yes | Yes |
| **For our affiliates to market to you** | Yes | Yes |
| **For nonaffiliates to market to you** | Yes | Yes |

| | |
|---|---|
| To limit our sharing | ▪ Call **888-540-7224** – our menu will prompt you through your choices **or**<br>▪ Visit us online: **http://www.marinerfinance.com/optout**<br><br>**Please note:**<br>If you are a *new* customer, we can begin sharing your information 30 days from the date we sent this notice. When you are *no longer* our customer, we continue to share your information as described in this notice.<br>However, you can contact us at any time to limit our sharing. |
| Questions? | Go to www.marinerfinance.com/resources/legal/privacy-statement/ |

| Who we are | |
|---|---|
| **Who is providing this notice?** | Mariner Finance, LLC, Mariner Finance of Virginia, LLC, Mariner Finance Florida, Inc., and Mariner Finance North Carolina, Inc. All references to Mariner Finance refer to the business which is maintaining your account. |
| **What we do** | |
| **How does Mariner Finance protect my personal information?** | To protect your personal information from unauthorized access and use, we use security measures that comply with federal law. These measures include computer safeguards and secured files and buildings. |
| **How does Mariner Finance collect my personal information?** | We collect your personal information, for example, when you:<br>▪ apply for a loan or give us your income information<br>▪ provide employment information or apply for financing<br>▪ give us your contact information<br>We also collect your personal information from others, such as credit bureaus, affiliates, or other companies. |
| **Why can't I limit all sharing?** | Federal law gives you the right to limit only:<br>▪ sharing for affiliates' everyday business purposes – information about your creditworthiness<br>▪ affiliates from using your information to market to you<br>▪ sharing for nonaffiliates to market to you<br>State laws and individual companies may give you additional rights to limit sharing. See below for more on your rights under state law. |
| **What happens when I limit sharing for an account I hold jointly with someone else?** | Your choices will apply to everyone on your account. |
| **Definitions** | |
| **Affiliates** | Companies related by common ownership or control. They can be financial and nonfinancial companies.<br>▪ *Our affiliates include companies with a Mariner Finance name.* |
| **Nonaffiliates** | Companies not related by common ownership or control. They can be financial and nonfinancial companies.<br>▪ *Nonaffiliates we share with can include mortgage lenders, investment advisors, insurance companies, and retailers of consumer goods.* |
| **Joint Marketing** | A formal agreement between nonaffiliated financial companies that together market financial products or services to you.<br>▪ *Our joint marketing partners include retailers of consumer goods.* |

## Other important information

**State Privacy Laws**: We comply with state privacy laws to the extent they apply. **California Residents:** We will not share nonpublic personal information with non-affiliates without your authorization, except as permitted by law. We will also limit our sharing of nonpublic personal information about you with our affiliates to the extent required by applicable CA privacy laws. **Texas Residents:** For questions or complaints about this loan, contact Mariner Finance at (844) 338-2080. The lender is licensed and examined under Texas law by the Office of Consumer Credit Commissioner (OCCC), a state agency. If a complaint or question cannot be resolved by contacting the lender, consumers can contact the OCCC to file a complaint or ask a general credit-related question. OCCC address: 2601 N. Lamar Blvd., Austin, Texas 78705. Phone: (800) 538-1579. Fax: (512) 936-7610. Website: occc.texas.gov. E-mail: consumer.complaints@occc.texas.gov.

**Important Information about Credit Reporting:** We may report information about your account to credit bureaus. Late payments, missed payments or other defaults on your account may be reflected in your credit report.

MARINER
FINANCE

# IMPORTANT INFORMATION ABOUT THE ACH TRANSFER PROCESS

Loan proceeds will be deposited into your bank account via ACH transfer; however, the specific timing of the disbursement of the loan proceeds into your account will depend on the day of the week and time of day your loan is processed and approved for funding.

Loans proceeds are typically sent to your bank via ACH transfer the business day following the day on which your loan was processed and approved for funding. For Mariner Finance's ACH transfers, business days exclude weekends and Mariner and bank-observed holidays.

Banks typically post the funds to your account by the next business day; actual posting time depends on your bank and may, in some cases, take more than one business day.

If you have questions about your ACH deposit, you should contact your bank's ACH department.

Mariner Finance

Date: December 04, 2020

[redacted]

RE: Account Number [redacted]

Dear [redacted]

Mariner Finance would like to thank you for the opportunity to assist with your financial needs. This letter includes important information about your new account as well as instructions on how to make your payments. Please retain this document with your loan agreement and records.

**Account Details**

Your new account number is _[redacted]____ and your first payment in the amount of $176.18 is due on January 08, 2021. After your first payment, your regular monthly payment of $162.33 will be due on the 8th day of each month. Please review your loan agreement for information regarding late payments and other fees that may apply.

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3) Upon completion of the registration process, you will be able to:
    a. view, download, and/or print your loan documents;
    b. view your account details and transaction history; and
    c. make payments online.

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You can make your monthly payment in any of the following ways:

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  Mariner Finance, LLC, P.O. Box 44490, Baltimore, MD 21236
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Mariner Finance
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**Additional charges may apply **Subject to normal lending requirements*

10692-01

# Exhibit B

S. HRG. 105-508

# EQUITY PREDATORS: STRIPPING, FLIPPING AND PACKING THEIR WAY TO PROFITS

## HEARING

BEFORE THE

## SPECIAL COMMITTEE ON AGING UNITED STATES SENATE

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

WASHINGTON, DC

MARCH 16, 1998

**Serial No. 105-18**

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# EQUITY PREDATORS: STRIPPING, FLIPPING AND PACKING THEIR WAY TO PROFITS

**MONDAY, MARCH 16, 1998**

UNITED STATES SENATE,
SPECIAL COMMITTEE ON AGING,
*Washington, DC.*

The committee met, pursuant to notice, at 1:01 p.m., in room SD–628, Dirksen Senate Office Building, Hon. Charles E. Grassley (chairman of the committee), presiding.

Present: Senators Grassley, Collins, and Breaux.

## OPENING STATEMENT OF SENATOR CHARLES GRASSLEY, CHAIRMAN

The CHAIRMAN. Good afternoon. I welcome all of you to our hearing, which is on the subject of "Equity Predators: Stripping, Flipping and Packing Their Way to Profits."

First, let me say welcome and thank you to each of our witnesses, one of whom is jeopardizing his future in the industry by being here, three of whom will relive some very painful situations, and our panel of experts who have taken time to share their expertise with us.

Next, let me also say welcome and thank you to other members, particularly Senator Breaux who is here, and there will be others coming along shortly because I know they want to take time out of their busy schedules to be with us, and of course, the members of the public who are here and are very much interested in this issue.

We are pleased to have in attendance today Mr. Raymond White, another victim of predatory lending practices. Mr. White is here today because he believes strongly that such practices must be stopped. I would like to ask Mr. White to stand so we can recognize him at this point.

[Mr. White stands.]

Thank you very much, Mr. White, for your interest in this issue.

"Equity predators" at first blush might sound like a new horror movie targeted to bring chills and thrills to teenagers across America. Unfortunately, the topic that we are talking about today is in fact a horror. However, there are no chills and thrills, and the target of these equity predators is not teenagers, but anyone who has a good deal of equity in their home, especially unsuspecting senior citizens, especially females, who are equity-rich and cash-poor.

What exactly are we talking about when we say that equity predators target folks who are equity-rich and cash-poor? These folks are our mothers and our fathers, our aunts and uncles, and all people who live on fixed incomes. These are people who oftentimes exist from check to check and dollar to dollar, and who have put their blood, sweat and tears into buying a piece of the American dream, and that is their own home.

This should not come as a surprise. In fact, do not be surprised, because it is estimated that more than 23 million American homeowners have no mortgage debt and that the average age of such a homeowner is 64½. Indeed, for many senior homeowners, the equity in their homes represents their lifetime savings and their largest asset. In fact, the estimates of their collective equity range from 600 billion to more than 1 trillion. So it is no wonder that these folks have become the apple of many a lending company's eye.

Before I get into a little bit more depth about the practices used by some lending companies to rip off our senior citizens, there is something that needs to be said clearly and unequivocally. Most subprime lending institutions operate in an appropriate, ethical, moral, compassionate and legal manner. They provide a vital service to those borrowers who may be unable to take advantage of traditional lending institutions because of such things as poor credit and insufficient income. These lending companies are providing thousands of seniors with needed cash—cash that is used to pay for everything ranging from medical bills to transportation.

Now let me turn more directly to our matter at hand. Equity predators, these con artists, are in the cheating and swindling business. They make money by stripping, flipping and packing the loans they make to unsuspecting consumers. These are often trusting senior citizens with little knowledge about finance and the practices of lending institutions.

You just heard me say a few terms that might have different meanings depending on what part of the country you come from. Those terms are "stripping," "flipping" and "packing." We have a chart up here that will give you the definitions—a glossary of terms that will be useful as we discuss the practices used by some in this industry.

Another question legitimately asked is just how prevalent this problem is. I wish I had a statistically valid number for you, but none exists, and that is very unfortunate. But there are a few things I can say and can say with certainty. During the course of conducting the investigation for this hearing, it became apparent that often the victims of equity predators are rarely aware of the fact that they have been the subject of a scam. In fact, it has been reported that home repair and equity fraud have stripped the value from the homes of about 100,000 unsuspecting people in 20 States.

In addition, the sheer size of the home equity market is incredible and would naturally attract unworthy business people. Just imagine—home equity loans jumped from 1 billion in 1982 to 600 billion in 1996. Next, it is estimated that about 663,000 elderly households have lived in their homes for over 20 years, own their homes free of mortgage debt, have incomes of $30,000 or less and have equity of $100,000 or more. Even the experts to whom we spoke all seemed to agree on one thing—they are seeing more and more cases of predatory lending and, as I said, who knows what we are not seeing.

In fact, we learned that the State of California determined the problem of predatory lending was significant enough to merit a fraud unit with local district attorneys' offices devoted solely to addressing this problem.

Today we are going to hear from seven panelists. Three witnesses are going to talk about their personal and very painful experiences with lending institutions. While listening to these witnesses, please pay particular attention to each of their stories. One will explain how her family was scammed through a home repair scheme, one through the financing of a consumer item, and one by simply calling one of the 800 numbers advertising that the company sold money.

These witnesses all ended up in the same boat—just about losing their homes—but the way it happened was tailored to their particular situations at the time.

Then we will hear from a gentleman who worked in the lending business. He will give us the real scoop on how predatory lenders do what they do to unsuspecting homeowners and the crafty, systematic practices employed by some lending institutions that actually "bleed" the equity from the borrowers' homes.

Thereafter we will hear from a professor of law who will speak about some internal corporate documents and provide his opinion on some segments of the training tape used to train employees in the "ways of lending."

The Federal Trade Commission will speak about their most recent investigation into predatory lending practices; and last but not least, we will hear from a committed, experienced, legal aid attorney who has devoted the last decade to helping unsuspecting borrowers on the verge of collapse.

Before we begin, I want to quote a victim—a quote that in my mind sums up what we are all talking about here today. She said the following: "They did what a man with a gun in a dark alley could not do. They stole my house."

I will now turn to Senator Breaux and then to Senator Collins.

## STATEMENT OF SENATOR JOHN BREAUX

Senator BREAUX. Thank you very much, Chairman Grassley, for having these extremely important hearings at this particular time.

There is clearly no greater violence to standards of decency and justice in America than to have predators who prey on children and predators who prey on the elderly in our country. Our hearing this afternoon focuses on what is, unfortunately, just the latest scam that is being perpetrated against older Americans in this country.

Victims of predatory lending practices often spent an entire lifetime building equity in their homes. They become vulnerable to unscrupulous lenders because of their limited incomes and trusting natures, essentially being tricked into mortgaging what is probably their only tangible asset—their home. Because of limited cash flow, these homeowners are often tempted to refinance their homes to consolidate debts, or to make needed home repairs or improvements to their homes.

In recent years, the subprime lending market, where credit is extended to high-risk borrowers, has greatly expanded. Some may argue that this is only in response to increasing demand for credit and that subprime lenders are in fact providing a service to those who cannot simply walk into a bank and get a low, fixed-rate loan. Nevertheless, from what we will hear today, the subprime industry appears to be ripe for abuse.

Many lenders, and in fact most lenders, in the subprime market are reputable lenders and are not the subject of this hearing today. We are here today to discuss, rather, those who are thriving in the market by taking advantage of unsuspecting, needy and elderly homeowners.

What makes these bad apples different from the good guys in the industry is the use of deception, forged documents, and intimidating borrowers into borrowing money based not on their ability to repay the loan, but rather on the equity that exists in their home. And it takes cash—not a home—to repay a loan.

Some of these lenders in the subprime industry seek to profit by taking advantage of some of the weakest, least informed members of our society. Our goal for this hearing is to raise awareness of these kinds of practices and to educate seniors on how to identify and avoid these problems before they are drawn into a loan or a mortgage that they will not be able to repay before they lose their homes.

Elderly people who live on fixed incomes are often easy prey for lenders who seek to take advantage of them. An older homeowner is often a predatory lender's dream. After years of making timely mortgage payments, these men and women have built up a wealth of equity in their homes, and they usually get by on fixed incomes and may not have enough money to make the necessary repairs to their homes or to make purchases of high-cost necessities such as prescription drugs. They are equity-rich but cash-poor. A home equity loan is similar to dangling a bundle of cash in front of them.

The predatory lenders use deceptive and intimidating practices to coerce homeowners into accepting loans that will ultimately prove detrimental to their financial situation. These practices, as Chairman Grassley has pointed out, include "stripping," which is extending a loan based on the equity accrued in a home and not the ability to repay the loan, or making a loan that is intended to fail; "flipping," which is continually inducing the borrower to refinance his or her loan while the loan balance simply grows larger and larger each time, and the lender makes more and more money through the high points that are charged; and finally, "packing," which is tacking unnecessary or overpriced credit insurance onto the loan balance.

Predatory lending can strip our seniors who have worked hard their entire lives of their one form of financial security—their homes. These homes represent their past, their hard work, perhaps where they raised their children, and hope to spend their final years.

It is easy for critics of hearings like this to say simply, "Well, the buyer should beware." While that is important to bear in mind, it does not mean that we should not also raise awareness about this issue and the deceptions involved. All borrowers, particularly seniors, should know about these predatory lending practices and be equipped with the knowledge and the tools that they need to avoid financial disaster.

Unlike a bad financial decision made when one is young, mortgaging a home the wrong way late in life usually cannot be corrected if it goes sour.

Thank you again, Mr. Chairman, for chairing these very important and worthwhile hearings.

The CHAIRMAN. I appreciate your cooperation, Senator Breaux, as the ranking member of this committee, not only on this hearing but on the several hearings that we have had.

Senator Collins.

### STATEMENT OF SENATOR SUSAN COLLINS

Senator COLLINS. Thank you, Mr. Chairman.

Mr. Chairman, I want to start today by applauding you for holding these hearings to shine the light of day on predatory practices in the subprime mortgage lending market. While any scam that targets our senior citizens is deserving of our condemnation, there is something particularly cruel and callous about schemes which have as their objective, or even as their likely outcome, the removal of people from their homes.

For most older Americans, a home represents far more than just a shelter. It is a source of security in what are often insecure times. It is a symbol of continuity during periods of rapid and sometimes unwelcome change. It is a repository of memories of young children and neighborhood friends who may have moved away. For some of our elderly, their home is their one substantial asset to which they can turn in the event of a personal or family emergency.

In preparing for this hearing, Mr. Chairman, I was particularly struck by the couple who had raised 10 foster children in their home, only to experience the fear and pain of a foreclosure proceeding brought about by clearly unfair lending practices. There is a tragic irony in the fact that a structure that had been the site of so much kindness could become the target of such unprincipled greed.

There is also a cruel irony in the fact that the abuses which are the subject of today's hearing exploit character traits that our society holds in high regard. People become the targets of these scams not because they have led extravagant lives, but because they have made the sacrifice to pay off their mortgages and to accumulate substantial equity in their homes. The reward for this financial responsibility is that they show up as large blips on the radar screens of the mortgage loan predators.

As with other scams directed at older Americans, this one exploits the trusting nature of so many of our senior citizens. One cannot help but be struck by the fact that the victims of shady financial practices are usually people who treat others with honesty and fairness, and they assume in turn that they will be treated in a like manner. It is a sad thought, Mr. Chairman, that we may have to start teaching suspicion and mistrust in our schools if we are to spare our young people the experiences of their grandparents.

Mr. Chairman, I spent many years as the head of the State agency in Maine that regulates the financial services industry. I am all too familiar with the abusive practices directed at our senior citizens, whether it be the sale of unnecessary insurance or the marketing of unsuitable investments or the making of unconscionable loans. All of these practices are really part of the larger problem of the exploitation of our older Americans, and it is a problem for which we have not yet found a satisfactory answer.

We live in a time when we are justly proud of the accomplishments of American capitalism, but there are those in our society who fail to understand that it is not the profit motive alone that drives our system, but also a sense of fair play and integrity. Strip away those latter values, and you are left with a perversion of the American ethic.

Although this issue is beyond the scope of today's hearing, I would suggest, Mr. Chairman, that ultimately, we may need higher legal standards for those who provide financial services to our senior citizens. The ordinary rules of the marketplace may simply not suffice; they may not be adequate. To make an unfair loan to an elderly person who does not appreciate the significance of the transaction should not be right even if done without telling outright lies and in compliance with all the legal technicalities. The day may come when people whom we treat as salespersons will have to take on more of a fiduciary role when they are dealing with our vulnerable senior citizens.

Mr. Chairman, let me end on a more upbeat note. While I am dismayed at the practices that you have uncovered and that we will be discussing today, I am heartened that there are people in this country who are committed to fighting them. I would especially note that one of our witnesses has spent 29 years advocating for the poor and the disadvantaged as a member of a legal aid office, and that we have another lawyer present who is representing a victim on a pro bono basis.

While I usually try to avoid being "politically incorrect" by saying something nice about lawyers, these individuals and others engaged in combating abuses of this nature certainly merit our praise and our gratitude.

Again, Mr. Chairman, thank you so much for holding this vitally important hearing today.

The CHAIRMAN. And thank you for the support you have given our efforts.

[The prepared statements of Senator Craig and Senator Enzi follows:]

PREPARED STATEMENT OF SENATOR LARRY E. CRAIG

Mr. Chairman, thank you for holding this very important hearing on predatory lending practices. The tactics used by sub-prime lending agencies are nothing less than legal scams preying on the vulnerability of the elderly. This is an issue of national significance and needs to be addressed.

My hope is that this hearing today will help to expose predatory lending practices, educate seniors about these practices, and empower seniors with the information so that they can avoid these scams. I commend the Chairman and the Ranking Member for gathering such a broad-based and experienced panel of victims and witnesses. I look forward to listening to everyone here today.

Seniors with fixed incomes and large amounts of equity have little to offer traditional loan services. This forces them into sub-prime lending agencies, who do provide a necessary service. It must be noted that not all lenders are predators. However, there are many loopholes found in existing protection laws which can and are easily exploited.

Stripping, flipping, and packing are the three most prevalent abuses perpetrated by equity predators. Traditionally, a senior's largest asset is his or her home. Unsavory practices place seniors' homes on the line, with the very real risk of foreclosure—with the promise of quick cash. These homes are their memories, their security, and represent a lifetime of effort and achievement.

Seniors are not powerless to this abuse. First and foremost, they need to be aware that predatory lending practices exist and how to avoid them. If they do fall prey and fraudulent procedures are used, there is legal recourse available through existing protection laws. Exposure, education, and empowerment are our greatest weapons.

I look forward to the discussions here today. It is important that we do what we can to stop these practices, and stop the victimization of seniors.

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## PREPARED STATEMENT OF SENATOR MICHAEL ENZI

Thank you Mr. Chairman for holding this important hearing to highlight the unethical and unscrupulous lending practices that target our nation's senior citizens. It is extremely unsettling that anyone could take advantage of an unsuspecting senior citizen, deprive him or her of income and assets, and potentially leave the individual homeless. Unfortunately, such predatory lending practices have been increasing as the sub-prime lending market expands. Since one of the primary roles of this Committee is to raise awareness of various frauds that target the elderly, I commend the Chairman for bringing this matter to the attention of Congress and the American public.

It is important that we educate our senior citizens so that they can avoid being the victim of an unscrupulous lending company. The complexity of today's financial products makes it easy for lenders to distort the terms of loans to many people, not just senior citizens. The fact that seniors often possess a great deal of equity in their homes but are living on fixed or limited incomes makes them a particularly appealing target. This hearing will help make seniors aware of the risks involved in agreeing to loans that appear to be perfectly reasonable. In addition, I am hopeful that this hearing will encourage those who have been victimized by unscrupulous lenders to step forward and bring their problem to the attention of someone who may be able to help them, such as an attorney or a local Legal Aid Office. Our first group of panelists should be applauded for their willingness to bring their own unfortunate experiences with lenders to the public's attention in an effort to prevent others from having similar problems.

This hearing will also expose some of the ruthless, cut-throat practices that exist in the sub-prime lending industry. It is important to know how and why lending institutions conduct these fraudulent practices so that we can work to eliminate them. It is also important to recognize, however, that most lenders in the sub-prime industry are conscientious businessmen that serve a valuable role by providing loans to individuals who may need money for unexpected expenses and may not be qualified for loans through traditional sources such as banks. I am hopeful that this hearing will put those lenders who choose to engage in abusive lending practices on notice that we will not tolerate their unethical behavior that harms our elderly population.

Once again, I thank the Chairman for holding this hearing. It is important that we raise the awareness of predatory lending practices that target our nation's vulnerable senior citizens and threatens their financial and emotional well-being. I am pleased that the Committee has addressed this particular issue in our ongoing efforts to improve the retirement security of all retirees, both current and future.

The CHAIRMAN. I will now call forward our first panel. This panel consists of three individuals, two of whom are here at the table in person, and the third who will be on videotape. These three individuals have experienced either first-hand, or through parents, the devastation caused by predatory lending practices. These witnesses will provide insight into how trusting individuals become entangled in unaffordable loans and expensive refinancing schemes offered by these predatory lenders.

Our first panelist is Ms. Helen Ferguson. Ms. Ferguson is a 76-year-old widow who resides here in Washington, DC. Her story is a classic case of mortgage flipping, which is an abusive practice that may subprime lenders engage in. She will tell us the story of how an unscrupulous subprime lender took advantage of her vulnerability and her trust.

Our second witness is Gael Carter, a 55-year-old widow who found herself saddled with debt from her husband's funeral expenses. She lives in fear that she is going to lose the home in which she raised seven children over the course of 35 years. She will share her story from a hospital room where she is today, of how she was relentlessly pursued by a subprime lender to secure a variety of loans and to ultimately refinance her home mortgage. Those decisions have led her into an unsurmountable mountain of debt, and she is currently litigating the legitimacy of the loan.

Our last witness is Ms. Vireta Jackson Arthur, here to testify on behalf of her parents, Rosie and Ormond Jackson. Her parents lived in their home in Brooklyn, NY, since 1969. Ms. Jackson will tell us how her parents were tricked into financing home improvements which were unknowingly secured against their life savings, which happened to be in their home. Ms. Jackson is here today to expose the deceptive subprime market practices. She hopes to prevent this from happening to others, especially the elderly, who are most vulnerable.

I am going to turn to Helen Ferguson, and then we will hear from Gael on video, and then to Ms. Arthur.

## STATEMENT OF HELEN FERGUSON; ACCOMPANIED BY JEROME SWINDELL, ATTORNEY

Ms. FERGUSON. Good afternoon, Mr. Chairman, and thank you for allowing me this opportunity to come before your committee.

My name is Helen Ferguson. I am a 76-year-old resident of the District of Columbia. I have lived at my present home at 236 Gallatin Street, N.W. since 1965, but my ability to remain in my home is in doubt because of the unfair practices of two lenders.

In 1991, my total monthly income from Social Security and SSI was about $504. With that income and the help of my family, I was able to make my $229 monthly mortgage payment for two loans from Lender A. But on that fixed income, I was not able to make much-needed repairs around the house. In order to make these repairs, I was forced to borrow money.

At around that time, I began to see and hear television and radio advertisements for Lender B. The ads said that Lender B could provide me with the money I needed at low interest rates and low closing fees.

Because of these advertisements, I went to Lender B to get a loan to pay for home repairs. That is when everything began to go wrong. On July 16, 1991, I signed the papers for a $25,000 loan with Lender B. This loan was intended to pay off my entire debt to Lender A so that I would have only one mortgage payment. For some reason that was never explained to me, this loan was never funded or recorded. Mixed in with all the other loan papers, Lender B placed a deed granting an interest in my home to my sister, Eloise Johnson. This was done without my knowledge or consent. Because I did not fully understand what I was signing, and because the documents were never explained to me, I did not discover the change in the deed until years later.

Two weeks after I signed the papers for the $25,000 loan on July 30, 1991, Lender B, prepared a second set of documents and had me sign them. I did not know that the documents were for a different loan. I later learned that Lender B only paid off the smaller of my two Lender A loans. Thus, I was now making two mortgage payments. My monthly payment increased to about $400. I have since discovered that Lender B collected over $5,000 in fees and settlement charges for a $15,000 loan. They also charged me interest at 17 percent.

Over the course of the next few years, Lender B repeatedly tried to convince me to take out more loans. They called me at home and called my sister at work. They sent letters and Christmas cards. All of this was aimed to get me further in debt.

In March 1993, I finally gave in, because I needed more home repairs. But once again, two sets of documents were prepared with different figures. In fact, Lender B changed the loan amount at least three times in March 1993. Eventually, the March 31, 1993 loan documents for $25,000 were recorded. Those documents included an interest rate of 18 percent and settlement fees of $5,900.

By March 1994, my financial condition had gotten worse. I could not keep up with my monthly payments. In an effort to reduce my monthly payments, I obtained a loan from Lender C through a loan broker. However, my monthly payments increased to almost $600 and later rose to $723. I was not aware that I had a variable interest rate, and the monthly payment would increase. I also did not know that I paid over $5,000 in fees to the broker who solicited me on behalf of Lender C and more than 14 percent in total fees and settlement charges. My loan payment to Lender C exceeded my combined Social Security and SSI income by $200.

Needless to say, my circumstances only worsened over the next 10 months. During that time, Lender B continued to call me and my sister and send advertisements to our home. In dire financial need, I entered into a fourth loan with Lender B in February 1995 for $67,000 at 15 percent interest. My monthly payments were over $783, and I was charged settlement fees in excess of $7,000.

Even though I defaulted on the fourth loan, in late November 1995, Lender B called and convinced me to get yet another loan. Their representative came to my home to collect information for a loan application from my sister and me. He told me that Lender B would fix my rates so that I would not have any trouble meeting my monthly payments.

In late December 1995, he returned to my home with a lawyer. I entered into a fifth loan agreement for $85,000. They charged me $9,424 in lender fees. They left my house, taking all the papers with them.

When my payment notice arrived, I discovered that I was obligated to make monthly payments of more than $800. They also did not tell me that because of taxes and insurance for the new year, my payment would increase to over $900. From 1991 to 1996, the debt on my home had increased from less than $20,000 to over $85,000. My income had increased only slightly. Neither Lender B nor Lender C cared if I was able to make the payments. They just seemed to want to get me further in debt.

If I had been told the true terms of these loans from the beginning, I would not have signed the papers. If I had the means to cancel the loans, I would have done so immediately. But Lender B would not give me the signed papers at the settlements. Instead, they would mail the papers after I had received the check and spent it on necessary repairs.

The check and the papers always came after the 3-day rescission period had passed. If I had known all the terms of the loan in time, I would have canceled. But because I did not receive either the notice of right to cancel or the copies of the loan terms until after the rescission period, I felt helpless. At the time, I did not know that Lender B had violated the law. It was only after I talked to lawyers at AARP that I was told that I did have some rights to get away from Lender B and save my home.

I have filed a lawsuit against Lender B, Lender C, and others with respect to these loans.

Thank you for listening to my story.

The CHAIRMAN. Well, don't you thank us; we thank you for taking time out of your busy schedule. So many people are reluctant to come and tell their stories, and the fact that you would come and do this publicly is a benefit not only to the Congress but to all the other people hearing your testimony who know that the same thing could happen to them.

We will now turn to the video testimony from the hospital bed of Gael Carter.

## STATEMENT OF GAEL M. CARTER

Ms. CARTER. My name is Gael M. Carter, and I would like to be part of this hearing about these lenders and predators who are preying on people and basically destroying their lives. I could not make it to the hearing. I am hoping to still make it, but if I cannot, I want to give part of my testimony here, so I can have a chance to tell other Americans and people that things just cannot go on this way; they have to stop.

I am 55 years old. When my husband died in 1992, I was left with the house in which I have lived since 1963. It is in this home that I raised my four children, two step-children, an adopted daughter, and a whole lot of other kids who did not belong to me, but they thought they did.

I had about $150,000 equity in my home at the time my husband died, and we were quite a bit in debt. The only thing I had in this whole world was my house. I was worried about how I was going to take care of it, so a friend of mine loaned me a small mortgage that would pay for the house. This would give me a lower monthly payment, from $1,200 a month to $400, and she told me they were going to charge me 6.5 percent.

So, of course, I jumped at that chance. It gave me more money coming in, and more money so I could help take care of my daughter.

I have only a ninth grade education. I last worked in 1978, and that was as a night cleaning lady in a movie theater. I had to quit working because of high blood pressure, liver problems and other problems. Now, I get by primarily on Social Security payments.

Starting in 1994, I was taken advantage of by a financial service company. It all began when I bought a toy car as a gift for my son-in-law. I took out a small loan for it, because I did not want part of my cash to pay for it. The man said that I had to fill out some paperwork. So he went and talked to somebody for a few minutes, and he came back, and he said, "You now have a loan. You have no problem whatsoever, Ms. Carter. We thank you."

Well, after I got that loan for that toy car, within 2 days, I was getting phone calls from this company, thanking me for being part of their growing business, a part of their family, and that this was going to really help because it was going to help me get my finances in order, and consolidate all my bills.

It turned out not to be true, it really did not. By the end of January 1995, I owed them payments totaling $328,322. With only Social Security, I was scared to death I was going to lose my home.

This company kept calling me all the time. They became very, very friendly with me. After they had made about 10 phone calls to me, I called up there, and I asked to speak to this lady. I said that she had promised me a loan and I wanted to come up and talk to her. She called back, and she took all the information over the phone, and when the day came for me to sign the papers, I was too sick to go. So I called her and told her—she had called me earlier in the morning—I called her back to tell her I was too sick, and I could not come out. And she said, "That is okay. I am going into Falls Church anyway, and I will come by your house with all the paperwork," which she did.

At my house, she was leaning on the table, pushing the papers at me, very fast, and going over things very fast. She told me that I had to have life insurance on this loan. She said the insurance was going to cost me $6,500. But she said, "Do not worry about that. You will not have to come up with that amount. We can just wrap it into the loan." And I told her at that time that I had all these health problems, and she said, "Oh, do not worry about that. I can get around that."

So I took her at her word. She talked me into taking out $100,000 worth of insurance on a $54,000 loan, and she told me that whenever something happened to me, there would be money left over to take care of my teenage daughter.

Then she told me that she would send me the checks. She gave me a check right there at the table for me to sign, because they needed to check out the creditors and everything. And she said that in 2 days, I could cash my check. I thought it was OK. Well, then, I started getting more papers, and it was not even time for the first monthly payment, and they told me I could get more.

Well, my daughter was getting married, and she wanted to borrow $8,000 for a wedding. Now, she did have money in the bank, but she could not touch it then. They told me that she could not have the loan, and I asked if I could cosign for her so she and her husband could have their wedding. I was told no, I could not do that, but I could increase my loan. Since I had not already made any payments this was good, because now they were not going to charge me anymore fees; they could just go ahead and put all the fees in the new loan, and since I was not borrowing that much more, there would be no problem getting it.

So once again, I went ahead with it. I went to their office with my son-in-law and daughter, and we got out there, and the kids sat out there, waiting for me. I went back and signed the papers, and she had the insurance in there. And she passed the papers to me and I signed the papers and she said, "OK. If you want to change your mind, you have 3 days; you can just call us."

So I started making payments, but they never gave me what I needed to borrow. They always kept telling me, "Well, if you make a couple payments, we can go ahead and increase it, and you will not be out a whole lot more. But you have just got to get rid of all these high credit cards."

So I came to find out later, though, she was not telling me everything. The insurance, which was something I never knew anything about, was a decreasing policy that might not even pay the loan off at all if I had died during the period of the loan, because this insurance was only good for 10 years, and the loan itself was for 15 years. But she said I could always take out a new loan, or I could refinance the last 5 years at that time and take it out of that.

After the second home equity loan, I kept getting calls and things in the mail, asking me to come back out. They told me that they could solve all my problems if I would just give them my first mortgage, which they kept trying to get all along, and I would not give it to them. I told them, "I have to be totally honest with you. She is likely to forgive this mortgage one of these days because she has the money to do it if she wants to." So, no, I do not want to give you my mortgage.

Well then, in October of that year, I went ahead and sent two house payments in; one on the 1st and one at the end of the month, because they kept sending me coupons every month. That way, they have always got you; you always have mail coming from them, and you are looking for your coupons, so you open it and look at it.

So that came, and there was a check—it was Christmas time, and there was a check for—I think that particular one was $1,500. Just sign this check. We have already approved you for it. Come out and get it. I told the kids, "I am going to do it, so we can get some stuff for the babies for Christmas."

So we went out there. We talked to the manager on the phone, and she said she was going to be there. We went out there, and a man came out and brought me all the papers to sign for this $1,500 "instant check"—it did not seem like an "instant," but it was supposed to be. Then he said, "I will get your check for you. I will get you the money."

So he went out and came back, and he said, "Here is another piece of paper you have to sign."

I said, "Why do I have to sign that? What is that for?"

He said, "This is the letter stating that you know this loan is at 31 percent, because you had a mortgage with us and you would not increase it, so we have to charge you this 31 percent."

He said, "But do you know something? You were talking about wanting to change your due date and everything. You do not have to keep this until the month and a half, two months, whatever. You can pay this one off when you increase your other mortgage."

I said, "I do not know about that." So I went over, and I talked to the manager, and I said to her—because we were friends; I called her by her first name—and I said, "Judy, what can I do to get my payoff date changed on my other loans?" I said my son-in-law was a car salesman and only got paid once a month. I said every month, my house payment is going to be late, and I am going to have to pay late charges—plus it is not helping my credit any.

She said, "Oh, well, you cannot do that unless you have $1,200 to give me."

I said, "What do I have to give you $1,200 for?"

She said, "Because that is interest you owe."

I said, "I do not owe any interest. I have paid all my payments. I even made November's back in October."

"Well, I should have told you about something like that. Our computer does not see it that way. All our computer knows is that you have not made a payment since October, so now you owe us all this interest."

So then I thought, now I am really in a pickle. She kept talking and talking, and she said, "Well, think about it. This can solve all your money worries. You can just go ahead and take out this loan." That was in late November, early December. So then I kept getting letters and phone calls, calling to see how the baby was doing and what was going on and all kinds of things, you know, being friends. I finally gave up. I said I cannot make all these payments, and I have all these credit cards here.

She kept saying, "Yes, remember, they are 22 percent and 26 percent."

I said, "Yes, but the loan with you is at 31 percent."

She said, "Well, I am sorry, but that is the way we have to do things. We will go ahead and draw you up papers, but you will have to have your son-in-law and your daughter sign as co-borrowers." I did not see how that was possible, but I said okay, because my son-in-law had had some problems earlier, a couple years before. Also, they were not on the loan mortgage with me—it was just me.

But as I got to looking at my papers, I realized afterward, after I took out this new loan, that number one, they did not say anything to me about points. I had never paid points on a loan to my knowledge. I went out there, and we were passing the baby around. My son-in-law, my daughter, then I would hold the baby, so we could each take our turn signing our name. She just kept flipping papers real fast and she said, "This is your payoff, this is where this is going, this is where that is going, this is your credit amount, but you have a variable rate."

I said, "Wait a minute, wait a minute. I did not hear anything about a variable rate, not until just now." I said, "I do not want a variable rate."

She said, "Well, you talk to your son-in-law. He has more business sense than you have."

I said, "Well, thanks a lot, Judy." She gave my son-in-law a piece of paper about half the size of this, and it showed that the payments would only go up a $100 at the most a month. But I did not have any choice. I went ahead and signed the papers, and we went home, and the more I thought about it, and the more I kept looking at the figures, it just did not add up to me.

So I started calling other banks and places, and they all kept saying, "You are not giving me all the figures, you are not giving me all the figures." They told me that they needed all the papers I had, and one of them was a HUD paper I had never received. That was where the problem was. They charged me 10 points, $14,500, plus the insurance, $6,500. The bank told me it was going to cost me $50,000 on that over the cost of the loan, and I still would not be insured. So I was just really scared to death.

I tried to call them four times in one day to cancel it, and no one would ever return my calls. They had told me someone would always man that line, and they would get back to me—but no one ever got back to me.

Monday was a legal holiday; they were not there. Tuesday, I got a call saying that we had to change the figures a little bit because I had forgotten to tell them I owed taxes, and they did not have enough money to pay off all these bills.

So the gist of that was that I was going to have to keep the 31 percent loan with them, and they were not going to pay off all these other bills. I told the kids, "We cannot go through with this." So I called my first mortgage lady, and I said, "Margaret, if you get a check in the mail, do not go to the bank with it. It will not do you any good. I have to sign it, and the kids have to sign it, and I know you will get scared when you get there and cannot get your money. I will give you the money."

Then I went and saw the attorneys and asked them to help me get this mess straightened out in my life, because my friend called back, and she told me that she knew my signature was a forgery. So she drove—well, she did not drive, because she is 84 years old, and she has never driven—she had someone bring her to my house to get all of our signatures to make sure, for her own peace of mind, that our signatures were not on those checks.

So that is what happened, and as I said, I contacted an attorney after that. I felt that if they did this to me to get this loan, they would do it to a lot of other people, a lot of old people, and a lot of people have been taken to the cleaners. I really felt that this needed to come to this Senate hearing so that the word could get out to help elderly people from getting caught up in the same mess that I did. It nearly ruined my life. I got deathly sick from trying to keep my house, and I have not been well since, and I do not want them to hurt somebody else.

That is my story.

[The prepared statement of Ms. Carter follows:]

**TESTIMONY OF GAEL M. CARTER**
**before the Hearing of the**
**UNITED STATES SENATE SPECIAL COMMITTEE ON AGING**
**"Equity Predators: Stripping, Flipping and Packing Their Way to Profits"**

**March 16, 1998**

My name is Gael M. Carter. Thank you for inviting me to appear here today to share my experiences. Thank you also for your patience while I read my statement. I have asthma and blurred vision. It is hard for me to read things close up.

I am 55 years old. When my husband died in 1992, I was left with the house in which I have lived since 1963. It is in this home that I raised my four children, two step-children, an adopted daughter and a ~~foster child~~. At the time of my husband's death, I had about $150,000.00 in equity in my house. My house is the only thing of value that I own.

I have a ninth-grade education. I last worked in 1978 as a night cleaning lady in a movie theater. I had to quit working because of high blood pressure, liver trouble and other health problems. Now I get by primarily on Social Security payments.

Starting in 1994, I was taken advantage of by a financial services company. It all began when I bought a toy car as a gift for my son. I took out a small loan for about a thousand dollars to pay for it. It turned out that the loan was from a company that makes its business out of tricking people like me. Over the next year, they kept giving me advice on my finances and getting me to take out loans with them. Every time, they told me they were going to put my finances in order and consolidate all my bills, and that just wasn't true. By the end of January 1995, I owed them payments totaling $328,322. I was scared to death I was going to lose my home.

After I bought the toy car, this company kept calling me all the time. They told me that they knew about the loan for the toy car and that they knew I owed some other bills. They kept calling and telling me that they could consolidate my bills and save me quite a bit of money per month. This woman from the company took an application for a home equity loan over the phone; later she came over to my house with all the papers for me to sign. She was leaning on the table and pushing papers at me fast, when I first heard the word "insurance". There was a $100,000 life insurance policy included in the loan papers, even though I had never asked her for insurance. When I asked about the insurance, she told me I had to have it. She told me that it would pay off the loan and have something left over to raise my daughter if I died. As I came to find out later, she didn't tell me a lot about the insurance, including that I would be paying finance charges for the cost of the insurance over the entire 15 years of the loan, even though the insurance was only good for 10 years.

When the papers were signed, it turned out that this loan didn't pay off my bills. The company told me not to worry about this, and that after I had the loan for a few months, I could come back to them and "re-up" the loan for the extra money

I needed for my bills. After this first loan, the company still kept calling me on the phone and sending me mail about borrowing more money, and so it was arranged that I would do a new loan the next month. The second time around, they again charged me for $100,000 in life insurance and told me that if I died the money would go to my estate. Again, they told me I had to have the life insurance to get the loan. As with my prior loan, I told the woman at the company about my serious health problems. A2s it seemed to me that my health problems might present a big problem in the insurance ever paying off. The woman from the company didn't care about the health problems, though, and she went right ahead and checked all the boxes on the form to show that I didn't have any health problems. She said that she was a manager at the company and could take care of things so I shouldn't worry. I was told that I wasn't going to be charged any points or fees for redoing the loan.

After the second home equity loan, I kept getting things in the mail from this company, as well as phone calls. It seemed like every time I opened the mailbox, there was something from them. They sent me these checks, telling me I was cleared for $3,000 in credit or $1,500 in credit, and all I had to do was cash the check. They were always telling me that I was a good customer and my credit was good with them. Finally, I cashed one of them to buy Christmas presents.

My third home equity refinance with this company started in late fall of 1994. Besides all the phone calls and mail from the company, I had been talking to the company's branch manager about trying to get the due date on the loan straightened out. In all of the phone calls with the company, the people from the company would act really friendly, asking about my kids and things like that. They always acted like they were family friends. This friendliness is one of the main reasons that I came to trust them so much. So, this woman from the company was telling me about how we could go about getting all my credit cards paid off finally. She said that to do that they would have to have a first mortgage on my house. This concerned me, because it would mean that I would have to pay off my existing mortgage of about $50,000 at the very low interest rate of 6.77% and almost double the interest rate through the new loan with the company. I didn't think this was such a good idea, but the woman kept talking to me and assuring me that this was the best way to go because my total monthly payments would be lower. She never said anything about points on the loan. She said that I had to have the credit life insurance, though, on the loan. I eventually went along with her suggestion and she arranged for me to take out another loan in early 1995. This time around she had my daughter and son-in-law co-sign on the loan papers.

After she got me to sign the paperwork for this loan, I started noticing that some things were wrong. At a certain point I made my mind up to go to a lawyer to get help. I started trying to figure out all the paperwork and where all the money had gone. As a result, we got the company to re-do the loan and

I got some of the money back that they had charged me for points. By the time of the third home equity loan for $154,500 they had charged me $17,848 in points, as I later found out.

I then spent the next year and one-half trying to get out from under this company. You see, I thought that a company that could lie to me as they had was capable of just about any kind of trickery. I was worried to death the whole time that the company was going to come after me somehow and take my house. With my health situation, I have enough worries on my mind anyway. I finally got some help from a regular lender to get me away from the company.

You see, I now know that the way this company gets you to take out all these loans and buy all the insurance and extras is that they tell you some lies and they just don't tell you anything at all about a lot of things. When it comes time to sign the loan papers, they just sail right through them. When you arrive at the closing, they've already prepared all the papers, with the life insurance and the points and extras added on. At the closing, they point at this and that in the papers but they don't explain really what any of it means. There's a whole lot of fine print in the papers that even now I just don't know what it means. At the loan closing, they don't give you any chance to figure it out. They don't want you to understand what's going on. And since they always act so nice and friendly, you come to trust them and rely on them to tell you all the important information about the loan.

What the company had told me over the phone about what they were doing turned out to be a lot different from what they did, as I found out later. They told me that they weren't going to charge me any points on the loans, but they did -- every time. They told me that I would have a fixed interest rate; I later found out that on the one loan it was variable. Later, I found out that the $100,000 credit life insurance that they made me buy with every loan decreases over the length of the loan and doesn't even cover the whole length of the loan. Also, because of my health problems, the company probably wouldn't pay anything on the insurance anyway. The insurance was all a scam so that the company could make money off me.

And that's not all. One of the pay-off checks on the third equity loan was supposed to go to the friend who held my $50K mortgage. I knew I hadn't signed the check for her so I called her up to let her know that. She told me that the check had already been signed. In fact, they forged my name on nine checks that were supposed to be pay-offs to my creditors from the third equity loan. They also forged my initials on a health questionnaire for the life insurance, saying I didn't have any health problems when they knew better.

As things started to get a little clearer for me, I was talking to my children and telling them about how I had been taken by this company and, I found out that my daughter-in-law had also been a victim of this same company.

I felt that if they did this to me and my daughter-in-law, they did this to a lot of other people and they should be called to account for it. I am now a plaintiff in a class action lawsuit against the company that did these things to me. I hope that as a plaintiff in the class action I can make a difference by getting justice for myself and all the other people who were hurt by that company. The class action has given me the chance, which I wouldn't have on my own, to do something about this problem. I also hope that by appearing here today I can help put an end to this kind of fraud.

The CHAIRMAN. Even though Ms. Carter cannot hear us, I thank her very much for her testimony, particularly, because she is in the hospital. I know she feels strongly about it, because it is not the best way for her to be able to testify.

We will now go to Ms. Arthur. Thank you for participating.

## STATEMENT OF VIRETA JACKSON ARTHUR

Ms. ARTHUR. Good afternoon. My name is Vireta Jackson Arthur. My parents are Ormond and Rosie Jackson. My mother passed away in December 1996, and my father is too ill to come here today to tell you what happened to them beginning in August 1990. My parents were victims of a home improvement mortgage foreclosure scam that left them penniless, traumatized and humiliated.

Both of my parents were retired at the time, and my father had to start looking for work again. He did odd jobs in the neighborhood, like sweeping out the corner bakery. They had to take boarders, complete strangers, into their home to try to make ends meet.

My father is from Barbados, and my mother was from Virginia. They came to new York and were married in the 1950's. They were hardworking people and saved their money to buy a house one day. My mother worked as a hairdresser and later for a laundry service. My father worked for a plastics company. They bought their home in the Crown Heights section of Brooklyn, NY, in 1970. We were happy in our home in Brooklyn.

But a knock on my parents' door on August 27, 1990 changed all that. A man by the name of Jimmy knocked on my parents' door that day. We later learned that Jimmy worked for GML Construction Company, a home improvement company in Brooklyn. Both of my parents were home at the time.

Jimmy told them that he noticed that they needed new windows. My parents told Jimmy that they did not have the money for new windows because they were both in their late 60's, living on a fixed income of Social Security, of $635 per month combined. Jimmy told them not to worry about that. He said they could pay for the windows at a cost of $43 per month over a 15-year period.

Jimmy never told them about a mortgage. My parents were honest, hardworking people, not very sophisticated in the business world. They thought that Jimmy was a nice young man, and they trusted him. They never thought the day would come where they would be in jeopardy of losing the only thing they had left—their home.

Before all of this happened, my parents had a mortgage of $10,800 left on their house. Their monthly payment was only $235 per month.

A few days later, Jimmy came back to the house. He told my parents that for a few extra dollars a month, he could renovate their kitchen and bathroom, along with putting in new windows. My parents were excited about fixing up the house and agreed. They shook Jimmy's hand and waited for the next step.

A week later, on September 6, 1990, Jimmy took my parents to an office someplace in Brooklyn to sign some papers. My father asked if he had to have a lawyer, but Jimmy said that he should not bother with that expense and that the papers were just a formality to get the work started. My parents had to sign the papers really fast and did not have time to read anything. Since Jimmy said it was just a formality, my parents went along with it.

There were several people at the meeting, but my parents did not know who anyone was. They only knew Jimmy. Of course, they had signed a first mortgage on their home for $75,038.79 at an interest rate of 17.71 percent, with monthly payments of $1,156.22, with hard-money lender named The Associates. The closing costs were high. They had to pay $6,500 in points and $3,538 for a credit life insurance policy.

The next month, my parents received mortgage coupon books and were shocked to learn that they owed $1,156.22 per month to The Associates. Their new mortgage payment with The Associates was practically twice the amount that they received in Social Security benefits each month. They were stunned. They felt too embarrassed to tell anyone, believing that they had been duped. They started making the monthly payments.

After just a few months, they telephoned The Associates because they were worried that they would not continue making these monthly payments for very long. They were told by The Associates that they could refinance the new mortgage and get more money to help with the monthly mortgage payments.

Feeling desperate about not being able to meet their new mortgage payments, and too embarrassed to tell anyone that they had been tricked by this home improvement scam, they agreed to refinance and close on a new mortgage on April 2, 1991, just 6 months after they had signed paperwork for the first mortgage. The Associates told my parents that the refinance would help them with their new mortgage payments.

They were distraught, could not afford an attorney, and barely had enough money to eat. They believed they had no other choice. But before the refinance with The Associates in April 1991, my parents did try to refinance their mortgage with a legitimate lender. They learned that given their income, they did not qualify for a mortgage of this magnitude.

I am still puzzled how The Associates qualified my parents, who live on Social Security, for a loan this size, when no one else would qualify them. The Associates' loan documents show that my parents received rental income from two tenants. They did not. But I found two leases in my parents' mortgage papers with The Associates showing that my parents received rent from two different tenants of $1,575 a month. The house is only a two-family house, and my parents lived downstairs. There is only one apartment to rent out. My parents had one tenant, and she paid, although not every month, $300 in cash. There was never a lease.

It is my opinion that these were forged leases, so that on paper, it would look like my parents had sufficient income to qualify for The Associates mortgage. I saw the signature on the lease and showed it to the tenant. She said that the signature on the lease was not hers and that it was definitely a forgery.

Having no other choice, on April 2, 1991, my parents refinanced with The Associates. The new mortgage amount was $87,971.99, with an interest rate of 15.92 percent. The monthly mortgage payments went up to $1,237.47 a month, which is $81.25 more per month than the first mortgage with The Associates. Again, the closing costs were high, the points were $7,500, the credit life insurance premium was $5,472.

Incredibly, in February 1994, The Associates again contacted my parents about still another refinance. I have an internal document from The Associates with a written comment dated April 6, 1994 that reads: “Elderly couple, both on Social Security. Have boarders. Finding it hard to scrape up payments each month. We suggested refinance, but daughter advised family against it. Cooperative people. No equity in property.”

My parents paid The Associates from October 1990 to September 1995. They paid almost $68,000 in mortgage payments over this 5-year period. To this day, I do not know how they got the money. My father took odd jobs in the neighborhood to try to scrape up the money. He worked sweeping out the bakery and did other odd jobs. They borrowed from family and friends. They took in boarders.

When they were late in their payments, a man by the name of “Mr. B” would come to the house for money. If they were not home, he would wait on the stoop. After 5 years, they were completely tapped out and could not afford the payments anymore.

Then, in February 1996, my parents were served with foreclosure papers. They were distraught about losing their home, the only thing they had left to their names. They were so frightened, they refused to open the mail. That is when they called me and told me the whole story.

I contacted literally dozens of legal services organizations to help my parents with the foreclosure. We wrote letters to the banking department and consumer affairs. No one would help. Finally, we found a lawyer who agreed to represent my parents in the foreclosure action. The case is still pending, but at least the foreclosure action was stopped, and my parents have not lost their home yet.

This whole ordeal has been a nightmare for my parents. Although my mother was not in perfect health, I am convinced that the whole ordeal contributed greatly to her death in December 1996. She started smoking again. They received foreclosure papers in February 1996, and my mother died later that year, in December. My parents were so traumatized that they were afraid to even open the mail. They would hold the mail and call me to open it for them.

We can only hope that something can be done to stop these predatory lending practices. Since this happened to my parents, I have learned that the same thing has occurred to many elderly people by the same lenders. It is clear to me that they purposely select the elderly to prey upon.

Thank you.

The CHAIRMAN. Thank you, Ms. Arthur.

I would ask staff to start the clock, and we will each have 5-minute rounds. I will begin.

Ms. Ferguson, first and most importantly, did anyone ever tell you that by entering into a loan that you could lose your home?

Ms. FERGUSON. No, they did not, not until December 1995. A lady from the mortgage company called and told my sister that she would send packing boxes out there if she did not receive the one late payment soon.

The CHAIRMAN. You and I come from a generation brought up in a time when a handshake, not having a bunch of lawyers around, established the trust needed to do business. How did the lenders you dealt with manufacture this sense of trust with you? I sense you trusted them very much.

Ms. FERGUSON. They all just acted like they were on my side and interested in my well-being and wanted to keep everything from being a strain on me. The mortgage company said they could help me out with any problem I had. They also sent Christmas cards to me and my sister. They came out to my house and said they were going to make things easier for me, that they were there to help people that needed help people who needed help. I trusted them.

Greg called my sister "trouble" because she was a little hesitant about signing. He said, "We treat you like one happy family." It sounded like they were honest, good people, and I trusted them. The mortgage company sent me a personal letter with my personal I.D. card to show that I was a special customer.

The CHAIRMAN. From your testimony, it sounds as if experiences that you have related to us have been very traumatic. Would you tell us what impact this has had on your physical and emotional well-being?

Ms. FERGUSON. I was already having problems with hypertension, pressure, and the doctor told me not to get emotionally stressed out. After 1996, when the mortgage company went up on my note instead of giving me the contract that they promised me, I worried all the time, and my health started going bad. I had headaches and dizzy spells.

In June 1996, I found out that my sister was added to the title and my deed, and I got very upset and depressed, and I did not know what to do. I came to legal counsel to take care of my deed. They looked at my papers and told me that I had mortgage problems. I was already paying high payments, and if anything bad happened to my house, I did not know how I would pay for it. I worried because I did not know how I got myself into this.

The CHAIRMAN. Thank you very much.

Ms. Arthur, your parents' bad experience started with a knock on the door from a home improvement person who wanted to sell windows. Did they get their windows?

Ms. ARTHUR. They got their windows, but they did not work for long.

The CHAIRMAN. They also had some work done on their kitchen and bathroom. How did that turn out?

Ms. ARTHUR. It was all substandard, fell apart a year later; everything basically fell apart.

The CHAIRMAN. If you can speak for your parents, were they satisfied with the work?

Ms. ARTHUR. No, they were never satisfied.

The CHAIRMAN. How did you learn about your parents' financial difficulties?

Ms. ARTHUR. After they had been foreclosed upon, they decided to tell us the whole story. We knew there was something going on, but we did not know quite what.

The CHAIRMAN. Why do you think it took so long for them to tell you what was happening to them?

Ms. ARTHUR. They were extremely embarrassed. They thought they could fix it themselves, and they just wanted it to go away. They did not want anyone to find out.

The CHAIRMAN. As I asked Ms. Ferguson, I would appreciate it if you would tell us what impact this traumatic experience has had on your parents' physical health and emotional well-being.

Ms. ARTHUR. It totally ruined their quality of life. My dad is very ill, and my mom passed away. Before she died, my mom would sit at the window; she was afraid to come out, because she thought someone would be sitting on the stoop, waiting for money. It just totally ruined her life.

The CHAIRMAN. Obviously, we are very sorry to hear about the death of your mother. Your parents were married for over 40 years. You say your father is not very well, and that stems from this as well?

Ms. ARTHUR. He is a diabetic, and he has suffered greatly because of this.

The CHAIRMAN. I thank both of you.

Before I call on Senator Breaux, I did not recognize Mr. Swindell, who is an attorney for the Fergusons. We thank you very much for coming and for helping her with her testimony.

Mr. SWINDELL. You are very welcome, Senator.

The CHAIRMAN. Senator Breaux.

Senator BREAUX. Ms. Ferguson, it is just exhausting to hear your story. You have had to live it, and it is exhausting for me just to listen to all the things that you have been through. There is an old saying back where I come from that sort of applies to your situation, and that is that "The further you went, the behinder you got." You just never could get out of it.

I think it is clear that many of these equity predators are really not making loans to have people pay them back. I do not think they want people to pay the loans back. What they are looking for is the house and the home.

Ms. Arthur, I think your situation with your parents is very clear. I was looking at the notes and the loan application filled out by the person who dealt with your parents, and it said, "Elderly couple, both on Social Security. Finding it hard to scrape up payments each month." And yet they made them a loan of $99,000. They knew they would never be able to pay that back, but they had a house that looked pretty tempting for the people making that kind of a loan.

The note here says they have boarders. Did they have boarders in the house?

Ms. ARTHUR. Eventually, they had to, to be able to make the payments.

Senator BREAUX. But at the time of the loan application, did they have people paying them?

Ms. ARTHUR. They had no boarders. They were fine at the time.

Senator BREAUX. Well, I just find all of this truly amazing. It is very hard for Congress to legislate decency. I just cannot understand how someone could go home at night after doing this all day long and sit down and think about what they did for the day and be able to continue to live with themselves. It seems to me that these situations are unfortunately becoming more and more common.

Seventeen percent interest rates, 19 percent interest rates, 31 percent interest rates, $7,000 fees on relatively small loans—if they do it for someone who has a law degree and an accounting degree, that is one thing, but to do it to people like Mrs. Ferguson here and your parents is really an example of the very worst in society.

I am glad we are having the hearing, Mr. Chairman. I am not sure what approach we need to take from here. Like I said, it is very difficult to legislate decency, but I think that an informed public and the work of the Federal Trade Commission as we will hear, informing citizens, and through associations like AARP and others that are trying to inform their members—we do not need anymore situations like Ms. Ferguson's. Ms. Ferguson, we are glad you are still here and still fighting them and not giving up. Do not do that.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Breaux, I want to assure you that the purpose of these hearings is to expose the problem and for all of us to find out if anything at all needs to be done, but at the very least, I can already conclude that the public needs to know more about equity predators preying on people who, in a sense, do not have a prayer—at least after they get done, they do not.

Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

I want to start by thanking Ms. Arthur and Ms. Ferguson for coming forward today with your truly heart-wrenching, terrible stories. My hope is that by your willingness to talk about your families' experiences and your own experience in the case of Ms. Ferguson, that others who might be trapped in the same kind of situation can avoid what happened to you.

Ms. Arthur, I want to ask you a couple of questions. I was struck as I listened to you that one of the most tragic things about your parents' situation is that it seems like it could have been nipped in the bud if they had sought out advice or help when they first discovered that their monthly payment was over $1,100 a month rather than the $43 that they were expecting. I think you testified in response to a question from Senator Grassley that they were very embarrassed about it, and that is why they kept it to themselves.

Do you think that we could do more as a society to educate people like your parents about financial matters, to give them more financial counseling so that they would have had a place to go to run this by someone or to get some help?

Ms. ARTHUR. To begin with, they never knew that they were signing a mortgage. They thought it was just formality papers to have work done on the house. So I do not think that that would have helped them, but I think it would definitely help others.

Senator COLLINS. One of the other parts of your testimony that struck me and disappointed me is that you said you went to some legal services organizations, and you were seeking out someone who would help you. I am stunned that nobody referred the case to law enforcement officials, because in your parents' case, it seems to be outright fraud; it truly does.

Now, in the audience today is the head of the Consumer Protection Bureau of the FTC, who is a very fine person, and I know she does a good job. I hope that she will review both of these cases to see if there are violations in the Truth-in-Lending Act which the FTC is responsible for, or other Federal laws.

It distresses me that no one at first gave you any help. Did you tell people the full story and the forgery part of the application and the other information and, as you said, that your parents had no idea that they were actually getting a mortgage?

Ms. ARTHUR. I told them, but by then, it was years later. I think if it had been at the onset of it, people would have been more interested, but by then, they were, like, too bad.

Senator COLLINS. Did you ever find out the connection, Ms. Arthur, between the home improvement company and the mortgage company?

Ms. ARTHUR. The home improvement company gets a finder's fee from the mortgage company. That is the connection.

Senator COLLINS. That is very helpful for us to know, because perhaps that is an area where there should be some additional regulation or some sort of standards put in place.

Ms. Ferguson, let me ask you a couple of questions as well. I notice that from 1991 to 1996, you went from having loans on your home of less than $20,000 to having a loan of more than $85,000, and during that period, if I counted right, I believe you had five new loans. Now, you testified that some of the money from the first loan was used for home improvement purposes. Could you tell us what the rest of the new loans were used for? In other words, did you actually get new money that you could use to buy things, or did the new loans just replace the old loans?

Ms. FERGUSON. All the money I got together I believe was less than $25,000. I got, like, $3,000 and $2,000. It was not a big lump sum, not from these people, Lenders B and C.

The CHAIRMAN. I think you need to emphasize that. She got just $25,000 out of an $85,000 loan.

Mr. SWINDELL. Senator, just to clarify, she took out a succession of five loans, and I believe in the first one, she received around $6,000 on a $15,000 loan. As the loan amounts increased to $25,000, $54,000, $67,000 and $85,000, she received less and less cash each time. So it is not as if she actually got $25,000 from one $85,000 loan; but she got only $25,000 from a succession of five loans. I think that that is a much different situation.

The CHAIRMAN. Yes.

Senator COLLINS. So she got less cash and deeper in debt each time.

Mr. SWINDELL. Exactly.

Senator COLLINS. Thank you.

I see my time has expired——

The CHAIRMAN. Do you have another question?

Senator COLLINS. Thank you, Mr. Chairman. I have just one more that I would like to ask Ms. Ferguson.

Ms. Ferguson, were you told certain things by the mortgage company about certain incentives—what were you told or offered, or what promises were made to you that led you to agree to these loans? The reason I am asking this is because I want others to be on alert for similar false promises. So if we could hear what you were told, maybe we can help some others.

Ms. FERGUSON. They promised to lower the monthly payments and the interest rates. They did not do what they promised. The note on the house went up each time.

Senator COLLINS. So it sounds to me like you got a lot of promises that turned out to be outright lies.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Our staff who was present at the taping of Gael Carter followed up with two questions to her that I would like to have her respond to, once again by video, from her hospital bed.

Ms. DISANTO. I just want to thank you for appearing before the committee. We have two main questions that we would like to hear your answers to.

If you had known how much money in up-front finance charges or points that you were paying on each loan, do you think that you would have continued with these loans?

Ms. CARTER. No, ma'am.

Ms. DISANTO. My last question is: From your testimony, it is apparent that this experience has been very traumatic for you and your family. What impact has it had on your physical and emotional well-being?

Ms. CARTER. It has had an awful lot on my physical well-being, because I worried myself sick that they were going to figure out a way, after I got an attorney, to take my house away from me. I just got sicker and sicker, and I was up in the hospital for 3½ months, paralyzed for months, was in a wheelchair. I just cannot do anything I used to do anymore.

Ms. DISANTO. Ms. Carter, I want to thank you on behalf of the Committee on Aging, on behalf of the Senators, and on behalf of the public for sharing with us this experience.

Thank you very much.

Ms. CARTER. Thank you.

The CHAIRMAN. We are done with this panel now, and once again I thank each of you for participating, and Ms. Carter from the hospital bed as well.

And Mr. Swindell, I acknowledge you as well, and I forgot to say that you are doing your work pro bono. We want to thank you for going the extra mile to help Ms. Ferguson.

Mr. SWINDELL. Well, I believe we need to increase our protection for the elderly in this area, so I am very happy to be a part of this hearing.

The CHAIRMAN. Thank you all for coming.

Senator BREAUX. Mr. Chairman, could I ask Mr. Swindell one question?

The CHAIRMAN. Of course.

Senator BREAUX. You have seen this case. What is not in the law that should be in the law to provide more protection for people like Ms. Ferguson? Is there something we can do legislatively that would make it easier for people like Ms. Ferguson?

Mr. SWINDELL. Well, I think what you have seen here is that the creditors take advantage of people who are not very sophisticated borrowers and who need assistance. I know that we have investigated the possibility of a reverse mortgage to get Ms. Ferguson out of this situation, and we have learned that in order to obtain a reverse mortgage, borrowers must go through credit counseling with an independent individual. I think that if it is possible to provide some sort of assistance to elderly Americans wherein they would be required to go through some sort of credit counseling with an independent individual, like in the reverse mortgage situation, that would be very helpful. If we require it in a reverse mortgage situation, why do we not require it in a regular mortgage situation where there is just as much opportunity for lenders to take advantage?

Senator BREAUX. Well, the committee thanks you very much for your contribution.

Mr. SWINDELL. Thank you.

Ms. ARTHUR. Can I make one quick comment?

The CHAIRMAN. Please do.

Ms. ARTHUR. My parents' attorney, Lynn Skully, who is here with me, is also working pro bono.

The CHAIRMAN. We should recognize that yes. Would you stand, please? Thank you very much. Thank you for giving us that information as well, Ms. Arthur.

Our second panel will consist of one person, a former employee of the subprime lending industry. He is here today to give us an insight and perspective on these predatory lending institutions.

"Mr. Dough," as we will call him, is prepared to discuss several aspects of the operation and activities of the subprime lender that employed him for several years. While he is no longer employed with that lender, he has asked for anonymity in speaking with us at this hearing since he still works in the industry.

At this point, I would ask that all cameras be turned away from our witness as he comes out so that his face will not be shown on television. I would appreciate that, both during the time he is at the witness table as well as that time as he comes out.

We are now prepared for our witness, Mr. Dough, to come out and to be at the table.

Senator BREAUX. I think it is interesting, Mr. Chairman, that you have spelled his last name, "D-o-u-g-h."

The CHAIRMAN. We now have Mr. Dough here in front of us, and we would ask that he give whatever testimony he wants to give, and then I will have questions, and I assume Senator Breaux will have questions.

Please proceed, Mr. Dough.

## STATEMENT OF "JIM DOUGH," FORMER EMPLOYEE OF A PREDATORY LENDER

Mr. DOUGH. Certainly. Good afternoon.

Thank you for inviting me to share my experience as a finance company employee. I have worked for finance companies for more than 7 years, and my testimony is based on my experience as an employee of three of this country's largest finance companies. Because I still work in the finance industry and fear retaliation, I do not wish to reveal my identity; however, everything I say today will be true.

During my employment with finance companies, I have served as a finance officer, assistant branch manager and branch manager. I have worked at several different branches and under the supervision of many different managers and supervisors. I was responsible for supervising branch employees, making arrangements with retail dealers for installment loans, contacting prospective and current customers, making loans, servicing loans, and collecting loan payments from delinquent customers.

Finance companies try to do business with blue-collar workers, people who have not gone to college, older people who are on fixed incomes, non English-speaking people, and people who have significant equity in their homes. In fact, my perfect customer would be an uneducated widow who is on a fixed income, hopefully from her deceased husband's pension and Social Security, who has her house paid off, is living off of credit cards, but having a difficult time keeping up with her payments and who must make a car payment in addition to her credit card payments.

The finance companies I have worked for use three primary methods to obtain new customers. First, they often send guaranteed loan vouchers to potential customers. These vouchers, also known as "live checks", permit someone to obtain a loan between $500 and $3,500 simply by either stopping in at the nearest branch or signing the back of the check and depositing it at a bank.

Second, finance companies often run different types of promotions using the mail to seek business from new customers. Sometimes the companies offer contests and prizes to entice new customers to take out loans.

Third, finance companies obtain many of their customers by participating in retail sales installment loans. The finance companies arrange to do installment financing with local retail dealers. When a retail customer wants to finance the purchase of a stereo, for example, the finance company, rather than the retail dealer, actually makes the loan and gains a new customer.

When a finance company obtains a new customer through one of the methods I have just described, it receives information about the customer's credit history, employment, income, home ownership and debts. As soon as the finance company makes that retail loan, for example, a branch employee reviews information about the customer, works up a financial plan and contacts the customer.

Although we would tell customers that we were calling to see if they got their merchandise, the real purpose of the call was to solicit the customer into converting the retail installment loan into a more profitable personal loan or home equity loan.

Going into the call, since you already have all the information on the customer, you can go ahead and work out a payment plan, payment options, bill consolidation plans, or home equity plans. We call this the "up-sell", and our goal was always to up-sell to the biggest loan possible. The conversion of a retail installment loan, live check or other small loan into a personal or home equity loan is also known as a "flip."

To flip one of these small loans into a personal or home equity loan, we were trained to sell the monthly "savings"—that is, how much less per month the customer would be paying off if we flipped the loan. In reality, the "savings" that we were trained to sell to the customers were just an illusion. The uneducated customer would jump for the "savings," thinking that he would have more money to buy other things. What the customer would not figure out, and what we would not tell him, is that he would be paying for a longer period of time and, in the end, would pay a whole lot more.

Finance companies require branch employees to make contact every 3 months with customers to prevent payoffs and up-sell to bigger loans. At some of my branches, we tried to call every one of our real estate customers at least once a month. The purpose of these contacts was to slip as many loans as possible. Our tactic was to try to gain the trust and confidence of the customer.

We typically began a telephone solicitation by asking if there were new events in the customer's life that called for additional money. We were trained that we should always ask the customer if he or she needed more money. For our home equity customers, we stressed that the interest on the loan was tax-deductible. Because the terms of those loans did not usually exceed 15 years, we told customers that they could retire earlier, because their house would be paid off sooner. For our debt consolidation customers, we stressed that they could take the money that they were saving in their monthly payments and invest it in a mutual fund.

The term "flipping" is commonly used by finance companies. In my experience in the industry, flipping was a common practice. We were instructed and expected to flip as many loans as possible. One of my supervisors imposed a daily requirement that each branch employee obtain at least two applications from present borrowers to refinance their loans. In other words, each branch employee was supposed to try to flip at least two loans per day.

When I served as a branch manager, increasing the number of refinance loans was a frequent topic at branch manager, district and statewide meetings. Among the things we were taught at these meetings was to target blue-collar workers for loan flips. We were also told to target present customers who were delinquent on their loan payments. Delinquent customers made good flipping candidates, because we could put additional pressure on them. We were instructed to tell those customers that they could either bring their account balance current or refinance their loan. We knew that these customers would almost always agree to refinance, because they did not have the money to pay on their current loan and did not want the finance company to institute foreclosure or collection proceedings.

We were also told to target personal loan customers whose terms had less than 6 months remaining and customers who owed less than 50 percent of the original principal balance on their loans. I recall one of my supervisors saying that there is a point in each loan when the customer starts to pay a significant portion of principal instead of mostly interest. We were supposed to try to get the customer to refinance at that point in the loan term.

Flipping loans allows finance companies to charge customers points, that is, a percentage of the amount borrowed, on each real estate loan conversion or renewal. The practice is to charge the maximum number of points legally permissible for each loan and each flip, regardless of how recently the prior loan that was being refinanced had been made. The finance companies I worked for had no limits on how frequently a loan could be flipped, and were not required to rebate any point income on loans that were flipped.

"Packing" is taking insurance products—as many as you can—putting them on the loan and then trying to cover them up or gloss over them. Packing is shoving as much insurance onto the customer as possible without the customer's knowledge or without the customer's understanding.

We attempted to pack insurance during our very first pitch to a new customer. For example, we were trained to tell a new retail installment customer that we had reviewed the customer's financial situation and could offer the customer a debt consolidation loan that would save the customer money by reducing the customer's monthly payments to creditors. The sales pitch would be substantially similar to the following: "Mr. Smith, in reviewing your loan application, I see that you have a lot of credit card payments. What if I could save you $550 a month through consolidating your debt into one loan?"

I was taught that the most effective way to sell insurance was to always include insurance products in this quote without telling the customer that my monthly quote included insurance. I was taught that I should always include as many insurance products as possible in the monthly payment quote so long as I could quote a figure that would be less than the customer's current outstanding debt obligation.

Using that method, if the customer did not express interest in my initial quote, I could eliminate one insurance product without telling the customer that I was doing this, and give a quote for an even larger monthly savings.

For example, if the customer rejected my pitch to save him $550 a month, I would eliminate one insurance product and respond: "Suppose I could save you $600 a month?" Usually, the more naive the customer, the more insurance I would pack on the loan before I made the initial monthly payment quote. This tactic was very effective with immigrants and non-English-speaking people.

Do not be fooled by training manuals. The manuals are written for regulators and auditors, but finance company employees are trained to ignore the manuals if they expect to make their profit quotas and keep their jobs. For example, even though my training manuals discussed quoting a monthly payment both with and without insurance, I was trained by my supervisors that unless my conversation was being audited, I should ignore the manuals and always quote the monthly payment on a proposed loan with insurance, unless the customer specifically asked what the cost would be without insurance.

The tactic we used at all the finance companies I worked for was, "If the customers do not ask, do not tell." I heard this phrase often from many of my managers and supervisors.

The "do not ask, do not tell," policy was successful because customers were not aware until closing, if at all, that the loan included insurance. Once the customer indicated that we could schedule a closing regarding the loan proposed in the telephone solicitation, we merely presented the loan documents with insurance included, even though insurance had not been discussed previously.

Through their training and experience, finance company employees know that customers are often desperate for the money and usually will not object to the insurance once the loan reaches closing. If customers objected to the insurance at closing, we would add more pressure by telling them that if they wanted the loan without insurance, it would be necessary to redo their loan documents, and the closing would need to be rescheduled for a later date. That was a half-truth. We could redo the loan documents in only a few minutes. It was not really necessary to reschedule the closing for a later date, but we knew that customers would be more likely to cave in and accept the insurance if they thought they could not get the money that day. In my experience, this was usually enough to persuade the customer to go through with the closing and take the insurance.

When insurance was to be included with the loan, our computer programs automatically calculated the maximum amount of insurance as provided by State law. The amount of insurance coverage on the loan was never arrived at through negotiation with a customer.

Insurance sales are very important to finance companies. My supervisors often used phrases like "Insurance drives profits". One of my supervisors said that insurance was more important to our company's profitability than its spread on interest rates.

Because insurance sales are so important to the bottom line, finance companies require that their employees meet goals and quotas regarding insurance. Insurance sales are tracked by dollar volume, penetration rate and premium-to-volume ratios. For example, one of my employers required that its branches maintain an 80 percent penetration rate for credit life. That is, employees were expected to sell credit life insurance in at least 8 out of every 10 loans. My employers made it clear that I would not keep my job unless I fulfilled my insurance sales quotas.

Finance companies also provide additional rewards for employees who meet or exceed their insurance sales quotas. All of my finance company employers had a quarterly bonus system. Part of my bonus depended on whether my branch met its insurance sales quotas. All of my finance company employers also ran quarterly insurance sales contests. We would be eligible for contest awards if we exceeded quotas regarding insurance penetration and insurance sales volume.

I am glad that I no longer work for a finance company. If they want to keep their jobs, finance company employees must flip and pack loans. They are under enormous pressure to meet quotas regarding loan volume, repeat business and insurance sales. In fact, the pressure to produce loan volume and insurance sales is so great that on many occasions, I have seen finance company employees commit forgery on a massive scale. These employees have forged everything from insurance forms, RESPA documents, income verification forms, and even entire loan files.

These practices have always disturbed me, and I hope that something can be done to make finance company customers more aware of these practices so that they can keep from becoming victims of flipping and packing schemes.

The CHAIRMAN. Mr. Dough, we appreciate very much your taking the time to come here and give us the inside scoop on how this system of fleecing elderly people out of the equity in their home works.

In your testimony, you discussed the types of customers targeted by finance companies. Why do they target blue-collar workers?

Mr. DOUGH. Our entire sale is built on confusion. Blue-collar workers tend to be less educated. I know I am being very stereotypical, but they are the more unsophisticated. They can be confused in the loan closings, and they look to us as professionals—they look to us as not only loan professionals, but as professionals who can handle their bill and their incomes as total financial representatives. That is not it. The majority of us are not college-educated. We start doing this 2 days after we are hired on in these companies. We do not have the formal training that they expect us to have. So they are more trusting toward us.

The CHAIRMAN. You also targeted people on fixed incomes. Why? And can I ask whether, by targeting people on fixed incomes, you are aware that finance companies are targeting a large segment of our elderly population?

Mr. DOUGH. I am very aware that we are targeting the elderly, and the reason why it is successful for finance companies to target these people is because they have less of a choice in where they go for the loan product. It is much easier, if you have a full-time job and disposable income, to get a loan from your local bank; whereas we can save them $100 a month and close the loan within a week. That is all they are looking for.

When you are talking about fixed incomes, you are talking about minimal incomes, also.

The CHAIRMAN. Yes. And you also targeted people with equity in their homes. Why?

Mr. DOUGH. Again, a couple of different reasons. You want as much equity as possible so you can get the biggest loan. The more equity, the more fees, the more points you can charge, the more bills you can pay off, and the more times you can flip that customer.

The CHAIRMAN. People having problems making ends meet with their present debt obligations are another group that was targeted. Why would you want to lend money to people who are already having a hard time keeping up with their debts?

Mr. DOUGH. Desperation. Those people are desperate. They will sign at whatever rate you give them and however many points you give them.

The CHAIRMAN. Can you describe for us the role of the corporate office—in other words, do they put pressure on individual employees and branch offices? If so, what kind of pressure, and what form does that pressure take?

Mr. DOUGH. The pressure directly on the employees from above? Many times in my years with finance companies, I have been told: Either you do it this way, or you find another job. The big one is: If you cannot do it, we will find somebody who will. And this is a constant, everyday thing, where if your numbers are not where home office or upper management wants them to be, then you are done, you are fired.

The CHAIRMAN. You mentioned that at times, documents are forged. Could you describe for us what types of documents are forged, and why they are forged?

Mr. DOUGH. All different types of documents are forged, from W–2's and pay stubs so you can get a loan approved, to RESPA forms and loan papers. You do that so you can get by the auditor, or you can even forge entire loan packages; insurance questionnaires—if you know somebody is not going to qualify for insurance, but you need the insurance to meet your quota, you do not ask them the questionnaire. You go through and do it after the loan.

The CHAIRMAN. The forgery also involved signing people's names?

Mr. DOUGH. Yes.

The CHAIRMAN. You did that?

Mr. DOUGH. Yes.

The CHAIRMAN. That obviously is illegal, where a lot of the other practices might be unethical and immoral, but not necessarily illegal.

Mr. DOUGH. Yes, sir.

The CHAIRMAN. Did you know at the time that you were breaking the law by forging the name?

Mr. DOUGH. Yes.

The CHAIRMAN. Did corporate headquarters and corporate leaders and people higher up in the chain of command order you to forge documents, or was that your own practice to meet their goals without their knowledge of that?

Mr. DOUGH. The forgeries that I saw in the offices where I worked were either orders from their direct supervisor, or they were doing it to protect themselves against auditors.

The CHAIRMAN. But there were some instances in which they were ordered by supervisors or people higher up in the corporate command to do that?

Mr. DOUGH. Certainly.

The CHAIRMAN. Do you think that that was an ethic that came from the very highest ranks of corporate headquarters, or from lower and middle ranks?

Mr. DOUGH. I do not think it was actually ever said to have your people forge documents to get loans done, but creative financing is done. They tell you just get the job done; do it. I have not heard it passed down from upper management to forge documents, just from local supervisors. But they let you know what they want you to do.

The CHAIRMAN. I have just a couple more questions. If you could describe for us the atmosphere that you were trying to create during a loan settlement, I think it would be helpful.

Mr. DOUGH. Sure. The first thing you do is instill trust between yourself and your customer. You have already talked to them on the telephone, so if you were good, you got names of children, if they had any pets, what kind of car they drove, so that when they came in, you could talk to them on a personal level. This created the atmosphere that you were there for them, that you were their personal financial person and that you were there to look out for their money. From there, you just went on with the closing.

The CHAIRMAN. My last question is one of summation. Could you describe the perfect borrower for the subprime market in which you were employed?

Mr. DOUGH. Sure. As I said in my previous statement, it would be somebody who was elderly, hopefully, a minority, less-educated. I am looking for somebody on a fixed income who is living off of credit cards. I want somebody who has a car payment and somebody who owns his or her house free and clear would be perfect.

The CHAIRMAN. Thank you very much.

Senator Breaux.

Senator BREAUX. Let me start by thanking the witness for being here, because only through testimony such as yours can we find out the nature and extent of the problem. Hopefully, your testimony will be very positive for future activities in the sense of trying to find a way to eliminate the practice that you have so carefully outlined to the committee.

I have just got to ask you a question. Are you still doing this?

Mr. DOUGH. No. I am out of the finance companies.

Senator BREAUX. How many finance companies did you work for, approximately?

Mr. DOUGH. Three.

Senator BREAUX. I do not want their names, but I am trying to find out the category. Are these the "instant credit," immediate finance companies, with "instant money" on a signature, that you see advertised sometimes, or were any of them—because I do not know who you worked for—were any of them what you would term a more reputable company? Or were they all fly-by-night finance companies?

Mr. DOUGH. All three were major finance companies.

Senator BREAUX. That you would not put into the category of fly-by-night, signature-alone, finance companies.

Mr. DOUGH. They work as fly-by-night companies, but all three have been there for years and will be there for years.

Senator BREAUX. And they were not limited to one locale or location, but were really—I guess you said—national in scope?

Mr. DOUGH. We are talking about thousands of branches nationwide, and in some instances, worldwide.

Senator BREAUX. Now let me ask you a couple of questions about your testimony. I noticed on page 3, you talked about flipping the loans, and that you would show a customer how, by flipping the loan, they could get a lower monthly payment; but that what the customer would not figure out, and you would not tell him, is that he would be paying for a much longer period of time, and obviously, in the end, would pay a much larger amount back to the finance company.

Is it not required by Federal regulation or State regulation that that information be clearly presented to the customer—that if you keep your loan, here is what you pay and what you finish with, and if you refinance with us, here is how long it is going to take you, and here is how much you are going to pay—in simple English?

Mr. DOUGH. It is written in simple English, and it is on all the loan documents, but I can get around any figure on any loan sheet.

Senator BREAUX. In other words, as long as you felt that you presented that person with this detailed explanation which nobody reads, you did not feel that you were legally required to explain it to them in language they could understand?

Mr. DOUGH. Exactly. The majority of customers are looking at one thing—that is monthly payment—and if that is what I quoted them on the phone, then they are perfectly happy when they leave.

Senator BREAUX. Now, on flipping loans, you were able to charge points to the customer each time the loan was flipped. Are there statutory limits on how many points you can charge?

Mr. DOUGH. I would guess that in each area, it would be different, but there is a limit on how much I was allowed to charge, yes.

Senator BREAUX. But there was no limit on how many times you could charge points?

Mr. DOUGH. If there was, there were ways to get around it.

Senator BREAUX. And by flipping the loan and making another loan, you could charge more points each time you made a new loan.

Mr. DOUGH. Right; and the way you flip the loan, in the different systems with the different companies, there was always a way to collect all your points on the previous loan and get all of your points on the next, even if it is only a month later.

Senator BREAUX. On the packing question, requiring them to buy credit life and life insurance and other insurance in order to get the loan, is there any requirement in the law that would spell out whether insurance was needed, and if so, how much is necessary, or is it pretty much an open-ended situation?

Mr. DOUGH. There are requirements saying that you must tell the customer, with and without insurance, the loan payments, the total of the loan. In the paperwork, it shows that it is optional, and you have the questionnaire, but again, that is just like all the other figures. The customers believe what I tell them.

Senator BREAUX. Was it a common practice, in other words, to insinuate to the customer that you would not make the loan without insurance?

Mr. DOUGH. Yes, you would insinuate that. You would tell them the importance of having the insurance on there.

Senator BREAUX. Was that part of a disclosure form that was given to the customer that was lost in the pages and pages of information?

Mr. DOUGH. Yes, it gets lost, but if a customer is backing out of the insurance, then you just delay the loan until he agrees to take it. There are laws saying that I have to disclose the information. There is no law saying in what time period I have to do a loan.

Senator BREAUX. I said in the beginning that I think you are being very helpful to this committee and to the Congress by laying out some practices which apparently, Mr. Chairman, are far too common and are not just among what I would call fly-by-night loan companies, but are practices that are also engaged in by reputable companies. I think you have said very clearly that the majority of people involved in financing and refinancing and equity financing are good, solid companies, and we are certainly not intending by this testimony to suggest that the majority or any percentage of the industry are bad actors. But apparently, there are some very significant abuses, and that is what we are trying to get at.

The interesting question I have—and maybe we cannot answer it right now—is that I have heard this witness say that he engaged in forgery. Now, that, by any stretch of the imagination, is a criminal offense.

The CHAIRMAN. It is a violation of the law, and it could be prosecuted, yes.

Senator BREAUX. I just want to note that for the record. I mean, you have been very helpful to this committee, but in doing so, you have also acknowledged that some of the things you were doing were clearly in violation of the criminal statutes of this Nation, and that raises some points that I think need to be further considered.

But I do thank the witness for his participation.

The CHAIRMAN. And I thank the witness. I do not have any further questions. Senator Collins may have some that will be submitted to you in writing, and if she does, we would appreciate your responding in writing.

I would ask now, before the witness leaves, that the cameras once again be turned to the side. You can now come and get the witness, please.

The CHAIRMAN. Our final panel features leading experts, including a law professor who specializes in consumer protection issues; also, the director of the Bureau of Consumer Protection at the Federal Trade Commission, and the director of the Home Defense Program of the Atlanta Legal Aid Society.

Mr. Gene Marsh, our first witness, is a professor of law at the University of Alabama. He has written and lectured extensively on the subjects of subprime lending markets, lender liability based on marketing practices, credit insurance, and the practice of flipping. He has served as an expert witness in consumer finance litigation cases nationwide. I welcome him.

Our next witness is Ms. Jodie Bernstein. Ms. Bernstein is director of the Bureau of Consumer Protection at the Federal Trade Commission. She will talk generally about the predatory lending practices and the role of the Federal Trade Commission and what role that agency plays in enforcing existing legislation addressing equity predators.

Mr. William Brennan, our third witness, has been a staff attorney at the Atlanta Legal Aid Society for 29 years, specializing in housing and consumer issues. For the past 10 years, he has been director of the Home Defense Program. This program provides referrals and legal representation to homeowners who have been victimized by home equity loan scams. He assists individual homeowners who have been targeted by local and national companies with abusive predatory mortgage lending practices.

Professor Marsh.

## STATEMENT OF GENE A. MARSH, PROFESSOR OF LAW, UNIVERSITY OF ALABAMA LAW SCHOOL, TUSCALOOSA, ALABAMA

Mr. MARSH. Thank you. You have heard extensive testimony on the practices of loan flipping and packing, so I will try to avoid getting on top of that and will be very brief.

I have studied the industry in general beyond just the one or two companies that are being described here in the subprime market and have paid particular notice to the fact that so many of these loans, particularly mortgage loans, have a great deal of dead weight in them. The dead weight is due to the dollars that are being piled onto the loan through the flipping of the loans and the packing of insurance products. This is also particularly common in the types of mortgage loans that you are describing that target the elderly.

Finance companies flip loans largely because of the way the credit math works—that is, early on in any loan, they make more money in the principal and interest balance. Later, as the loan matures, as we all know in our own lives with mortgage loans and car loans, we start to "make hay" against the principal balance. So the newer the loan is, the better it is for the lender, and that is just the way the credit math works.

In the industry, flipping is normally done through the dangling of a few dollars in front of a borrower who may have made one or two, or perhaps has a history of payments, and it is quite an inducement to say—and you have heard described these sort of "instant check" loans where someone receives a check, and if they cash it, they may think they are getting a few additional dollars that they may need for Christmas or whatever, when in fact what is happening is that the old loan balance is really being restarted.

As has been pointed out by other people who have testified, the higher our educational level and so on, the more likely we know what is going to happen to us when we renew and refinance loans. In fact, many people are going through refinancings now in their mortgage loans because of terms that are favorable.

In the subprime market, you have a particularly aggressive strategy of loan flipping that is geared largely, I think, from the inside out—that is, a designed practice from the industry and then also, you face people who often just do not understand what is coming at them and the ramifications. Not only because of perhaps their educational level, but because of the fairly slick practices that are used in making flipping work.

There are actually employee incentive plans related to flipping throughout this industry. Sometimes the base pay for people who are managers and loan officers is fairly low, and sometimes the returns for them if they have a good month, so to speak, are quite good. And in the bonus system in some of the finance companies that I have studied, loan volume is double-counted. That is, if you have old money that is turned over, that old money is calculated, again, in the flip toward whatever the monthly loan volume was, and that becomes a part of the bonus system for employees.

You mentioned that you were surprised, as I think all of us are, to find out that sometimes the strategy is that if you have a borrower who is struggling, that sometimes the loan is renewed. That is hard to imagine, but it is also fairly common. That is, I have studied cases where the employees have said that as they come to the end of the month, and they are looking at their bonus system, and they are afraid of getting a demerit based on loan delinquencies, that they would actually want to make the loan look current by going out and re-upping the loan, or restarting the loan. Normally, as one of the folks testified, the focus of the borrower is quite often on the monthly payment and not on the long-term ramifications, so in deposition testimony in other places, employees have mentioned that renewing loans that are in default is a common strategy. That, by itself—some people would ask, well, what is wrong with that. Well, I think what is wrong with that is not just the fact that the loan is being restarted, but that you have people who are already on the fringe, in some trouble, and they get more debt piled on them. In many cases, because of the packing of insurance, a lot of that new debt is really dead weight; that is, it is not money that you are going to see, it is money that is going into credit insurance products.

I have provided some passages on credit math, but rather than bore you with that, I will just leave it for your study. It is an important part of this, but I think you can read it, and some of the other written testimony includes discussion of it.

One thing I would point out is that the subprime market is very aggressive in pitching flipping—that is, in seasonal pitches, "instant checks," and so on—far more than what you or I would face if we borrowed money from a bank for a car loan or a home mortgage loan. You do not really expect to hear much from the bank or from the mortgage lender again; you just keep making your payments, and your car gets paid off, and you move on. But in this industry, you will hear as frequently as once a month from folks every time you receive a statement.

I have a brief excerpt from a training video that is used and then a couple of exhibits to share with you, and then I will be finished.

Mr. BREAUX. Who is this training video from?

Mr. MARSH. It is one of the finance companies in the industry. It is actually a longer video—it is about a 30-minute video—but it has been edited down to about 2 minutes.

["Keys to Success" videotape shown.]

Mr. MARSH. I do not think you will see that at the Academy Awards. [Laughter.]

There are four points there, and they appear to be fairly subtle. I will make them quickly. One is that you hear a description that we are in the business of selling money. That is true enough, and I think that that is something that is cultural, and people kind of get used to it, and you have to get used to that; that is what lenders do. But on the other hand, they also sell a lot of things that people do not need, that is, the credit insurance products, and they go about it in a way that no one needs, and that is flipping.

You saw the excerpt on the idea that it is common and believable and okay to handle a delinquent account by renewing it, and I think we have talked enough about that.

As far as the fellow who needs the roofing work done, notice that they said, "Come on in, and we will have $1,984 additional available for you." Usually, what happens is that not only do you get the check for $1,984, but the old loan is restarted, and that is something that I think is lost on people.

Then, finally, you saw the one on the fellow needing $1,000 to pay taxes. On top of that $1,000, you saw the pitch that, Golly, we forgot to sell credit insurance once again. So it is just sort of a constant push to sell the credit insurance products.

I have two exhibits here, and I will also have two more put up, and then I will be finished. The document on the left is from a finance company document that is used in training, and it specifically points out that there is a certain point in every loan where the credit math shifts and starts to work to the advantage of the borrower and the disadvantage of the customer, and that is the point at which you should target the loan for renewal. You can see the description, and I recommend your study of it, but it is very vivid in the way it describes how the principal and interest breakdown occurs. It also has the credit life and credit insurance penetration rates noted at the bottom of that same document.

The other one, to the right, is from a training tape which basically describes the process of keeping people in debt—"Renewed loan approvals take us right to collection again"—so you see this continuing cycle is at the very heart of the business.

Then, if I could quickly get the other two up, credit life insurance is supposed to be a voluntary product. It is "take it or leave it." In fact what happens in the industry is that it is often put in front of you with really almost no chance of taking it off. One of the quotes in the training materials that comes from one of their employees reads: "I reassure the customer about the benefits of the insurance. They especially like it when they realize that it is already included with the payment, and it has already been quoted." Well, that is a problem, that is a serious problem, and I think these folks here would agree.

Then, the one on the right I think is also very vivid, and that is that although the company advertises itself as one that takes care of you and is here to help you and so on, the employees get this clip that says: "Do not shoot yourself in the foot by addressing objections, concerns or questions you think the customer might have." And all I would say is that when you contrast that with, basically, the pitch that the borrowers are getting, it is really day and night.

Thank you very much.

The CHAIRMAN. Thank you, Professor Marsh.

[The prepared statement of Mr. Marsh follows:]

**United States Senate Special Committee on Aging**

**Monday, March 16, 1998**

**Testimony of Professor Gene A. Marsh**

**The University of Alabama School of Law**

I am a professor at the University of Alabama School of Law. In the School of Law I teach courses on contracts, payment systems and business organizations. I also teach a seminar on consumer protection. I have published and lectured in a number of areas of lender liability, consumer finance, sub-prime lending, secured transactions, payment systems and banking law. I served as the reporter for the revision of Articles 3 and 4 of the Uniform Commercial Code in Alabama. In 1996 I served on Governor Fob James' Mini-Code Task Force and have been involved in drafting revisions to Alabama's consumer finance laws. In national and state continuing legal education programs I have spoken on such subjects as the Alabama Mini-Code, federal Truth in Lending, the sub-prime credit market, lender liability based on marketing practices, credit insurance and the practice of flipping.

I have served as a consulting and testifying expert for lenders, credit sellers and borrowers in consumer finance litigation. I have worked for public utilities, retailers and financial institutions in reviewing and revising their deposit agreements, installment sales contracts and extended service agreements. I have conducted several compliance seminars for the Alabama Bankers Association. I serve on the Board of Advisors for a national consumer finance publication.

In the course of my work I have studied pleadings, exhibits, loan files, operating manuals, training manuals, training videos, depositions and other documents used in consumer loans and installment sales. I have studied materials in cases involving over 30 consumer finance companies and other mortgage lenders, many of which operate in the sub-prime market. I have written and lectured extensively on the subjects of sub-prime credit markets, flipping and abuse in the sale of credit insurance products. Loan flipping and abusive credit insurance sales practices are particularly common in sub-prime credit markets.

A. ***Why Finance Companies "Flip" (Renew) Loans***—Lawyers representing consumer debtors with finance company loans are often surprised to find that new loans are made and existing loans refinanced several times each year. Although we live in a world of "easy credit terms" and are surrounded by examples of the improvident use of credit, consumer finance company lending practices often surprise even the most hardened advocates of E-Z credit. These lending practices are particularly noteworthy when one considers that many of their borrowers started out as credit risks, having come to the finance company after being bounced by a bank or other depositary institution. In other words, these are people who are in the sub-prime credit market.

Finance companies frequently will contact existing customers, offering a few hundred additional dollars. Some training manuals urge the employees to make solicitations every time the customer comes in to make a payment. If the debtor bites at the apple, the existing loan will be "paid off" and a new loan will start, but with a great deal of the balance being "old money." That is, after rebates (most likely credits on the account) for unearned interest and insurance premiums, the new amount financed will be comprised of the unpaid principal balance from the old loan, the few hundred additional dollars given to the debtor in the new loan, and new credit insurance products (credit life, credit property, nonfiling, credit disability, etc.) that were sold and financed by the creditor. Where a mortgage loan is involved, the debtor's equity declines at an alarming rate, while the debt load mounts.

These frequent loan renewals are rabidly marketed through telephone and mail solicitations. Most of us would stop dealing with a bank or other lender that solicited us for new money nearly every time we made a car payment. However, finance companies are not timid in offering new money to debtors. The mechanics and incentives in establishing the flipping system are described below. The system is a product of several forces at work, including the compensation system for finance company employees, state law which favors creditors in the amounts rebated for unearned interest and insurance premiums, very slick (and at times deceptive) marketing practices, and some borrowers who have no credit discipline. The problems are magnified when a borrower is poorly educated and even illiterate. Many finance company borrowers come to the table with little formal education.

All of us are familiar with the advantages, disadvantages, and the reality of refinancing home mortgages, and even car loans. However, most people are surprised by the system that has been implemented by the consumer finance company lending industry, where debtors often send in regular payments, but make little progress against loan principal. The system resembles the nightmare where one is running hard but making little progress against the tiger that is about to pounce. Finance company loan renewals establish a pattern which makes people indentured servants, working hard but never making progress against debts.

The flipping system also magnifies the harm done in the sale of consumer credit insurance products that are so prevalent in finance company lending. Consumer credit insurance, which is generally a bad bargain by any measure, is especially costly where the rebates for unearned insurance premiums are credited under the Rule of 78ths. The use of the Rule of 78ths works to the creditor's advantage when loans are renewed early in the term.

**B.** ***Employee Incentives and Marketing Strategies in Loan Renewals***—Commercial banks have never been known for paying overly generous salaries to consumer lending officers who are in the trenches. Finance companies pay even less, and sometimes a great deal less. Additional financial incentives are sometimes offered in a bonus point system that is based on loan volume, with point subtractions for loans made that are late or delinquent. The bonus system may be based on individual branch performance.

In some companies, loan volume is double-counted. That is, monthly loan volume is measured without regard to whether the most recent loan includes a large block that is merely a renewal of an earlier loan. In depositions, some employees have reported that they renew loans in order to increase their loan volume. This is close to the system of "churning" accounts in the securities industry. Some employees have stated that as the end of the month approaches, the pressure to turn loan volume increases and the "quality" of new loans diminishes.

Deposition testimony also includes frank admissions that some loans are renewed in order to remedy the problem of loan delinquency. Thus, a loan looks current for the bonus system, even though the borrower has been having trouble making payments before the loan renewal. Not only testimony, but also training films include passages encouraging renewals for existing delinquent accounts, particularly if new collateral or a co-signer can be added to the loan. The same training video offers advice to employees, encouraging them to use loan renewals to cure delinquent accounts. The pressure to sell credit insurance products is also magnified in such a system because the insurance premiums are financed, thus raising loan volume.

Training manuals and video training tapes also include passages encouraging employees to use expressions such as "line of credit" in soliciting renewals. However, a complete refinancing of an existing loan and a restarting of the clock on the old money is hardly what you get in a true line of credit. A true line of credit--even a home equity loan with an established line--allows for draws without much in the way of transactions costs. However, it is the operation of the Rule of 78ths, new prepaid finance charges, and the other transactions cost that are so expensive for borrowers whose loans are flipped by finance companies.

Other passages in lending manuals include directives that "all efforts are devoted toward motivating individuals to make contact with our office." One manual states that "the bulk of our business is repeat business," and that "renewals are SOLD, NOT BOUGHT." Another noteworthy passage is one that reminds lenders that "the alert employee will map out an effective game plan," and "sell eligible applicants to his maximum worth or high credit." However, a study of loan documents and admissions by employees suggests that high credit limits are sometimes exceeded in order to make a delinquent account look current. As is often the case in commercial and corporate loans, some of the loans become problems because the lender ignores internal directives on approval ratios.

In fairness to lenders, it is a fact of life that financial institutions are in the business of selling money and sales volume is critical in any business. In many ways, selling money is no different than selling shirts. However, the lender-borrower relationship has never been viewed as a place where all bets are off relating to disclosures, sales practices, and complications after the sale is made. Thus, the exceptionally aggressive lending practices of finance companies will not be viewed simply as the sale of the next shirt. When it comes to consumer lending, the dynamic changes, and people expect more than the law of the jungle to prevail.

C. ***Add-On Interest and the Rule of 78ths***—The most common methods utilized in the calculation of interest in consumer finance loans are the add-on and actuarial methods. Actuarial Interest is calculated by applying a periodic interest rate to the outstanding balance of the loan principal for each period for the term of the loan. This is the method that is used to amortize real estate mortgage loans. In order to calculate actuarial interest and payments for installment transactions, one generally must resort to formulas or tables which are widely available.

Computing interest by the add-on method is easy and is the method most commonly utilized by consumer finance companies in Alabama. Add-on interest is a method for calculating precomputed interest, where the consumer agrees to pay the total of payments, which includes both principal and the full amount of precomputed interest. Thus, if a consumer agreed to borrow $1,000 at twenty percent interest, to be paid over a twenty-four month period, the calculation for payments would be as follows:

(1) $1,000 x .20 x 2 yrs. = $400 interest

(2) $1,000 principal $400 interest = $1,400/24 mos. = $58.33/mo.

With the add-on system, interest is calculated as though the borrower had full use of the principal for the full period of the loan, but because some principal is being repaid with each installment, the debtor pays a fixed amount of interest on a diminishing principal. Thus, the add-on method understates the true simple interest rate and the real cost of the loan.

It is the actuarial method—not the add-on method—that most closely approximates and will in some cases match (if there are no prepaid finance charges or other complications) the annual percentage rate (APR) that most of us know under the mandates of TILA. Because TILA requires a common method for reporting the true interest rate on loans based on an annual percentage rate (APR), the add-on rates dramatically understate the effective "simple" or actuarial rate on a loan.

Because interest on add-on loans is precomputed, the lender must have some system in place to rebate or credit the account for unearned interest in the event the loan is paid off early or refinanced. The most common method for rebating unearned interest charges (and unearned credit insurance premiums) is under the Rule of 78ths, or the Sum of the Digits Method. The Alabama Code follows a federal mandate requiring the use of some method other than the Rule of 78ths for loans with terms longer than sixty-one months. However, because most consumer finance companies make loans with maturities of five years or less, the Rule of 78ths is widely used to rebate unearned interest and unearned insurance premiums in Alabama.

Although the Rule of 78ths is easy to use, it carries a disadvantage for the borrower. The method used by the Rule of 78ths weighs the early months too heavily and the latter months too lightly in calculating interest earned by the creditor. Thus, if a loan is prepaid (or started over, in the case of a refinancing), the creditor would be credited with more interest earned (and not rebated) than if the interest calculation were made on the actuarial method.

It is readily established mathematically and accepted beyond dispute that the higher the APR for a given indebtedness, the greater is the error in the Rule of 78ths in calculating interest earned by the creditor at certain points in the loan, when compared to the actuarial method. Further, with many consumer loans, the point at which there will be the greatest divergence (error) between the Rule of 78ths and the actuarial method is roughly one-third of the way through the loan term. At any point in the loan, the difference between an actuarial rebate and a Rule of 78ths rebate on any given precomputed loan will vary with loan size, the interest rate on the loan, the loan term, and the time of prepayment.

D. ***Observations on Flipping***—With regard to both car loans and home mortgages, most of the early payments are largely interest and little is principal. It is only later in the loan that a borrower starts to make serious progress against the principal. Conversely, most of the interest income for lenders is made early in the loan. In depositions, finance company employees and executives readily admit that the companies make more money on "new" loans and that old loans are not profitable. This is no great revelation and holds true whether interest is calculated on an actuarial basis or in a precomputed, add-on arrangement. There is no real "fault" or devious practice here. It is merely mathematics at work.

Many borrowers can grasp the ramifications of restarting an old loan (such as home mortgage refinancing) and know the costs and benefits of doing so. These borrowers can read and write. They also do not receive solicitations for "new money" every time they make a payment or receive a monthly statement. Additionally, they are not met with pitches for credit insurance products at every turn.

The same cannot be said for consumer finance company borrowers, many of whom do not bring much formal education to the table. Among the many consumer finance company loan documents and depositions I have studied over the past several years, only a few borrowers were college graduates and many were people who did not finish high school. Others could not read or write. The data on educational levels, dropout rates and illiteracy among some states makes none of this a surprise. When some of these borrowers are matched against very polished, rehearsed, and high pressure promotional practices, with use of terms such as "line of credit" and representations regarding the value (and even the necessity) of credit insurance products, it is no contest in the negotiation process.

Many finance companies include advertisements for more money in each monthly statement they send to the borrower. Seasonal pitches are common, offering a few hundred additional dollars for Christmas money or a summer vacation. Other pitches included on the monthly statement will congratulate the borrower for making a few timely payments, and offer several hundred more dollars if the debtor will visit the office. However, rather than making a new and second small loan, which is the impression created by the advertising, the creditor will restart the clock on the old money in a consolidation.

When pressed on why the finance company could not make a second, small loan, particularly when the loan request was triggered by the lender's solicitation, the standard answer is "it's company policy." No further explanation is offered.

Accounting firms hired to work in consumer finance litigation have developed excellent models to compare the costs to the borrower of the refinancing (flipping) system that is in place and the costs to the borrower if payments on the old loan were allowed to continue, while a new, second small loan was made. The differences in costs are dramatic in most cases and have not been refuted. Even if the APR on the renewal loan is lower than the APR on the old loan, the actual out of pocket costs for the new refinanced loan may be greater than those that would be paid if a second small loan were made available, while payments on the old loan were continued.

The extra costs to the borrower of the system in place are in part the result of the operation of the Rule of 78ths (as it is applied to interest and unearned credit insurance premiums). In order to induce the borrower to take on more debt, some finance companies extend the loan maturity to a new term. Thus, what was once an initial loan with a twenty-four-or thirty-month maturity will often turn into a new loan at forty-eight or even sixty months. Although the debtor may take this arrangement because the monthly payment stays the same, the mountain of interest builds, particularly in a precomputed, add-on loan scenario. And because the creditor will most likely make a new pitch for a loan renewal (and a few hundred more dollars) several months down the road, the principal amount remains largely undiminished or grows.

To see an illiterate borrower who has had a loan "renewed" five, six, or even eight times in two years, and who is sometimes sold as many as three or four credit insurance products (credit life, credit property, credit disability, "involuntary unemployment insurance," and nonfiling may appear individually or all together in one loan), is enough to make most traditional lenders shake their heads. And in some cases, because of the dismal credit record of the borrower before the first loan was made, the expression "throwing good money after bad" appears to be unknown in selected consumer finance company branches, where loan volume dictates incentives and policies.

The frequency of loan renewals in consumer finance company lending is not merely the result of borrowers who voluntarily go to the well too many times. This practice is designed and encouraged by finance companies, without question. The Committee has been provided with exhibits and excerpts from an industry training tape which describe borrowers as "targets" for loan renewal and the packing of insurance products.

E. ***Packing of Insurance Products***—On the matter of the packing of insurance products, one large national company promotes a system which essentially requires the customer to refuse credit insurance and other add-on products, rather than providing a clear explanation and meaningful choice for the customer. Factors considered by the FTC and other regulators (as well as in case law) examining coerced credit insurance sales include the creditor's penetration rate, the profits and financial incentives in making the sale, and the practice of including insurance in loan payment quotes or on loan documents provided to the consumer prior to offering a choice on credit insurance products.

Material provided to the Committee includes employee testimonials relating to credit insurance. One quote reads, "They especially like the insurance when they realize that it is already included with the payment that they have already been quoted." Another entry in that exhibit under a section on "Handling Concerns" reads "Don't 'shoot yourself in the foot' by addressing objections, concerns or questions you 'think' the customer 'might' have." In all the marketing literature I have reviewed, this is one of the most callous statements I have encountered and is contrary to the literature being sent to customers which suggests that the company cares for the customer.

In one document provided to consumers, the company promises "to recommend only those products and services that fit your needs" and "to explain our loan documents and financial products in non-technical terms that YOU can understand." At the same time, employees are being told not to address concerns you think the customer might have. The depositions of former employees and other documents show that it is a common practice among lenders in the sub-prime market to include credit insurance products in the quotes and documents, and to remove those products from the final deal only when the customer objects or has reached a ceiling on debt load or loan-to-value indicators.

**F.** ***The Sub-Prime Credit Market***—Although there is no universally accepted industry standard for credit grades, most lenders use categories such as "A," "A-," "B," "C," "D" and "F." Consumers with "A" ratings generally have no late mortgage payments and no credit card payments over 30 days delinquent in the last year. At the other end, consumers with "F" ratings are currently in bankruptcy or foreclosure. Although the term "sub-prime" lending means different things to different people, most lenders use the term when referring to "B," "C" and "D" credit. Consumers with "D" credit ratings are generally described as experiencing problems that are severe.

In recent years there has been a considerable boom in sub-prime lending activity involving automobiles, home mortgages and even credit cards. In the auto industry there were approximately 25 sub-prime lenders in 1991. Today there are more than 150. Mortgage lenders are also vying to make loans to people with shaky credit and sub-prime mortgage loans are being bundled and securitized. According to one industry publication, the securitization of sub-prime mortgages increased by 50% from 1996-1997.

And even in the sale of consumer products such as satellite television reception equipment, private label credit card issuers have established separate programs to identify and market credit cards to customers who were previously turned down. In some cases the credit card issuers created the programs in response to dealer complaints that too many customers were refused credit in an initial application. As one would expect, the risks inherent in sub-prime lending are reflected in higher interest rates. Sub-prime borrowers are described in industry material as borrowers who often do not shop around or haggle over terms. Sub-prime borrowers may be relegated to finding credit <u>at any price</u>.

Lending to sub-prime borrowers was once considered the province of small loan companies, finance companies and "fringe banks." However, the sub-prime market is now also served by large mortgage companies, national banks and credit subsidiaries of automobile manufacturers.

Several of the largest national banks provide financing for auto purchasers with impaired credit records, buying used-car loans at a discount from face value. Purchasing the contracts at a discount is also a common practice in sub-prime mortgage lending and even in the acquisition of credit card paper.

Not all sub-prime lenders engage in predatory lending practices and responsible lenders should not be criticized for setting their interest rates at a level that reflects the risk represented by the borrower's credit history. However, the practice of loan flipping and the packing of credit insurance products are common in the sub-prime market, particularly to those people in the "D" range. Some employees have testified in depositions that the more unsophisticated and desperate the borrower, the more likely the company would flip and pack loans. Employees have also testified that in offers for debt consolidation loans, borrowers who were the most desperate were offered additional cash in order to hook the loan. A common outcome among the most predatory lenders in the sub-prime market is that those borrowers who can least afford credit insurance products receive the strongest pitch for the purchase of those products. Those borrowers also are targeted for frequent loan renewals with the lender dangling a few additional dollars as the bait for the loan flip.

Through additional testimony and the other industry material provided, the Committee can get a feel for the predatory lending practices that exist in <u>some parts</u> of the sub-prime market. I will be happy to answer any questions you might have or provide additional material as you study the sub-prime market.

The CHAIRMAN. Ms. Bernstein.

**STATEMENT OF JODIE BERNSTEIN, DIRECTOR, BUREAU OF CONSUMER PROTECTION, FEDERAL TRADE COMMISSION, WASHINGTON, DC.**

Ms. BERNSTEIN. Thank you, Mr. Chairman, Senator Breaux and Senator Collins. I also thank you for holding this hearing and for the opportunity for me to appear on behalf of the Commission on this very important—critically important—subject.

I must say, having heard these really heart-wrenching stories from the previous witnesses, that it is really hard to fathom, as Senator Breaux said, that there can be people who are so greedy and so callous that they can engage in such work every day. And for Senator Collins—and I know she has had to leave—you can be sure that we will follow up on each of these witnesses' stories and investigate them further.

Like Professor Marsh, I know you have heard a good deal about what is happening in this market and the abuses, so I will make a few points just briefly that are largely based on what the Commission has found in connection with this subprime lending market. Some will be general, some rather more specific, along with some detail about our enforcement efforts and our education efforts.

As has been noted earlier, the subprime mortgage lending market has grown dramatically, and there seem to be a number of reasons why this is occurring. It has really been in the last 3 or 4 years that this has occurred.

First of all, I guess it is obvious that it is very highly profitable. Rates can range as high as 20 to 24 percent. The demand for borrowers has increased enormously; that may have to do with the increasing level of debt among American consumers. Finally, the secondary market opportunities seem to be growing a great deal, infusing a good deal more capital into this market than occurred before.

So, a dramatic set of changes have been produced by this quickly growing market, and a number of large corporations, nationwide corporations, have now entered this market.

We all agree, of course, that it is critically important for consumers to be able to have home loans that they previously could not have had before because they had limited access to credit in the past, and we all want that market to operate cleanly and effectively. But these predatory and abusive practices seem to have proliferated so much that, obviously, I think many steps will need to be taken in order to see to it that the market does not operate in that way.

It is just critically important that consumers be able to trust, as they go about obtaining a loan that the lenders are going to be treating them fairly and honestly.

The reported abusive lending practices on our records cover a wide range. The three that the Commission has found, as others have here today, the most harmful—and I will not detail them because they have already been detailed—are stripping, flipping, and packing.

I would say only one thing in regard to equity stripping, which does result in the most injury to consumers, that it almost seems as if a loan that is based on equity in a property rather than on income to repay the loan has got to be designed to fail, designed to seize the equity.

The others have been described; Professor Marsh described the packing. We have already addressed that in enforcement efforts at the Commission, and we intend to continue to do that. And flipping obviously just continues to escalate the borrowers' debt over and over again in ways they cannot possibly deal with and increases the prospect of losing the equity.

All of those—stripping, flipping, and packing—are practices that occur before the loan is closed. To add insult to injury—and not much has been said about this—after the loan is closed, consumers may be subject to what is called "loan servicing practices", that is, practices that extract additional moneys not owed under the loan terms or that inhibit refinancing options with another, perhaps legitimate, lender. They may add fees and charges that are not owed to the monthly payment demands—you just get a notice saying you owe more than we said you owed before.

The complexities of loan terms are such that it is really very difficult for an individual borrower to be able to know exactly what the payment demands are and whether they are accurate or not.

So a lender may fail to provide full or accurate payoff information to consumers—we have experience with that—and that makes it difficult for borrowers to refinance with another lender.

You also heard about forgeries earlier today, and of course, it has been acknowledged that that is a criminal offense. The other practices are and can be subject to civil enforcement which the FTC enforces, namely, Truth-in-Lending, the Equal Credit Opportunity Act, HOEPA, and Section 5 of the FTC Act.

I will briefly summarize here so as not to use up the time, but the Commission brought a major lawsuit in January of this year, filed a complaint in District Court against Capital City Mortgage Corporation, a DC. area mortgage lender, and its owner. Almost all of the abuses that have been described were incorporated into that complaint, and it is in litigation at the moment.

Last year, we also settled a case against The Money Tree, a consumer finance lender, and its president. That case involved allegations that the company required consumers to purchase credit-related insurance and other extras with their loans without disclosing to consumers the true cost of the credit.

In addition to our enforcement efforts, we are also working with State and local agencies in order to be sure that we are all fully enforcing the law and have issued today a new consumer fact statement called "Borrowers Beware," which describes the practices we have talked about and also much more detail about what these loans are and are not, and how to avoid getting into problems with them.

We also have an FTC help line, FTC–HELP, which we urge consumers to call to tell us what their problems are so we can follow up on them; that is how we hear about them. And we have a web page, www.ftc.gov, which consumers hopefully will use to tell us their problems, their experiences, and in many instances, I hope we will be able to be of some additional help to them.

Thank you.

The CHAIRMAN. Thank you, Ms. Bernstein.

[The prepared statement of Ms. Bernstein follows:]

**PREPARED STATEMENT OF THE FEDERAL TRADE COMMISSION**

before the

SENATE SPECIAL COMMITTEE ON AGING

on

Home Equity Lending Abuses in the Subprime Mortgage Industry

March 16, 1998

47-447 98 - 3

## I. INTRODUCTION

Mr. Chairman and members of the Committee: I am Jodie Bernstein, Director of the Bureau of Consumer Protection of the Federal Trade Commission.* I appreciate the opportunity to appear before you today on behalf of the Commission to discuss the serious problem of abusive lending practices in the subprime mortgage lending industry. These comments do not address those lenders within the subprime mortgage industry who play by the rules and provide an important source of capital to various segments of borrowers. I will discuss the recent growth of this industry, abusive lending practices that reportedly are occurring in the industry, and the Commission's recent activities in this area. First, however, let me briefly speak about the Commission's role in enforcing laws that bear on these problems.

The Commission has wide-ranging responsibilities concerning nearly all segments of the economy. As part of its mandate to protect consumers, the Commission enforces the Federal Trade Commission Act ("FTC Act"), which broadly prohibits unfair or deceptive acts or practices.[1] The Commission also enforces a number of laws specifically governing lending practices, including the Truth in Lending Act ("TILA"),[2] which requires disclosures and establishes certain substantive requirements in connection with consumer credit transactions, and the Equal Credit Opportunity Act ("ECOA"),[3] which prohibits discrimination against applicants for credit on the basis of age, race, sex, or other prohibited factors. The Commission has jurisdiction over most non-bank lenders.[4] In addition to our enforcement duties, the Commission

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* The views expressed in this statement represent the views of the Commission. Responses to any questions you have are my own, however, and do not necessarily reflect the Commission's views or the views of any individual Commissioner.

also satisfies many requests for information about credit issues and consumer credit laws from consumers, industry, state law enforcement agencies, and the media.[5]

We increasingly are hearing reports of problems in the home equity loan business, and the Commission is working in a number of ways to address them. Commission strategies include law enforcement activities, often coordinated with other law enforcement officials, and consumer education. It is crucial that as many consumers as possible have access to capital, but, at the same time, this access must not be hindered by deceptive or other unlawful lending practices.

## II. THE SUBPRIME MORTGAGE INDUSTRY

Subprime lending refers to the extension of credit to higher-risk borrowers, a practice also commonly referred to as "B/C" or "nonconforming" credit.[6] Loans to subprime borrowers serve communities that may have been underserved by other lenders in the past. In recent years, subprime mortgage lending has grown dramatically, with over 90% of all subprime mortgage loans made in or after 1993.[7] By the end of 1996, the total value of outstanding subprime mortgage loans exceeded $350 billion.[8] In 1997 alone, subprime lenders originated over $125 billion in home equity loans.[9] Subprime loans have become a significant and growing part of the home equity market. Subprime originations constituted 11.5% of the total home equity lending market in 1996; by the first half of 1997, they had grown to 15.5% of this market.[10] At the same time, the composition of companies involved in the subprime market is evolving. One of the dramatic changes in this market has been the growth in subprime mortgage lending by large corporations that operate nationwide.[11]

The subprime mortgage market has flourished because such lending has been profitable, demand from borrowers has increased, and secondary market opportunities are growing. Lenders typically price subprime loans to consumers at rates of interest and fees higher than conventional loans.[12] Higher rates and points can be appropriate where greater credit risks are involved, as is often the case with subprime loans.[13] Critics assert, however, that the interest rates and fees charged by some subprime lenders are excessive, and much higher than necessary to cover increased risks, particularly since these loans are secured by the value of a home.[14] Some attribute lenders' high rates on first mortgages in part to federal deregulation of certain state interest rate ceilings in 1980.[15]

The relatively high profit margins in the subprime mortgage industry have fueled demand in the secondary market from investors seeking higher-yielding securitized assets, especially in an environment of generally low interest rates.[16] In 1996, the subprime mortgage sector issued over $38 billion in securities, the largest increase in securitizations for any lending industry sector in that year.[17] The secondary market's expansion has, in turn, helped to sustain growth in the industry by enabling lenders to raise funds on the open market to expand their subprime lending activities.[18] Freddie Mac, one of the primary government-sponsored enterprises involved in the purchase of mortgages, recently announced plans to enter the secondary market in subprime loans by purchasing significant numbers of "A minus" subprime mortgages by 1998 and the higher-risk "B and C" loans by 1999.[19]

The market for subprime loans is expected to continue growing. Credit card delinquencies are rising and personal bankruptcies are at record levels, which negatively affect borrowers' credit histories, pushing more consumers into higher risk categories. Meanwhile, consumer spending continues to be strong.[20] Together, these factors increase the market for subprime loans. In addition, more borrowers generally may be seeking home equity loans due to the change in the tax code limiting allowable interest deductions to those on a first mortgage.

## III. THE PROBLEM OF ABUSIVE LENDING PRACTICES

The enormous growth of the subprime mortgage industry has enabled many consumers to obtain home loans who previously would have had much more limited access to the credit market.[21] Questions increasingly are being raised, however, about certain lending practices, often referred to as predatory lending, that reportedly are occurring in the subprime mortgage market and about their effect on the most vulnerable consumers.[22] These abusive lending practices often involve lower-income and minority borrowers.[23] Elderly homeowners, in particular, are frequent targets of some subprime home equity lenders, because they often have substantial equity in their homes, yet have reduced incomes.[24] In many cases, those living in lower-income and minority neighborhoods -- where traditional banking services continue to be in short supply -- tend to turn to subprime lenders regardless of their credit history.[25] While subprime lenders point out that they are expanding access to credit to individuals who otherwise would be shut out of the market and consumers whose credit histories make them too risky for conventional loans, such lenders are in a position to take advantage of the consumers in the weakest bargaining position.

It is critically important for all consumers, especially those who live in lower-income communities, to have access to capital. Access that is based on deceptive mortgage lending, however, is false access. Deceptive lending practices hide from consumers essential information they need to make decisions about their single greatest asset -- their home -- and the equity they have spent years building.[26] Deceptive lending practices are particularly devastating because these loans usually are sought at a time of great need, when borrowers are most susceptible to practices that can strip them of substantial sums of money and, ultimately, their homes.

Reported abusive lending practices in the subprime mortgage market cover a wide range. We will mention here a few highlighted in recent reports. While the reported practices are quite varied, there are common traits. They generally aim either to extract excessive fees and costs from the borrower or to obtain outright the equity in the borrower's home.

Among the most harmful of these reported practices is "equity-stripping." This often begins with a loan that is based on equity in a property rather than on a borrower's ability to repay the loan -- a practice known as "asset-based lending."[27] As a general rule, loans made to individuals who do not have the income to repay such loans usually are designed to fail; they frequently result in the lender acquiring the borrower's home equity. The borrower is likely to default, and then ultimately lose her home through foreclosure or by signing over the deed to the lender in lieu of foreclosure. Such a scheme is particularly damaging because these vulnerable borrowers often have no significant assets except the equity in their homes.[28]

Another practice of serious concern is "packing," the practice of adding credit insurance or other "extras" to increase the lender's profit on a loan.[29] Lenders often stand to make significant profits from credit insurance, and therefore have strong incentives to induce consumers to buy it as part of the loan.[30] At the same time, observers have questioned the value to consumers who obtain the insurance in conjunction with their loans, given the high premium cost and comparatively low claims rate.[31]

Typically, the insurance or other extra is included automatically as part of the loan package presented to the borrower at closing, and the premium is financed as part of the loan. The lender often fails to provide the borrower with prior notice about the insurance product [32] and then rushes the borrower through the closing. Sometimes, the lender represents that the insurance "comes with the loan," perhaps implying that it is free. Other times, the lender simply may include the insurance in the loan closing papers with no explanation. In such a case, the borrower may not understand that the insurance is included or exactly what extra costs this product adds to the loan. Even if the borrower understands and questions the inclusion of the insurance in the loan, subprime borrowers are not in a position to negotiate loan terms. They often need to close the loan quickly, due to high debt and limited financial resources. Therefore, they generally will not challenge the loan at closing if they believe or are told that any changes may cause a problem or delay in getting the loan.

Lenders are permitted to require the purchase of credit insurance with a loan, as long as they include the price of the premium in the finance charge and annual percentage rate. In some instances, however, the lender effectively requires the purchase of credit insurance with the loan, but fails to include the premium in disclosures of the finance charge and annual percentage rate, as mandated under the Truth in Lending Act.[33] When the lender excludes the required insurance premium from the borrower's disclosures, the cost of credit may appear significantly lower than the true cost of the credit. As a result, the consumer cannot make an informed decision about the cost of the loan.[34]

Another practice that has recently received attention is some subprime mortgage lenders engaging in "flipping," the practice of inducing[35] a consumer to refinance a loan, repeatedly, often within a short time frame, charging high points and fees each time.[36] This causes the borrower's debt to steadily increase. Although a consumer's debt may be on the rise anyway if she borrows money in connection with the refinancing, in some cases, the amount of cash received may be smaller than the additional costs and fees charged for the refinancing. While a consumer's option to refinance is an integral part of a functioning mortgage market, subprime lenders engaged in "flipping" may misrepresent to the borrower the terms and ultimate benefits of the transaction, or induce the borrower to take on more debt than she can handle. By taking advantage of its unequal relationship with a particularly vulnerable consumer, an unscrupulous lender can compromise a borrower's ability to make an informed choice about financing options.[37]

Another reported abuse in the subprime mortgage industry is the targeting of consumers by home improvement contractors who are effectively working as agents of lenders.[38] One alleged abuse involves contractors who may obtain the borrower's consent for a loan with high rates and fees through the use of deception or coercion. For example, the contractor and homeowner may agree on a price for certain work. The contractor, after beginning work on the home, may then present the homeowner with loan documents from the lender indicating higher rates and fees than those that were agreed upon. The consumer is then pressured to sign the papers as drafted -- especially when faced with the untenable prospect of leaving the improvements unfinished. In another reported scenario, the contractor may receive the loan proceeds directly or indirectly from the lender without providing any services to the homeowner, or without providing services commensurate with the amount of the payment. Nevertheless, the lender may still demand full payment from the homeowner.

Abusive practices by home improvement contractors and their affiliated lenders[39] are particularly problematic because the targeted homeowners often start out with no mortgage at all or a market-rate first mortgage that they later are induced to refinance. Because of the home improvement scheme, however, a homeowner with an affordable mortgage or no mortgage, and who is seeking aluminum siding or new windows, may suddenly find herself with a high-cost home equity loan.[40]

After a loan is closed, consumers may be subject to loan servicing practices that extract monies not owed under the loan terms or that inhibit refinancing options with another lender.[41] A lender may provide inaccurate monthly-payment demands, adding fees and charges that are not owed. Because of the complexities of loan terms, it is difficult for the borrower to know whether the lender's payment demands are accurate. A lender also may fail to provide full or accurate pay-off information. Consequently, the borrower becomes tied to a lender without a means of escape.[42]

Some of these reported abusive lending practices may be illegal under various federal or state laws, including a number of laws enforced by the Commission. Depending on the particular facts, some of the practices may constitute deceptive or unfair practices in violation of Section 5 of the FTC Act or a comparable state statute. In addition, these practices may constitute violations of the TILA, as well as violations of the protections for high-rate and high-fee loans under the Home Ownership and Equity Protection Act ("HOEPA"), an amendment to the TILA that became effective in October 1995.[43] If a lender charges similarly-qualified borrowers higher prices based on age, race, and/or sex, such a practice would constitute pricing discrimination in violation of the ECOA.[44] Additionally, if a lender targets borrowers for abusive practices based on age, race and/or sex, such targeting, depending on the facts, also could violate the ECOA.

## IV. THE COMMISSION'S RESPONSE

Given this background, the Commission is taking a variety of steps to address reported abuses in the subprime home equity market. First, the Commission is increasing its enforcement activities to halt subprime lenders who are engaged in abusive lending practices. At the same time, the Commission has been working with states to increase and coordinate enforcement efforts. The Commission also is educating consumers in order to help them avoid potential home equity lending abuses.

In January 1998, the Commission filed a complaint in the United States District Court for the District of Columbia against Capital City Mortgage Corporation, a Washington, DC-area mortgage lender, and its owner, alleging numerous violations of a number of federal laws resulting in serious injury to borrowers, including the loss of their homes.[45] The company allegedly made home equity loans to minority, elderly, and low-income borrowers at interest rates as high as 20-24 percent. Borrowers often faced foreclosure on their properties, after which the company would buy the properties at auction for prices much lower than the appraised value of the properties.

The Commission's complaint alleges that the defendants engaged in deceptive and unfair practices against borrowers at the beginning, during, and at the end of the lending relationship, in violation of Section 5 of the FTC Act. The complaint alleges that the defendants deceived borrowers about various loan terms; for example, by making representations that a loan was an amortizing loan that would be paid off by making payments each month. In fact, the loan was an interest-only balloon loan with the entire loan principal amount due after all of the monthly payments were made. The complaint also alleges that the defendants deceived borrowers during the loan period with phony charges of inflated monthly payment amounts, overdue balances, arrears, service fees, and advances. In addition, the complaint alleges that the defendants deceived borrowers regarding amounts owed to pay off the loans. Further, the complaint alleges that the defendants violated the FTC Act by: withholding some loan proceeds while requiring a borrower to make monthly payments for the entire loan amount; foreclosing on borrowers who were in compliance with their loan terms; and failing to release the company's liens on title to borrowers' homes even after the loans were paid off. In addition to the Commission's allegations of violations of the FTC Act, the Commission also charged the defendants with violations of the TILA, the Fair Debt Collection Practices Act,[46] and the ECOA.[47]

In the area of loans sold with credit insurance, the Commission has a long enforcement history. Most recently, the Commission settled a case last year against The Money Tree, a Georgia-based consumer finance lender, and its president. The case involved, in part, allegations that the company required consumers to purchase credit-related insurance and other "extras" along with their loans, without disclosing to consumers the true cost of their credit. The settlement, in part, requires Money Tree to offer refunds of certain insurance premiums to customers whose loans were open at the time the settlement became final. It also mandates that the company approve borrowers' loan applications prior to any discussion with the borrower regarding credit insurance and requires that the company provide expanded disclosures.[48] In 1992, the Commission approved a consent agreement with Tower Loan of Mississippi settling similar charges regarding its consumer loans.[49] The Commission is using the knowledge it has developed through the Money Tree and Tower Loan cases, as well as earlier enforcement actions,[50] to investigate potential insurance problems in home equity lending.

In addition to its casework and ongoing investigations, the Commission is sharing its knowledge and experience with other enforcement agencies and with consumers. Last year, the Bureau of Consumer Protection's Division of Credit Practices held joint law enforcement sessions on home equity lending abuses with state regulators and law enforcers in six cities around the country. These training sessions were conducted to assist states in exercising their relatively new enforcement authority under HOEPA[51] and to share information about recent trends.

In the area of consumer education, the Commission has developed a brochure focusing on consumer rights under HOEPA, for high-rate, high-fee loans covered by that law. In conjunction with the filing of the Capital City complaint, the Commission began distributing a Consumer Alert, advising consumers on how to avoid home equity scams. The Commission today is releasing a new consumer education brochure with additional advice for consumers on home equity abuses.

## V. CONCLUSION

The Commission recognizes that abuses in the home equity lending market are a serious national problem. Due to sharp growth in the subprime mortgage industry, it appears that the abuses by subprime lenders are on the rise. As a result of unfair and deceptive practices, and other federal law violations by certain lenders, vulnerable borrowers -- including the elderly --

are facing the possibility of paying significant and unnecessary fees and, in some cases, losing their homes. Using its enforcement authority, the Commission continues to work to protect consumers from these abuses.

**ENDNOTES**

1. See 15 U.S.C. § 45(a).

2. See 15 U.S.C. §§ 1601 et seq.

3. See 15 U.S.C. § 1691.

4. See, e.g., 15 U.S.C. § 45(a); 15 U.S.C. § 1607.

5. A number of the remarks in this testimony are based on the Commission's administrative and enforcement experience in the area of home equity lending, including consultations with individual consumers, consumer groups, and industry.

6. Credit to "prime" borrowers, borrowers generally with good credit histories, is referred to as "A" credit. "A" mortgage loans are those that conform to the secondary market standards for purchase by the government-sponsored entities, Fannie Mae and Freddie Mac (although Freddie Mac now is purchasing "A minus" subprime loans).

7. See Martin Wahl and Craig Focardi, *The Stampede*, Mortgage Banking, Oct. 1997, at 26, 31. This figure stands in contrast with an increase of 61% in the prime mortgage market for approximately the same period.

8. See Wahl and Focardi, supra note 7, at 31.

9. See *Top 25 B & C Lenders in 1997*, Inside B & C Lending, Feb. 16, 1998, at 2.

10. See Wahl & Focardi, supra note 7, at 29. The number of mortgage brokers in this market skyrocketed from 500 in 1985 to 20,000 in 1996. See *The Two Faces of B&C Lending*, Am. Banker, May 6, 1997, at 2A.

11. See *Home Loan Leaders*, Am. Banker, Oct. 7, 1997, at 16A, 20A; Timothy L. O'Brien, *Lowering the Credit Fence*, N.Y. Times, Dec. 13, 1997, at B1; Adam Zagorin, *Sub-Prime Time*, Time, Nov. 4, 1996, at 67.

12. See Paul Muolo, *Profits Put Sizzle in Subprime Lending*, U.S. Banker, Aug. 1997, at 62. Following a recent boom, earnings in the subprime home equity market generally dipped in the fourth quarter, although many companies' profits already are back on the rise. See Heather Timmons, *Home Equity Sector Rises After Do-or-Die Quarter*, Am. Banker, Feb. 5, 1998, at 9.

13. Many subprime lenders justify their rates and fees on this basis.

14. See O'Brien, supra note 11, at B3.

15. See, e.g., Norma Paz Garcia, Dirty Deeds: Abuses and Fraudulent Practices in Los Angeles' Home Equity Market, Consumers Union, October 1995, at 25; Mike Hudson, *Stealing*

*Home*, Wash. Monthly, June 1992, at 23, 26. Congress removed federal interest rate ceilings and preempted many state usury laws on first lien mortgages with passage of the Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C. § 1735f-7.

16. See Wahl & Focardi, supra note 7, at 29.

17. See *Record B & C Securitization Seen in 1996*, Inside B & C Lending, Feb. 17, 1997, at 4.

18. See Wahl & Focardi, supra note 7, at 29. Growth in subprime originations also has been facilitated somewhat by the increasing availability of warehouse lines of credit, which provide short-term funding to lenders for the purpose of loan financing. See *Warehouse Lines of Credit: Limited for B & C Lenders?*, Inside B & C Lending, Feb. 17, 1997, at 9.

19. See *Subprime Loans Supreme*, ABA Banking J., Nov. 1997, at 77; *Freddie Mac Announces Aggressive Timetable for Full Involvement in Subprime Mortgage Business*, Inside Mortgage Fin., Oct. 10, 1997, at 3. In the letter-grade system for categorizing risk, which ranges from "A" through "D," borrowers who are the most creditworthy are "A"credit risks and those who present the worst credit risks are "D" credit risks. The subprime market generally refers to loans below the "A" level, however the criteria for each credit category are not standardized across the industry and therefore differ among subprime lenders.

20. See Kim Clark, *Why So Many Americans Are Going Bankrupt*, Time, Aug. 4, 1997, at 24; Thomas Goetz, *Loan Sharks, Inc.*, Village Voice, July 15, 1997, at 33, 34; Michael Markowitz, *U.S. Bankruptcies At Record Level*, Bergen County Rec., Jan. 8, 1998, at A1; *Nothing Sub-Prime About These Profits*, Business Week, Sept. 4, 1995, at 98; *The Two Faces of B&C Lending*, supra note 10 at 2A.

21. A full discussion of the entire subprime market is beyond the scope of this testimony.

22. Attention to practices of subprime lenders also has increased due to lawsuits challenging lender payments to brokers under the Real Estate Settlement Procedures Act ("RESPA"). See generally Culpepper v. Inland Mortgage, 132 F.3d 692 (11th Cir. 1998); Barbosa v. Target Mortgage Corp., 968 F. Supp. 1548 (S.D. Fla. 1997); Mentecki v. Saxon Mortgage Inc., Civ. No. 96-1629-A, U.S. Dist. LEXIS 1197 (E.D. Va. January 10, 1997); see also Carol M. Cropper, *Even With Mortgage Brokers, Let the Borrower Beware*, N.Y. Times, Sept. 8, 1996, § 3, at 8.

23. See Complaint at 6, F.T.C. v. Capital City Mortgage Corp., No. 1:98-CV-00237 (D.D.C. filed Jan. 29, 1998); Goetz, supra note 20, at 33; Anastasia Hendrix, *Oakland Widow: They Stole My House*, S.F. Examiner, Apr. 13, 1997, at A-1; O'Brien, supra note 11, at B3; Kay Stewart & David Heath, *High-Cost Loans Trap Those Least Able To Afford It*, Louisville Courier-Journal, Feb. 16, 1997, at 16-17; Lucille Renwick, *Wolf at the Door*, L.A. Times, Mar. 14, 1993, at 16.

24. For example, the Department of Justice announced a settlement in September 1996 with Long Beach Mortgage Company addressing allegations, inter alia, that the company

discriminated against the elderly, African Americans, Latinos, and women by charging higher rates than were offered to other similarly-qualified borrowers. The combination of these factors was alleged to be crucial. For example, African American females over the age of 55 were 2.6 times more likely than white males under age 56 to be charged fees and points that amounted to 6% or more of the loan amount. See Complaint, United States v. Long Beach Mortgage, Civ. No. 96-6159DT (CWX) (C.D. Cal. filed Sept. 5, 1996).

25. See Goetz, supra note 20, at 34.

26. Fifty-eight percent of seniors living below the federal poverty level own their own homes. Derived from U.S. Dept. of Commerce & U.S. Dept. of Housing and Urban Development, American Housing Survey of the United States, 1993. Thirty-nine percent of all families below the federal poverty level own their own homes. Derived from U.S. Dept. of Commerce & U.S. Dept. of Housing and Urban Development, American Housing Survey for Selected Metropolitan Areas, 1991-94.

27. *Hearings Before the Federal Reserve Board on the Effect of Truth in Lending Act Provisions Enacted in 1994 on the Home Equity Loan Market*, June 17, 1997 (testimony of Elizabeth Renuart, National Consumer Law Center).

28. While the TILA, as amended by the Home Ownership and Equity Protection Act, prohibits a pattern or practice of asset-based lending, this proscription only applies to the narrow set of high-rate and high-fee loans covered by the statute and does not apply at all to purchase-money loans. See 15 U.S.C. § 1639; 12 C.F.R. § 226.32. For a discussion of HOEPA's requirements, see infra note 43.

29. See The Money Tree, No. C3735 (F.T.C. Apr. 28, 1997) (settling allegations that credit insurance and other "extras" were required but not included in finance charge and APR disclosures in violation of the TILA and, in certain instances, the FTC Act); Tower Loan of Mississippi, 115 F.T.C. 140 (1992) (same).

30. The guidelines established by the National Association of Insurance Commissioners suggest that lenders and insurers may retain up to 40 cents on the dollar from premiums paid by borrowers, with 60% of premium payments paid out for claims. In most states, however, lenders and insurers retain more than 40% of premium monies; in some states, they keep up to 70% or 80% of the proceeds. See Jane Bryant Quinn, *Credit Life Insurance Often Overpriced*, Wash. Post, Feb. 9, 1997, at H2.

31. See Mike Hudson, *Credit Insurance: Overpriced and Oversold*, N.Y. Times, July 3, 1994, at 8 (discussing overcharging for credit insurance policies). Concerns regarding the value and marketing of credit insurance date back to the 1970's. See Charles Hassell, *Credit Insurance Problems*, National Association of Attorneys General Consumer Protection Newsletter, May 15, 1975, Vol. 3, No. 5, at 11 (finding that lenders often do not disclose to borrowers material facts about policy provisions and exclusions); Phillip Stern, *Debt Insurance Charges*, Wash. Post,

Nov. 12, 1974, at A9 (asserting that purchasers of credit life insurance were overcharged a total of $615 million in 1973).

32. This scenario is known as "bait and switch," because the closing papers differ from the loan package previously discussed with the borrower.

33. See 12 C.F.R. § 226.4(b)(7). Typically, lenders can easily induce borrowers to sign a line in the thick package of complex loan closing papers indicating that the purchase of insurance is voluntary when, in fact, they have little choice if they want to close the loan at that time. Whether credit insurance is in fact required or optional is a factual question. See Federal Reserve Board, Official Staff Commentary to Regulation Z, § 226.4(d)(5).

34. Lenders have incentives to omit required credit insurance premiums from the disclosures of the annual percentage rate and finance charge. First, the appearance of a lower rate may induce the borrower to follow through on the transaction. Second, the lower figure may cause the lender's annual percentage rate to appear to fall below state rate ceilings, which it may in actuality be exceeding.

35. One method of inducing a borrower to refinance is by issuing a balloon note -- particularly one in which the borrower is paying only interest -- where the note comes due in a relatively short period of time. When the note comes due and the borrower owes a substantial lump sum -- sometimes equal to the entire principal of the original loan-- the borrower must again obtain a loan in order to finance the balloon payment that is due at that time.

36. See, e.g., Kay Stewart, *Widow Sold Her House To Pay Loan She d Hoped Would Ease Her Debts*, Louisville Courier-Journal, Feb. 16, 1997, at 16 (lender refinanced borrower's loan four times in nine months). Lenders in the consumer finance industry have long relied on refinancing, and sometimes repeated refinancing, as a source of business. See W. Artz & R. Neihengen, Jr., *Analysis of Finance Company Ratios in 1994,* 78 J. Commercial Lending 33, 37 (Sept. 1995) (showing that, from 1990 to 1992, companies refinanced existing loans to present borrowers in a range of 63% to 66.8% of the cases); Report of the Presiding Officer on Proposed Trade Regulation Rule: Credit Practices, Federal Trade Commission, Aug. 1978, at 43-44 (creditors self-reported refinancing loans for existing customers in a range of 35% to 75% of accounts, with an average of 56.5%).

37. See, e.g., Emery v. Am. Gen. Fin., 71 F.3d 1343 (7th Cir. 1995) (noting that disclosures do not wholly protect a vulnerable borrower from misrepresentations in connection with loan refinancing and holding that flipping can present a civil cause of action under RICO).

38. See Complaint, Newton v. United Cos. Fin. Corp., Civ. No. 97-CV-5400 (E.D. Pa. filed Sept. 2, 1997) (class action suit on behalf of low-income borrowers who paid fees and charges of up to 50% of the cost of the home improvements); Complaint, Harris v. Green Tree Fin. Corp., Civ. No. 97-CV-1128 (E.D. Pa. filed Feb. 14, 1997) (class action suit challenging deceptive home improvement loan contracts); see also Stuart L. Ditzen, *From Home Loans to Lawsuits,*

Phila. Inquirer, Dec. 17, 1997, at B1.

39. Although a consumer targeted by a home improvement contractor often has no direct contact with the lender, the consumer generally still can bring an action against the lender. The contractor, pursuant to the Commission's Trade Regulation Rule on Preservation of Consumer Claims and Defenses, known as the Holder Rule, is obligated to include in the consumer's loan documents a provision stating, in part, that "any holder of [that] consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller of goods or services . . . ." See 16 C.F.R. § 433.2. Therefore, depending on the facts of a particular case, the lender could be subject to any claims that the borrower could have brought against the contractor. If the contractor omits this language from the loan documents, the omission itself would constitute a violation of the Holder Rule.

40. Lenders have several incentives to refinance a homeowner's existing mortgage rather than to merely originate a new loan for the home improvements. First, lenders generally seek to originate one combined loan rather than only a second mortgage for the smaller cost of the improvements. This allows the lenders to maximize fees that are obtained based on the loan principal. Second, lenders generally prefer the initial lien position because of the benefits that would accrue to them in the event of a borrower's bankruptcy. Third, under current federal law, state usury caps do not apply to first liens. See 12 U.S.C. § 1735f-7.

41. See Complaint at 11-13, F.T.C. v. Capital City Mortgage Corp., No. 1:98-CV-00237 (D.D.C. filed Jan. 29, 1998). See infra note 45 and accompanying text for a discussion of this case.

42. A borrower also may be tied to a lender if the lender's appraisal intentionally and significantly overvalues the property because the borrower's loan-to-value ratio may be too high for refinancing. This is known as a "bumped appraisal."

43. HOEPA prohibits various practices and requires that certain material disclosures be provided in advance for certain home equity loans. HOEPA applies only to loans where the APR exceeds the comparable Treasury security rate by more than 10 percentage points or where the total fees and points exceed the larger of $435 or 8 percent of the total loan amount. (The $435 figure is applicable to 1998 and is updated annually by the Federal Reserve Board.) If a loan meets this considerable threshold, a lender must provide several special disclosures of loan terms and conditions. In addition, the loan may not be based solely on equity and may not include, inter alia: negative amortization, most pre-payment penalties, balloon payments for loans with less than five-year terms, and default interest rates higher than pre-default rates. HOEPA does not apply to purchase money, reverse mortgage, or open-end mortgage loans. See 15 U.S.C. § 1639; 12 C.F.R. § 226.32.

44. See supra note 24 for a discussion of the Department of Justice's settlement with Long Beach Mortgage.

45. See Complaint, F.T.C. v. Capital City Mortgage Corp., No. 1:98-CV-00237 (D.D.C. filed Jan. 29, 1998).

46. See 15 U.S.C. § 1692.

47. See also Complaint, F.T.C. v. Nationwide Mortgage Corp., Civ. No. 85-0976 (D.D.C. filed Mar. 26, 1985); Complaint, F.T.C. v. R. A. Walker and Assoc., Civ. No. 83-2462 (D.D.C. filed October 5, 1983). In Nationwide, the Commission alleged that Nationwide solicited consumers whose mortgages were in default and offered them one-year, interest-only loans with balloon payments of the entire loan balance due at the end of the year. The complaint alleged that Nationwide's practices were deceptive and violated Section 5 of the FTC Act because Nationwide told consumers falsely that they would be able to obtain refinancing at the end of the year. The complaint also alleged violations of the TILA based on Nationwide's alleged failure to disclose the balloon payment and the company's alleged practice of inducing some consumers to sign statements indicating their loans were for business purposes, which are exempt from TILA protections, when in fact they were consumer loans. In R. A. Walker, the complaint alleged that Rita Walker solicited consumers whose mortgages were in default, persuaded them to transfer title to their property to Walker, and engaged in unfair and deceptive practices in violation of Section 5 by falsely claiming that the transfer of title was a temporary measure to avoid foreclosure and that Walker would obtain financing for the consumers that would allow them to remain in their homes.

48. See The Money Tree, No. C3735 (F.T.C. Apr. 28, 1997).

49. See Tower Loan of Mississippi, 115 F.T.C. 140 (1992).

50. See, e.g, Commercial Credit Co., 82 F.T.C. 1841 (1973), *order reopened and modified*, 98 F.T.C. 783 (1981).

51. States also have authority to enforce HOEPA. See 15 U.S.C. § 1640 (e).

The CHAIRMAN. Mr. Brennan, thank you for being here.

**STATEMENT OF WILLIAM J. BRENNAN, JR., DIRECTOR, HOME DEFENSE PROGRAM, ATLANTA LEGAL AID SOCIETY, ATLANTA, GA**

Mr. BRENNAN. Mr. Chairman, members of the committee, thank you for giving me the opportunity to address the committee on the issue of predatory mortgage lending practices targeted at elderly homeowners.

We are grateful that you are holding these hearings—and when I say this, I do not speak just for myself as a legal services attorney, but for nonprofit housing counselors, legal services attorneys around the country, private attorneys who represent homeowners targeted with predatory scams, and community activists who are addressing this issue. I think this is the first time there has been a concerted effort by the Congress to really look into these practices and see what is going on. We are most grateful for your interest and your willingness to shine the light of day on these sleazy practices that are especially harmful to elderly homeowners, who should be living out their lives in peace and quiet but instead are subjected to this kind of stress.

The CHAIRMAN. If we had followed your work over the last few years, we probably would have arrived here sooner.

Mr. BRENNAN. Thank you, Senator. Nonetheless, we are grateful that you are looking at it now.

As you said, Mr. Chairman, I have been a legal services lawyer for 29 years and have been doing this work for the past 10 years. I have been struck by the fact that this was not going on 7 or 8 years ago, or 10 years ago. What we were seeing then was people with finance company problems, but these were signature loans of under $3,000. It is when the finance companies and other high-cost mortgage lenders got into the subprime mortgage lending business that the trouble started.

On a daily basis, my associate, Karen Brown, who is here today and is another legal services attorney, two paralegals and a part-time secretary and I are inundated with cases of mostly elderly homeowners who come into our offices telling us that they are losing their homes.

I must say that I am really angry that I have to use this "Atlanta Foreclosure Report" daily to look up their names to see if they are being foreclosed on next month, because if they are being foreclosed on the first Tuesday of the next month, we have a serious problem, and we have got to stop everything and try to find a way to save their house.

The names of those large national companies that are listed in here as foreclosing month after month are frequent. The foreclosure rate of these companies is much higher than the foreclosure rate of conventional mortgage companies. So we are really in the business of trying to save houses, and this should not have to be.

Why is it happening? Having done this for so long, we start coming to conclusions. The fact that people have high equity in their homes is a major factor, caused by the fact that elderly people have paid their mortgages down and the fact that values of houses have increased.

The lack of enforcement of consumer protection laws, or the absence of consumer protection laws, are major factors. Another major factor is the redlining practices of some banks which create credit-starved communities where the predatory lenders can go and take advantage of people who do not have access to credit at reasonable rates.

Finally, we know the profits for these lenders are just enormous; they are incredibly high. And these profits are multiplied by the fact that many of these companies are bundling together their mortgages and selling them to investors as asset-backed securities on Wall Street.

I have said why we think it happens. Now let me describe for you our typical elderly client. We have elderly homeowners who, as I say, tend to have substantial equity in their homes, but they live on fixed incomes—Social Security or retirement benefits. Their homes may be in need of expensive repair. They have retired, so they have stopped fixing the roof. Or, I have so many clients who are widows. Their husbands used to do a lot of work around the house. Usually, it is a roof. I have had so many cases where people have been scammed because home improvement contractors working with predatory lenders approached them about roofing work.

We have homeowners who have fallen behind in their property taxes or have incurred substantial medical bills not covered by Medicare or Medicaid or health insurance. Again, we have widows who have suffered a loss of income after the death of their husbands, or vice versa.

A common characteristic of these victims is that they see a need for money. Sometimes it is real, or it is suggested by these lenders, and that, combined with a lack of financial sophistication, creates the problem. This situation is often exacerbated by diminished mental capacity as a result of Alzheimer's or other dementia-related diseases that some elderly homeowners suffer from.

I would like to briefly talk to you about how these things originate and use some demonstrative materials to show you. These companies market these loans in neighborhoods where financially vulnerable people live with signs on telephone poles, mailers, phone solicitation, door to door home improvement solicitations, and TV ads. Here are some of the kinds of signs that we see blanketing the neighborhoods where our lower-income elderly homeowners live.

They focus on poor credit, and they try to solicit people to "make that phone call." We have other signs here that set out the kinds of things that they are trying to get people to take notice of. One of them always catches my eye, and that is "Capital Truss Company." By the way, as a caveat, I must say that I do not know if these particular companies hook people up with abusive lenders, but these signs are typical of those used by mortgage brokers who do this. I do not know about these particular companies, but "Capital Truss Company" cannot even spell correctly. So many of these companies are brokers——

The CHAIRMAN. "T-r-u-s-s," instead of "T-r-u-s-t."

Mr. BRENNAN. Yes. "Truss" for a hernia, in other words. [Laughter.]

In any case, these are brokers that are aggressively marketing these products into the community, and many of them are fly-by-nights; all they need is a fax and a phone, and they are in business.

Let me show you these mailers. These are the kinds of mailers we see being mailed out all the time, Mr. Chairman. This is one company that uses an envelope which looks like a Government check.

The CHAIRMAN. Like a Social Security check.

Mr. BRENNAN. Yes, correct. It does not have a return address on the envelope. It says, "Department of Communications Electronic Mail Section." And when you pull it out, it looks like some kind of Government check, and it is an offer of $50,000 if you will just make the application and sign up for the equity mortgage loan.

Then, we see these kinds of mailings that look like urgent telegrams, but in fact——

The CHAIRMAN. It looks like mail that Congressmen get.

Mr. BRENNAN. Right; probably generated by a computer.

The CHAIRMAN. When an important bill is coming up, we will get mail that looks like that.

Mr. BRENNAN. Some of our unsophisticated homeowners—these mailings are designed to trigger their interest and make them pick up the phone and make the call, and that sucks them into the predatory mortgage loan. The result is devastation. The results of these high-cost mortgage loans wreak havoc in our clients' lives.

Our typical client is so much like Ms. Ferguson and the Jacksons and Gael Carter who was on the videotape. Those are my clients, the kind of people we see day in and day out and they are saddled with high-cost loans with high interest, insurance packing and the rest.

Here is an example of my client, Ms. McNab. After borrowing about $54,000, and after making monthly payments for 15 years, she will still owe 87 percent of the loan. After making total payments of $107,000 over 15 years, she will still owe $47,000. That is called a "balloon payment," and it is a device to indirectly enhance the profitability of these types of loans for the lenders.

The CHAIRMAN. Would she be better off borrowing on a credit card than this way?

Mr. BRENNAN. Probably. She would really be better off not borrowing at all, to tell you the truth.

The CHAIRMAN. Oh, I know, but as far as the interest is concerned.

Mr. BRENNAN. Correct. Most people think that loans amortize down to zero during the term of the loan, and she did not even know the balloon was in the loan. They fanned the papers at the closing and she signed them. Then she came to me—in fact, I just spoke with her yesterday. This same company is calling her up now and saying, "Hey, you have a balloon in your mortgage; you need a new loan." I ask myself "why did they make the bad loan to her in the first place? Why did they give her a bad balloon loan and then call her up and say, You are in a bad loan; let us get you into a better loan that will pay its way out over the term of the loan"?

Those are the kinds of practices we are seeing: balloons, flipping etc. The insurance packing is also incredible. So many of these transactions start out as home improvement scams. The home improvement companies who solicit our clients work as bird dogs for the sub prime lenders; Their goal is not to do a decent home improvement job, but to sign somebody up for a high-cost mortgage.

To put all this in perspective, it might be useful to look at what middle-class and wealthy homeowners with good credit are able to get from a bank a home equity line of credit (a HELOC). Here are some ads from newspapers that show how these loans work. One is from Nations Bank and one is from the Bank of New York. HELOC's are loans with no closing costs, no points. The borrower can access the full amount of the loan based upon the equity in his or her house. They hand you a checkbook, and you can write a check for as much or as little as you want. There is no flipping, no successive refinancing with high costs.

Although some consumer advocates have a few problems with HELOC's compared with what we are seeing, these are good mortgage products. The interest is prime, one point below prime or one point above prime. What is really interesting is that there are no abuses no high interest, no high points in fact, there are no points, no flipping, no credit life insurance sold with these kinds of products, no balloon payments, no broker kickbacks, and no home improvement scams. So here is an alternative that puts what is happening to our clients in stark contrast to what is available to other types of customers.

We have a dual system for accessing credit. Elderly homeowners with fixed incomes are funnelled into the predatory system exemplified by those signs. Others are funnelled into very good mortgage loan products exemplified by these HELOC advertisements.

Why is that? The lenders say that the high risk justifies the high cost and these other abusive practices. I would invite you to look at the profits that these companies are posting. A very good bank can lend money and make profits at 5 to 7 percent. These companies are making profits 5 and 10 times that amount. If risk were the reason for the high cost and the other abuses, why aren't their profits similar to the banks lower profits? If they are suffering losses because they are lending to uncreditworthy people, why aren't their profits right about in line with the banks'? But they are not. Their profits are incredible. The CEO of one high-cost finance company mortgage lender in 1996 made 102 million in annual salary and compensation. These companies are immensely profitable, which is the bottom line reason for why this is going on.

I will briefly wrap up. What is really sad, Mr. Chairman, is that for so many of our elderly homeowners, there are reasonable alternatives available if they actually do need a mortgage loan. There are reverse mortgages, for example, that are very helpful to elderly people. They can access the equity out of their homes and they do not have to make a payment on the loan until after they die or if they vacate the house. There are also special programs that are arranged through nonprofit agencies like the Neighborhood Assistance Corporation of America in Boston. Bruce Marks, the director of NACA has investigated and criticized and demonstrated against predatory mortgage lenders for years, and he has worked out settlements with these institutions and with reputable banks for homebuyer programs and for refinancing homeowners out from under predatory mortgage loans and into loans with reasonable rates.

One thing Mr. Marks asked me to mention which he has investigated but which is not in my area of expertise that I think perhaps the committee might be interested in, is that, as Professor Marsh pointed out, the accounting methods used by these companies may present great risks for investors who own their stock or buy securitized mortgages. I think this house of cards may tumble some day, and it will mean great losses for the investors who own stock in those companies.

In conclusion, Mr. Chairman, what is happening here is that the equity in the homes of these senior citizens is being accessed, all right, but it is not being accessed for the benefit of the homeowners. It is being accessed for the benefit of the lenders, that is, for the lenders to make unconscionable profits.

Again we are most grateful to the committee for taking the time to listen and to investigate the abuses occuring in the sub prime. We are hopeful that some positive result may come out of this.

Thank you.

[The prepared statement of Mr. Brennan follows:]

**Statement of William J. Brennan, Jr., Director, Home Defense Program of the Atlanta Legal Aid Society, Inc., Before the United States Senate Special Committee on Aging on March 16, 1998**

Thank you for this opportunity to address the United States Senate Special Committee on Aging on the subject of predatory mortgage lending practices directed against the elderly. My name is William J. Brennan, Jr. For the past 29 years, I have been a staff attorney at the Atlanta Legal Aid Society, Inc. specializing in housing and consumer issues.

I have been the director of the Home Defense Program of the Atlanta Legal Aid Society for the past ten years. The Home Defense Program provides referrals and legal representation to homeowners who have been victimized by title conversion, home equity and home purchase scams. The Program is funded by the Atlanta Legal Aid Society and the DeKalb County, Georgia Community Development Department with HUD community development block grant funds.

On a daily basis, we assist individual homeowners who have been targeted by local and national companies with abusive, predatory mortgage lending practices. We provide them with legal advice. We evaluate their cases to determine whether legal claims exist. We settle some cases without litigation and litigate others. Most often, because of our limited resources, we assist homeowners in obtaining private attorneys to represent them in cases where the homeowners may have legal claims. Where appropriate, we also refer homeowners to local nonprofit housing counseling and other agencies which assist them in obtaining refinancing of their high cost mortgage loans through low-cost, conventional mortgage lenders or other special programs. Many senior citizen homeowners are referred for reverse mortgages. We also participate on a regular basis in a range of community education efforts aimed at warning homeowners against home equity theft scams, including abusive mortgage lending practices.

Home equity theft is the theft of the equity in the home or of the actual title to the home. The theft is accomplished through illegal practices and scams and also through otherwise legitimate business practices which are employed abusively and used for purposes other than those for which they were initially intended. There are two categories of home equity theft scams. The first are title conversion scams, which involve fraudulent representations made to homeowners resulting in the immediate loss of the title to the home. For example, foreclosure assistance fraud occurs when homeowners facing foreclosures are approached by "lenders" who offer to lend money to save the house from foreclosure but end up owning the home, evicting the homeowner, and accessing the equity in the homes with new mortgage loans for themselves. The second category is predatory mortgage lending.

Predatory mortgage lending consists of lenders who purposely target homeowners with substantial equity but less than perfect credit for high-cost, abusive mortgage loans. The lenders employ a bogus theory of high risk to legitimize lending money at unconscionably high interest rates and engaging in other abusive practices which increase the revenue on the loans. The abusive practices include loan flipping, balloon payments, and the sale and financing of overpriced credit life and disability insurance (insurance packing). See Exhibit A for a list of the abusive practices and a description of each.

**Why does predatory mortgage lending occur?**

First, high equity makes homes attractive for predatory lenders. High equity is generally the result of two factors: (1) the appreciation of property values; and (2) payment of mortgages, which over time results in the reduction of the principal balance on the mortgage loan.

Second, the absence of strong consumer protection laws and the lack of enforcement of existing laws permit these scams to flourish. For example, many states have no usury laws or have caps on interest rates which are set too high. The Georgia criminal usury statute allows mortgage interest rates of 60% per year. Many states, including Georgia, permit non-judicial foreclosure sales, which facilitate foreclosures and impede homeowners' efforts to raise defenses in court.

Third, redlining creates a credit-vacuum filled by predatory lenders. When some banks and other conventional lending institutions designate entire minority communities as bad financial risks and refuse to make them loans (redlining), high-cost finance companies target those same communities with overpriced loan products, knowing that the residents are a captive market with no access to reasonably-priced credit (reverse redlining). In this way, redlining produces reverse redlining as its logical complement. Therefore, it's not surprising to find that banks guilty of the former often profit from the latter, either by owning, lending money to or purchasing loans from finance companies which engage in predatory lending.

Fourth, greed is the primary driving force behind predatory mortgage lending. The yields and profits are incredibly high. The risk is minimal because the loans are secured by gilt-edged, gold standard collateral: homes and the equity in homes. The practice of bundling mortgages together to be sold to pension funds, mutual funds and other investors as asset-backed securities further increases the profitability of this business. A review of the profits of some of the predatory lenders will verify this.

**Types of Victims**

The communities that fall prey to predatory mortgage lending predominantly consist of elderly, low and moderate income, and/or minority homeowners. Elderly homeowners, who tend to have substantial equity but live on fixed incomes (social security and retirement benefits), are perhaps the principal targets. Their homes may be in need of expensive repairs (often roofing work) or they may have fallen behind on their property taxes, incurred substantial medial bills not covered by Medicare, Medicaid or health insurance, or suffered a loss of income after the death of a spouse. The common characteristics of these victims are a need for money (either real or suggested by the lender) combined with a lack of financial sophistication, often exacerbated by diminished mental capacity as a result of Alzheimer's and other dementia-related diseases.

Minority groups are disproportionately targeted by predatory lenders because their access to legitimate sources of loans and other financial services is disproportionately denied. As mentioned above, redlining produces credit-starved communities that will pay exorbitant prices for loans.

Low and moderate income homeowners are also targets when they have or appear to have less than perfect credit ratings. Conventional lenders tend to deny loans to these individuals and often steer them to predatory lenders.

**Historical Perspective**

The last 10-15 years have seen a tremendous increase in home equity lending in general. Initially, home equity lending targeted middle-class and wealthy homeowners with good credit ratings, substantial income, and significant home equity. Recently the industry has expanded to encompass lower income and other communities formerly on the margins of the mortgage loan market; as this segment of the industry has demonstrated explosive growth, so have the predatory lending abuses described in Exhibit A.

In my practice as a legal services attorney over the last 29 years specializing in consumer and housing issues, I am struck by the fact that 15 years ago our typical homeowner clients did not have equity mortgages. A few had second mortgages, but in Georgia the terms of those mortgage loans were strictly regulated. There was a cap on interest rates for second mortgage loans, and if the lender violated the law the penalty was forfeiture of the remaining balance due on the mortgage. (That law has since been repealed). Our homeowner clients' involvement with finance companies was limited to signature loans in small amounts, usually $3,000 or less. Finance companies were not mortgage lenders at that time.

In the mid to late 1980's, these finance companies began making mortgage loans. Unfortunately, their mortgage lending operations were not subject to the state regulatory agencies which monitored their small, unsecured loan business. (Although later, many states enacted licensing laws to regulate mortgage lenders and brokers.) The growth of mortgage lending by finance companies and other subprime mortgage lenders over the last 10-15 years has been phenomenal. Additionally, banks, insurance companies, car manufacturers, a giant agribusiness corporation, and a host of other large corporations have entered the field of subprime mortgage lending. Moreover, new companies have been formed to take advantage of the lucrative profits generated by this business.

The growth of the home equity lending industry and the reasons therefor have been chronicled by Julia Patterson Forrester in an excellent law review article entitled, "Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing," 69 Tulane L. Rev. 373 (1994). Among other points, Professor Forrester explains how predatory mortgage lending practices have flourished within the context of the massive increase of equity lending.

My impression is that today, in the low and moderate income neighborhoods where our clients live, the penetration by subprime predatory mortgage lenders has been enormous. It appears that virtually every other house in these neighborhoods is burdened by a predatory mortgage loan. Nonprofit housing counseling agencies in our area report increases in predatory mortgage lending cases, especially among elderly homeowners. They refer many of these cases to my program. Additionally, legal services programs around the country report dramatic increases in these types of cases. Dozens of programs now have attorneys specializing in these cases. They are filing lawsuits against these companies on behalf of homeowners under various federal statutes including the Truth in Lending Act (TILA), the Real Estate Settlement Procedures Act (RESPA), and the Home Ownership and Equity Protection Act of 1994 (HOEPA). They also pursue claims under state Uniform Deceptive Acts and Practices (UDAP) statutes, and assert claims based on fraud or seek recission in equity based on unconscionability. Private attorneys around the country have also seen an influx of these cases and are filing lawsuits based on the same claims. The National Consumer Law Center, based in Boston, MA, now conducts foreclosure prevention workshops for legal services and private attorneys around the country. This excellent program teaches attorneys how to assist homeowners who have been victimized by predatory mortgage lenders (for information on this program, contact Elizabeth Renuart in the Washington, DC, NCLC office at 202-986-6060).

What we are all seeing is that the substantial equity in the homes in these neighborhoods which formerly constituted an element of wealth for these homeowners, albeit in small amounts, is now held hostage or owned outright by predatory lenders. Their abusive business practices have resulted in a substantial increase in foreclosures which divest homeowners of their property and make them homeless. The result is destabilization of what were formerly vibrant neighborhoods populated by owner-occupied homes and an increase in the need for government-funded social service agencies to address the social ills generated by this destabilization.

To put these abuses in perspective, consider the terms of home equity lines of credit (HELOCs) which banks offer to middle and upper income homeowners. While we have serious concerns about certain features of HELOCs, it is interesting to note that: they have no closing costs and no points; the annual interest rate is either slightly above prime, at prime, or below prime; they do not promote the sale of credit life insurance; they do not have balloon payments; and because the borrower can access additional equity without a new loan, these loans are not flipped. The dichotomy here is that a customer with good credit, middle to high income, and $30,000 in equity will qualify for one of these loans. In contrast, a lower income person with less than perfect credit who may be elderly and/or a minority with the same $30,000 equity is funneled into a predatory mortgage loan which has high interest and points, expensive credit life insurance, a balloon payment, and other abusive features. This loan is then frequently flipped two or more times, resulting in additional, unnecessary costs to the homeowner. Since the collateral for both loans is 80% of the value of the home, the slightly higher risk in the second loan cannot justify its much higher cost.

The state of Texas will provide a fascinating microcosmic illustration of the evolution of the predatory mortgage lending industry. Until recently, because of a broad homestead exemption dating back to 1839, home equity lending was virtually nonexistent in Texas. However, an intensive 20-year campaign by the mortgage industry has culminated in a constitutional amendment which sets the stage for the proliferation of home equity lending. Substantive provisions protecting borrowers from many lending abuses were included in the constitutional change. Texas will now afford us a laboratory-like setting to observe whether these protections will effectively deter predatory mortgage lending abuses as equity lending rapidly expands throughout the state.

**Preferable Alternatives for Elderly Homeowners**

The best advice for elderly homeowners is not to get an equity loan at all. An equity loan can often trigger the slippery slide into foreclosure, particularly for elderly retired homeowners who are living on a reduced fixed income. Occasionally, there are good reasons for elderly homeowners to access the equity in their homes: a new roof, replacement of a furnace, or large medical bills. Under these circumstances, a predatory mortgage loan is the worst possible option. While a HELOC would be a better option, some homeowners may not qualify. The best option for senior homeowners is a reverse mortgage, sometimes called a home equity conversion mortgage (HECOM). Homeowners qualify for these loans based upon their age and equity. With a reverse mortgage, a homeowner can borrow a substantial part of the equity in his home and the loan does not have to be paid until he vacates his home or dies. Under this plan an elderly homeowner may choose to make payments to reduce the balance but is not under threat of foreclosure and eviction if he does not make these payments. However, recent news articles have reported that some mortgage brokers have gouged elderly homeowners by charging them thousands of dollars in brokers' fees simply for referring them to reverse mortgage lenders. To avoid this pitfall, seniors should contact their local housing counseling agencies for information about and referrals for reverse mortgages. These agencies are funded by HUD, the American Association of Retired Persons (AARP) and other entities to provide these types of services free of charge. Two relevant articles from the HUD publication "Counselor's Connection" are attached hereto as Exhibit B. Elderly homeowners already victimized by predatory mortgage lenders should seek legal advice from private attorneys or legal aid attorneys in their area.

**Illustrative Cases**

At this point, I would like to provide the stories of four victims of predatory mortgage lending abuses. Genie McNab is a seventy year old African-American woman. She is retired and lives alone on Social Security and retirement benefits. She has owned her home in Decatur, Georgia for twenty years. In November 1996, she obtained a 15-year mortgage loan from a large national finance company in the amount of $54,300. The annual percentage rate is 12.85%. Under the terms of this loan, Ms. McNab will pay $596.49 per month until the year 2011 when she will be required to pay a final payment of $47,599.14. Thus, when she is 83 years old she will be saddled with a balloon payment that she will never be able to make. Moreover, although she paid a mortgage broker a $700 fee, supposedly to help her find this loan, the lender also paid the broker a $1,100 fee.

Beatrice Smith is a sixty-eight year old African-American woman. She is retired and lives alone on Social Security retirement benefits. She has owned her home in Atlanta, Georgia for 29 years. Over a period of six years, from 1987 to 1993, she was given six mortgage loans. The first loan was for $20,334.71. The last loan was for $34,790.50. The first four loans were made by a national finance company. The company was subsequently purchased by a major national bank. The bank's subsidiary made two additional loans to Ms. Smith. In all of the six loans, the lender sold Ms. Smith credit life insurance with premiums ranging from $2,339.43 in one transaction to $2,905.82 in another transaction. Ms. Smith was required to pay closing costs in each loan. For the six loans, the closing costs totaled $2,544.79. The interest charged on each loan ranged from 9.99 to 15.5004%. Instead of making one loan to Ms. Smith for the money she may have needed, these lenders made her an original loan and flipped her through five successive loans that were of decreasing benefit to her and of increasing benefit to them. They sold her expensive credit life insurance which was of no use to her but, once again, was of great financial benefit to the lenders, one of whom owned the insurance company while the other received large commissions for selling the policies. For the past one and a half years, Ms. Smith has been unable to afford the payments. For months, the lender subjected Mrs. Smith to a campaign of abusive debt collection tactics: minutes after the regional collection office would call her demanding payment and threatening foreclosure, the local branch office would repeat the process, upsetting her greatly. I called the company and insisted that they stop contacting her.. The only reason she has not been foreclosed on and evicted from her home is because I wrote the lender and demanded the cancellation of her mortgage loan on grounds of unconscionability. Although the lender has not complied with my request, it has not pursued foreclosure. See Exhibit C (copy of a chart outlining Ms. Smith's loans).

Beatrice Yorke is an eighty-two year old African-American widow. She is retired and lives alone on Social Security retirement benefits. She has owned her home in Norcross, Georgia for thirty-six years. In the late 1980's and early 1990's, she obtained three loans from a subsidiary of a large northeastern bank. The first loan was a mortgage loan for $15,812.16 with an annual percentage rate of 16.86%. The second loan was a signature loan for $780 with an annual percentage rate of 42.64%. The third loan was a mortgage loan which refinanced the two existing loans. This loan was for $16,851.84 and carried an annual percentage rate of 15.54%. This lender was the subject of intense controversy in the early 1990's when allegations were made that it engaged in predatory mortgage lending practices in Georgia and dozens of other states. This company entered into settlements with the Georgia Attorney General and various plaintiffs in class action and individual lawsuits totaling over $100 million. This company eventually left the business of subprime mortgage lending. However, it sold most of its existing mortgage loan portfolio to another large national finance company. Ms. Yorke has struggled to make payments to this company, but has been unable to do so for the last few months and is now facing foreclosure and eviction. We are working to find a way to stop this 82-year old woman from losing her home and being evicted.

Sanders Faust is a seventy-two year old African-American man who can neither read nor write. He is retired and lives alone on Social Security retirement benefits. He has owned his home in Decatur, Georgia for thirty-one years. There have been four mortgage loans on Mr. Faust's house since 1991. On September 1, 1991, he borrowed $16,499.99 from a finance company that is a subsidiary of a large corporation. On April 2, 1992, this company refinanced his loan for $22,234.79. On December 21, 1992, this same company refinanced his loan again for $25,831.91. These loans included credit life insurance premiums for $2,943.41 and $2,533.52. Finally, on September 13, 1995, he refinanced with a different company for $33,000. However, this other company promptly sold his loan to another subsidiary of the same corporation. The last loan carries an annual percentage rate of 16.185%. He has been unable to make the payments and we referred him to a private attorney for a Chapter 13 bankruptcy for the purpose of saving his home from foreclosure and preventing subsequent eviction. In the midst of this effort, the attorney has learned that the loan has been sold to another company.

These cases typify what we have been seeing in the Home Defense Program for the last 10 years: unconscionably high interest and points, balloon payments, loan flipping, insurance packing, abusive collection tactics, and so forth. Why are we seeing these cases? Predatory lenders say that the high cost of these mortgage loans is justified and required due to the high level of risk associated with borrowers with less than perfect credit. This explanation is bogus. These are not uncollateralized, signature loans. If they were, the argument about risk might be justified. Most predatory lenders lend up to only 80% of the value of the home, leaving the other 20% as a cushion to protect the lender in case of foreclosure. If the homeowner is able to make the payments, the revenue stream created by these loans is very profitable because of the high interest, points and other revenue enhancers. If in fact a default occurs, the lender forecloses, always buys the home at the foreclosure sale, and resells it for a substantial profit. The lender ultimately profits in either scenario, rendering the risk justification illusory.

The test of whether my assertions are correct involves determining whether these lenders' profit margins are in line with those of conventional lenders. In fact, a cursory inspection of industry trends suggests that the subprime mortgage lending market is enjoying spectacular growth and profitability. Even as these hearings proceed, the subprime finance company subsidiary of a major corporation is being sold off to stockholders for $25.8 billion. Within the last few weeks, another company was purchased by a large national bank for $2.1 billion. The CEO of yet another company received $102 million in total compensation for 1996 and $65 million in the previous year. In an article entitled "Loan Sharks, Inc.," Thomas Goetz reports that:

(s)ubprime companies say their interest rates are so high to compensate for the greater risk these borrowers bring. But a welcome side effect of high rates is the profits that traditional banks can't hope to match. According to *Forbes*, subprime consumer finance companies can enjoy returns up to six times greater than those of the best-run banks. Corporate America hasn't failed to notice. *Village Voice*, July 15, 1997 at 33.

What I know from first hand experience is that their success is very much founded upon business practices which makes the lives of my clients miserable. Subprime lenders assert that they provide a positive service to borrowers who could not obtain credit elsewhere, but my clients would emphatically disagree. They don't feel helped, they feel exploited. This is especially true for my elderly clients, like Ms. McNab, Ms. Smith, Ms. Yorke, and for Mr. Faust. At a time when they should be enjoying retirement after a life of hard work, they are at best struggling to make mortgage payments they cannot afford and at worst desperately trying to find ways to save their houses from foreclosure and themselves from being evicted - put out on the street.

**Conclusion**

Home ownership has always been an essential component of the American dream. To fulfill this dream, homeowners work hard to pay off their mortgages so that they may peacefully live out their retirement in a paid-for home. In countless cases this dream has been shattered by predatory mortgage lenders whose drive for exorbitant profits has undercut the well-earned security of elderly homeowners. This is a tragic story for many seniors. Some are saddled with loans they never needed and cannot afford, while others who legitimately needed money were sucked into the worst possible option - a predatory mortgage loan.

Respectfully submitted,

William J. Brennan, Jr.

DATED: March 6, 1998.

# PREDATORY MORTGAGE LENDING ABUSES

The following is a catalogue of predatory mortgage lending abusive practices. We have divided the practices into abuses associated with the origination of the loan, servicing of the loan, and collection of the loan.

## I. ORIGINATION OF LOAN.

1. **Solicitations.** Predatory mortgage lenders engage in extensive marketing in targeted neighborhoods. They advertise through television commercials, direct mail, signs in neighborhoods, telephone solicitations, door to door solicitations, and flyers stuffed in mailboxes. Many of these companies deceptively tailor their solicitations to resemble social security or other U.S. government checks to prompt homeowners to open the envelopes and otherwise deceive them regarding their predatory intentions.

2. **Home Improvement Scams.** Predatory mortgage lenders use local home improvement companies essentially as mortgage brokers to solicit business. These companies solicit homeowners for home improvement work. The company may originate a mortgage loan to finance the home improvements and then sell the mortgage to a predatory mortgage lender, or steer the homeowner directly to the predatory lender for financing of the home improvements. The home improvements are often grossly overpriced, and the work is shoddy and incomplete. In some cases, the contractor begins the work before the three-day cooling off period has expired. In many cases, the contractor fails to obtain required permits, thereby making sure the work is not inspected for compliance with local codes.

3. **Mortgage Brokers - Kickbacks.** Predatory mortgage lenders also originate loans through local mortgage brokers who act as bird dogs (finders) for the lenders. Many predatory mortgage lenders have downsized their operations by closing their retail outlets and shifting the origination of loans to these brokers. These brokers represent to the homeowners that they are working for the homeowners to help them obtain the best available mortgage loan. The homeowners usually pay a broker's fee. In fact, the brokers are working for predatory mortgage lenders and being paid kickbacks by lenders for referring the borrowers to the lenders. On loan closing documents, the industry employs euphemisms to describe these referral fees: yield spread premiums and service release fees. Also, unbeknownst to the borrower, his interest is raised to cover the fee. Within the industry, this is called bonus upselling or par-plus premium pricing.

**Exhibit A**

4. **Steering to High Rate Lenders.** Some banks and mortgage companies steer customers to high rate lenders, including those customers who have good credit and would be eligible for a conventional loan from that bank or lender. In some cases, the customer is turned away before completing a loan application. In other cases, the loan application is wrongfully denied and the customer is referred to a high rate lender. The high rate lender is often an affiliate of the bank or mortgage company, and kickbacks or referral fees are paid as an incentive to steer the customer to the lender.

5. **Lending to People Who Cannot Afford The Loans.** Some predatory mortgage lenders purposely structure the loans with monthly payments which they know the homeowner cannot afford with the idea that when the homeowner reaches the point of default, they will return to the lender to refinance which provides the lender additional points and fees. Other predatory mortgage lenders, whom we call hard lenders, purposely structure the loans with payments the homeowner cannot afford in order to trigger a foreclosure so that they may acquire the house and the valuable equity in the house at the foreclosure sale.

6. **Falsified Loan Applications, Unverified Income.** In some cases, lenders knowingly make loans to homeowners who do not have sufficient income to repay the loan. Often, such lenders wish to sell the loan to an investor. To sell the loan, the lender must make the loan package have the appearance to the investor that the borrower has sufficient income. The lender has the borrower sign a blank loan application form. The lender then inserts false information on the form (for example, a job the borrower does not have), making the borrower appear to have higher income than he or she actually has.

7. **Adding Co-signers.** This is done to create the false impression that together both borrowers have sufficient income to be able to pay off the loan, even though the lender is well aware that the co-signer has no intention of contributing to the repayment of the mortgage. Often, the lender requires the homeowner to transfer half ownership of the house to the co-signer. The homeowner has lost half the ownership of the home and is saddled with a loan she cannot afford to pay.

8. **Incapacitated Homeowners.** Some predatory lenders make loans to homeowners who are clearly mentally incapacitated. They take advantage of the fact that the homeowner does not understand the nature of the transaction or the papers that she signs. Because of her incapacity, the homeowner does not understand she has a mortgage loan, does not make the payments, and is subject to foreclosure and subsequent eviction.

9. **Forgeries.** Some predatory lenders forge loan documents. In an ABC Prime Time Live news segment that aired on April 23, 1997, a former employee of a

high cost mortgage lender reported that each of the lender's branch offices had a "designated forger" whose job it was to forge documents. In such cases, the unwary homeowners are saddled with loans they know nothing about.

10. **High Annual Interest Rates.** The very purpose of engaging in predatory mortgage lending is to reap the benefit of high profits. Accordingly, these lenders always charge unconscionably high interest rates, even though their risk is minimal or non-existent. Such rates drastically increase the cost of borrowing for homeowners. Predatory mortgage lenders routinely charge Atlanta area borrowers rates ranging from 12% to 18%, while other lenders charge rates of 7.0% to 7.5%.

11. **High Points.** Legitimate lenders charge points to borrowers who wish to buy down the interest rate on the loan. Predatory lenders charge high points but there is no corresponding reduction in the interest rate. These points are imposed through prepaid finance charges (or points or origination fees), they are usually 5 to 10% of the loan and may be as much as 20% of the loan. The borrower does not pay these points with cash at closing. Rather, the points are always financed as part of the loan. This increases the amount borrowed, which produces more annual interest to the lender.

12. **Balloon Payments.** Predatory mortgage lenders frequently structure loans so that at the end of the loan period, the borrower still owes most of the principal amount borrowed. The last payment balloons to an amount often equal to 85% or so of the principal amount borrowed. Over the term of the loan, the borrower's payments are applied primarily to interest. The homeowner cannot afford to pay the balloon payment at the end of the term, and either loses the home through foreclosure or is forced to refinance with the same or another lender for an additional term at additional cost.

13. **Negative Amortization.** This involves a system of repayment of a loan in which the loan does not amortize over the term. Instead, the amount of the monthly payment is insufficient to pay off accrued interest and the principal balance therefore increases each month. At the end of the loan term, the borrower owes more than the amount originally borrowed. A balloon payment at the end of the loan is often a feature of negative amortization.

14. **Padded Closing Costs.** In this scheme, certain costs are increased above their true market value as a method of charging higher interest rates. Examples include charging document preparation of $350 or credit report fees of $150, both of which are many times the actual cost.

15. **Inflated Appraisal Costs.** This is another padding scheme. In most mortgage

loan transactions, the lender requires that an appraisal be done. Most appraisals include a typical, detailed report of the condition of the house (interior and exterior) and prices of comparable houses in the area. Others are "drive-by" appraisals, done by someone driving by the homes. The former naturally cost more than the latter. In some cases, borrowers are charged a fee for an appraisal which should include the detailed report, when only a drive-by appraisal was done.

16. **Padded Recording Fees.** Mortgage transactions usually require that documents be recorded at the local courthouse. State or local laws establish the fees for recording the documents. Mortgage lenders typically pass these costs on to the borrower. Predatory mortgage lenders often charge the borrowers a fee in excess of the actual amount required by law to record the documents.

17. **Bogus Broker Fees.** In some cases, predatory lenders charge borrowers broker fees when the borrower never met or knew of the broker. This is another way such lenders increase the cost of the loan for the benefit of the lender.

18. **Unbundling.** This is another way of padding costs by breaking out and itemizing charges which are duplicative or should be included under other charges. An example is where a lender imposes a loan origination fee, which should cover all costs of initiating the loan, but then imposes separate, additional charges for underwriting and loan preparation.

19. **Credit insurance - Insurance Packing.** Predatory mortgage lenders market and sell credit insurance as part of their loans. This includes credit life insurance, credit disability insurance, and involuntary unemployment insurance. The premiums for this insurance are exorbitant. In some cases, lenders sell credit life insurance covering an amount which constitutes the total of payments over the life of the loan rather than the amount actually borrowed. The payout of claims is extremely low compared to the revenue from the premiums. The predatory mortgage lender often owns the insurance company, or receives a substantial commission for the sale of the insurance. In short, credit insurance becomes a profit center for the lender and provides little or no benefit to the borrower.

20. **Excessive Prepayment Penalties.** Predatory mortgage lenders often impose exorbitant prepayment penalties. This is done in an effort to lock the borrower into the predatory loan for as long as possible by making it difficult for her to refinance the mortgage or sell the home. Another feature of this practice is that it provides back end interest for the lender if the borrower does prepay the loan.

21. **Mandatory Arbitration Clauses.** By inserting pre-dispute, mandatory, binding arbitration clauses in contractual documents, some lenders attempt to obtain unfair

advantage of their borrowers by relegating them to a forum perceived to be more favorable to the lender than the court system. This perception exists because discovery is not a matter of right but is within the discretion of the arbitrator; the proceedings are private; arbitrators need not give reasons for their decisions or follow the law; a decision in one case will have no precedential value; judicial review is extemely limited; a lender will be a frequent user while the consumer is a one time participant; and injunctive relief and punitive damages will not be available.

22. **Flipping.** Flipping involves successive, repeated refinancing of the loan by rolling the balance of the existing loan into a new loan instead of simply making a separate, new loan for the new amount. Flipping always results in higher costs to the borrower. Because the existing balance of one loan is rolled into a new loan, the term of repayment is repeatedly extended through each refinancing. This results in more interest being paid than if the borrower had been allowed to pay off each loan separately. A powerful example of the exorbitant costs of flipping is the case of Bennett Roberts, who had eleven loans from a high cost mortgage lender within a period of four years. See, Wall Street Journal, April 23, 1997, at 1. Mr. Roberts was charged in excess of $29,000 in fees and charges, including ten points on every financing, plus interest, to borrow less than $26,000.

23. **Spurious Open End Mortgages.** In order to avoid making required disclosures to borrowers under the Truth in Lending Act, some lenders are making "open-end" mortgage loans. Although the loans are called "open end" loans, in fact they are not. Instead of creating a line of credit from which the borrower may withdraw cash when needed, the lender advances the full amount of the loan to the borrower at the outset. The loans are non-amortizing, meaning that the payments are interest only so that no credit will be replenished. Because the payments are applied only to interest, the balance is never reduced.

24. **Paying Off Low Interest Mortgages.** A predatory mortgage lender usually insists that its mortgage loan pay off the borrower's existing low cost, purchase money mortgage. The lender is able to increase the amount of the new mortgage loan by paying off the current mortgage and the homeowner is stuck with a high interest rate mortgage with a principal amount which is much higher than necessary.

25. **Shifting Unsecured Debt Into Mortgages.** Mortgage lenders badger homeowners with telephone and mail solicitations and other advertisements that tout the "benefits" of consolidating bills into a mortgage loan. The lender fails to inform the borrower that consolidating unsecured debt into a mortgage loan secured by the home is a bad idea. The loan balance is increased by paying off the unsecured debt, which necessarily increases closing costs (which are

calculated on a percentage basis), increases the monthly payments, and increases the risk that the homeowner will lose the home.

26. **Making Loans in Excess of 100% Loan to Value (LTV).** Recently, some lenders have been making loans to homeowners where the loan amount exceeds the fair market value of the home. This makes it very difficult for the homeowner to refinance the mortgage or to sell the house to pay off the loan, thereby locking the homeowner into a high cost loan. Additionally, if a homeowner goes into default and the lender forecloses on a loan, the foreclosure auction sale generates enough money to pay off the mortgage loan. Therefore, the borrower is not subject to a deficiency claim. However, where the loan is 125% LTV, a foreclosure sale may not generate enough to pay off the loan and the borrower would be subject to a deficiency claim.

## II. SERVICING OF LOAN

1. **Force Placed Insurance.** Lenders require homeowners to carry homeowner's insurance, with the lender named as a loss payee. Mortgage loan documents allow the lender to force place insurance when the homeowner fails to maintain the insurance, and to add the premium to the loan balance. Some predatory mortgage lenders force place insurance even when the homeowner has insurance and has provided proof of such insurance to the lender. Even when the homeowner has in fact failed to provide the insurance, the premiums for the force placed insurance are often exorbitant. Often the insurance carrier is a company affiliated with the lender. Furthermore, the cost of force placed insurance is frequently padded because it covers the lender for risks or losses in excess of what the lender may require under the terms of the mortgage loan.

2. **Daily Interest When Payments Are Made After Due Date.** Most mortgage loans have grace periods, during which a borrower may make the monthly payment after the due date and before the end of the grace period without incurring a "late charge." The late charge is often assessed as a small percent of the late payment. However, many lenders also charge daily interest based on the outstanding principal balance. While it may be proper for a lender to charge daily interest when the loan so provides, it is deceptive for a lender to charge daily interest when a borrower pays after the due date and before the grace period expires when the loan terms provide for a late charge only after the end of the grace period. Predatory lenders take advantage of this deceptive practice.

## III. COLLECTION OF LOAN

1. **Abusive Collection Practices.** In order to maximize profits, predatory lenders either set the monthly payments at a level the borrower can barely sustain or structure the loan to trigger a default and a subsequent refinancing. Having structured the loans in this way, the lenders consciously decide to use aggressive, abusive collection tactics to ensure that the stream of income flows uninterrupted. (Because conventional lenders do not structure their loans in this manner, they do not employ abusive collection practices.) The collection departments of predatory lenders call the homeowners at all hours of the day and night, send late payment notices (in some cases, even when the lender has received timely payment or even before the grace period expires), send telegrams, and even send agents to hound homeowners in person. Some predatory lenders bounce homeowners back and forth between regional collection offices and local branch offices. One homeowner received numerous calls every day for several months, even after she had worked out a payment plan. These abusive collection tactics often involve threats to evict the homeowners immediately, even though lenders know they must first foreclose and follow the eviction procedures. The resulting emotional impact on homeowners, especially elderly homeowners, can be devastating. Being ordered out of a home one has owned and lived in for decades is an extremely traumatic experience.

2. **High Prepayment Penalties.** See description in I. 20 above. When a borrower is in default and must pay the full balance due, predatory lenders will often include the prepayment penalty in the calculation of the balance due.

3. **Flipping (Successive, Repeated Refinancing of Loan).** See description in I. 22 above. When a borrower is in default, predatory mortgage lenders often use this as an opportunity to flip the homeowner into a new loan, thereby incurring additional high costs and fees.

4. **Foreclosure Abuses.** These include (a) persuading borrowers to sign deeds in lieu of foreclosure in which they give up all rights to protections afforded under the foreclosure statute, (b) sales of the home at below market value, (c) sales without the homeowner/borrower being afforded an opportunity to cure the default, and (d) inadequate notice which is either not sent or backdated. There have even been cases of "whispered foreclosures", in which persons conducting foreclosure sales on courthouse steps have ducked around the corner to avoid bidders so that the lender was assured he would not be out-bid. Finally, foreclosure deeds have been filed in courthouse deed records without a public foreclosure sale.

U.S. Department of Housing and Urban Development

Housing Counseling CLEARINGHOUSE

COUNSELOR'S Connection

"Counseling—a Key to Homeownership"

Summer 1997

# Seniors Seek Reverse Mortgage Information

An increasing number of lenders are offering reverse mortgages, but they are of no use if older homeowners are unaware of their availability and do not receive adequate housing counseling.

One very good way for older consumers to get information and determine if a reverse mortgage is for them, is to get housing counseling from a HUD-approved housing counseling agency.

"No single plan works best for all persons," says Ken Scholen, director of the National Center for Home Equity Conversion. "It depends on each borrower's circumstances." The center is an independent nonprofit organization established in 1981 to educate consumers about reverse mortgages and their alternatives.

Older homeowners can obtain a free referral to a local HUD-approved housing counseling agency that provides reverse mortgage counseling by calling toll free 1-888-466-3487.

> "Reverse mortgages are an excellent way of allowing an older person or couple to unlock the accumulated cash value of their home without having to sell the home. This can make a dramatic difference in the lives of many senior citizens."
>
> — *Andrew Cuomo, HUD Secretary*

The AARP Foundation provides reverse mortgage training courses for housing counselors. The basic training, which is funded by HUD, focuses on the most widely available reverse mortgage—HUD's Home Equity Conversion Mortgage. The information counselors receive in the training course aids them in helping homeowners make informed decisions. Housing counselors can also provide the homeowner with information about local financial housing and social service programs such as home repair or property tax relief.

Housing counseling agencies seeking training for their staff members on reverse mortgages can call the Housing Counseling Clearinghouse (HCC) at 1-800-217-6970, check the calender of events on the HCC homepage at www.aspensys.com/HCC, or leave a message on AARP's reverse mortgage information request line directly at 202-434-6042. ♦

## *AARP Foundation Offers Reverse Mortgage Counseling Grants*

*In January, the AARP Foundation announced a new source of funding in FY '97 for housing counseling agencies providing reverse mortgage counseling. Only agencies that did not receive HUD housing counseling funding for FY '97 were eligible to apply for these grants, which were made possible by contributions from HUD and Fannie Mae to the AARP Home Equity Information Center.*

*Grants range from $1,000 to $12,000, based on prior reverse mortgage counseling volume. More than $123,000 in awards to 43 agencies were announced in February. The funds are to be drawn on a reimbursement basis of $50 per counseling certificate issued. Eligible agencies must have counseled at least 25 households on reverse mortgages in the past year and must demonstrate an ability to increase capacity. Agencies must also provide information on how they would reach older homeowners to let them know about the availability of reverse mortgage counseling services.* ♦

EXHIBIT B

## BEATRICE M. SMITH

| DATE OF LOAN | LENDER | AMOUNT FINANCED | MONTHLY PAYMENT | CLOSING COSTS | CREDIT LIFE PREMIUM | CASH OUT TO OR FOR BORROWER | LOAN TERM | ANNUAL PERCEN T-AGE RATE |
|---|---|---|---|---|---|---|---|---|
| 10/12/93 | Company A | $34,790.50 | $417.33 | $286.58 | $2,790.71 | $0.00 | 180 mos | 11.9904% |
| 4/29/93 | Company A | $32,700.00 | $492.00 | $136.50 | $28.50 (monthly) | $1,525.52 | Open | 9.99-19% vrm/heloc· |
| 8/14/92 | Company B·· | $31,000.00 | $490.00 | $336.00 | $28.50 (monthly) | $1,849.46 | Open | 12-19% vrm/heloc* |
| 1/3/92 | Company B | $31,301.56 | $448.87 | $233.00 | $2,905.82 | $1,256.32 | 180 mos | 15.5004% |
| 11/25/91 | Company B | $29,231.16 | $419.18 | $506.50 | $2,831.35 | $8,928.10 | 180 mos | 15.5004% |
| 6/9/87 | Company B | $20,334.71 | $267.41 | $402.80 | $2,339.43 | $16,692.48 | 180 mos | 13.7500% |

·Variable Rate Mortgage/Home Equity Line of Credit
··The parent company of "Company B" purchased "Company A"

EXHIBIT C

Senator GRASSLEY. Thank you very much.

Professor Marsh, have you seen an increase over the years in the predatory lending practices that we have discussed today?

Mr. MARSH. I would agree completely with the discussion here, that when you go back not too far in time, you find this kind of incredibly aggressive behavior largely coming out of what people would call the Small Loan Act companies. But now, it has gone to the level where the loans are much larger in mortgage lending, and you find very similar practices and the same sharp tone and the same aggressive marketing.

The CHAIRMAN. Recent reports have indicated that these subprime loans are being securitized. What is the incentive for the recent surge in Wall Street's interest?

Mr. MARSH. Well, like the securitization of mortgages, or, say, first mortgages, this is an advantage to the industry. That is, they can package and sell these in bundles and get an influx of capital.

I also think a lot of people believe the returns have been particularly great. But there is also a cloud; there are some companies that have filed for bankruptcy, a few fairly prominent, particularly in the auto area. As was pointed out here, it remains a question how long some of these companies will last. Like any other industry, as soon as these kinds of profits get reported, you will get a lot of entry into the market, and that is why we have seen such an incredible growth in subprime lenders.

The CHAIRMAN. Ms. Bernstein, to the extent to which your agency might see trends and keep specific numbers, have you seen an increase over the years in the predatory lending practices that we are discussing here, and if so, could you quantify those for me to whatever extent you can?

Ms. BERNSTEIN. It is difficult to have exact numbers of what is happening in the market, Mr. Chairman, but our records display that the number of complaints we get, the number of reports about foreclosures and the number of episodes that are reported to us by the States have definitely increased. As I said earlier, it has only been in the last few years that this has happened, but we have seen a very definite increase in reports of abuses occurring in this market.

The CHAIRMAN. And the same question I asked Professor Marsh—is there any way you can tell us Wall Street's interest in this, and anything else you might have to say about the interest of the secondary market? And what is the incentive of the recent surge in Wall Street's interest?

Ms. BERNSTEIN. I think probably the answer to all of those questions, Mr. Chairman, is that they are making more money on it. The mortgage rates for primary mortgages have been, as you know, at a very desirable low. I do not want to characterize Wall Street's motives, but I think it is that these mortgages carry higher rates of interest, so when they are bundled up together and sold as a group, as Professor Marsh said, they initially look as if they are going to be far more profitable, and in fact they have been more profitable.

So the interest is just that; it is because they are more profitable than prime mortgages.

The CHAIRMAN. Referring to the unscrupulous practices that this committee hearing is meant to expose, because of the involvement of Wall Street in a perfectly legal way, of course, has it given some credibility to these bad practices, or covered them in some way?

Ms. BERNSTEIN. I do not know whether it has covered them, but I suppose the respectability of subprime mortgages, bundled up together and sold, and then an infusion of capital that comes back in and further encourages subprime lending really says in essence, without questioning or challenging it, that Wall Street's going to tolerate these kinds of practices if they produce these rates. So that silence in essence says that the market is tolerating these practices.

The CHAIRMAN. And a purpose of our hearing today—and Senator Breaux has referred to his as well—is to hopefully encourage legitimate businesses to get rid of the con artists and the practices that are being exposed here.

Ms. BERNSTEIN. Well, it does not help legitimate businesses to have these practices proliferating. It is not in their interest, because if they are lumped together, their reputations suffer, and therefore, the acceptance of legitimate and honest offers of credit will suffer as well.

The CHAIRMAN. I would like to ask Mr. Brennan a question now. You have discussed increased predatory activity within the subprime lending market, particularly in recent years. What is your judgment as to why the market has suddenly grown so much in the last few years?

Mr. BRENNAN. As I mentioned earlier, Mr. Chairman, a lot of it has to do with an awareness of these lenders that the equity in the homes of more low and moderate income and elderly people is in a way there for the taking. They began to realize that although for each individual homeowner, the equity they have in their homes may be a small amount, in the aggregate, it could be billions of dollars. And by using the equity in such a broad base in these people's homes, they can engage in predatory lending practices where the risk is reduced because the value of the home itself, the equity value, makes these risk-free, as far as I can see, or a very low-risk type of lending.

The CHAIRMAN. OK. Today you have heard examples of victims who have tried to keep up their monthly loan payments, but obviously could not, and oftentimes the home is foreclosed on. Arguably, these loans set the borrower up for failure. That is probably the plan. My last question is, knowing such failure is inevitable, do these lenders employ aggressive collection strategies in order to collect their payments?

Mr. BRENNAN. Absolutely, and that is one of the worst features that we are seeing of predatory lending. Conventional mortgage companies lend to people and set the payments up where they know they can pay, so the defaults are not great. Predatory mortgage lenders, as you said, Mr. Chairman, try to max people out; they try to make the monthly payment as much as the person can pay short of failing, because they want that income stream. That goes back to the issue of the profitability. They want the income stream. But so many of them are set up to fail, where people finally cannot make the payments. Knowing that, these lenders employ around-the-clock collection teams that are calling people as soon as a payment is missed, harassing them, and threatening them. And that has just had a devastating impact on so many of our elderly clients, who sometimes have a spouse sick in bed, and they will say, "Get him out of bed and over to the phone. We want to talk to him about those payments." It just upsets people. They bounce them back and forth between the regional collection office and the local office in Atlanta. Ten minutes after getting one nasty call, my client gets another nasty call from the regional office. She says, "I just talked to your people here", and they say, "Well, we do not know anything about that. You have got to talk to me." It goes on and on, and that is to maximize the payments and keep the income flowing, and that is a feature that is just disgusting.

The CHAIRMAN. Senator Breaux.

Senator BREAUX. I thank the panel members.

Is credit life required by law, or is it just by policy of the lender?

Ms. BERNSTEIN. It is not required by law, and indeed, the law is that a lender can make having insurance a part of the loan package if it is disclosed that that is what they are doing and how much it costs.

Senator BREAUX. It has to be part of the premiums?

Ms. BERNSTEIN. Yes—but it is supposed to be disclosed as to what the cost of the insurance itself is.

Senator BREAUX. Let me make all of you a Senator for a day, and you have one sure chance to get a bill passed in this area, passed and signed into law. What would your suggestion be to solve this problem—as difficult, as I have said before, as it is to legislate common decency. I am not certain that more disclosure is the answer. Sometimes I think we have too much disclosure when they throw 20 pages of disclosure in front of you that is not written in English but in legalese and fine print that cannot be read without a magnifying glass. That is disclosure, but is it effective? I think the answer is that it is not very effective in many cases; people do not read it, and somebody is telling them, "Do not worry about it. Here is what it says," and they tell you what their opinion is of what it says, and that is not correct, because you did not get to read the fine print, and 99 percent of it is fine print.

So if you were Senator for a day, Dr. Marsh, what would you do to fix this?

Mr. MARSH. Let me say first that sometimes it sounds corny to say that better education is what you want to do, because when you hear some of this stuff, you want to go out with a hammer sometimes, or you want to prosecute or whatever. But I will say that I think what you are doing today is probably the most valuable thing you can do. That is when people hear this, and it spreads far and wide, it makes the sales harder the next time. I have seen employees testify to the fact that when an event like this occurs or a story is told, it makes their sale the next week harder. So this is a very important process——

Senator BREAUX. People ask questions.

Mr. MARSH [continuing]. And I congratulate you for it, and it is critically important. But when you say Senator for a day, I will tell you the one thing—and this is just my own call—would be to try to put an end to these sort of "instant check" loans which really are disguised mortgage loans that Bill spoke of, where you get a check that looks like a Government check, and lo and behold, what it really is is a mortgage loan. You sign off, and even though the disclosures will come hard and heavy, from a flipping component, I think they are probably the most dangerous thing in the market.

Senator BREAUX. They are not illegal per se now?

Mr. BRENNAN. No, and understand in all of these things that we are talking about, we are talking about lenders who probably have not violated truth-in-lending. As you point out, they make the disclosures, they are smart enough to know what the point limits are in a State, and so on. But at some point, I think you have got to step in and stop making things too easy. I think these "instant check", "instant loan" deals, at least in my view, are the most dangerous.

Senator BREAUX. Ms. Bernstein, what would you do?

Ms. BERNSTEIN. Well, I am a believer in disclosure that is meaningful, Senator, but I also agree that part of the problem here is that the written disclosures have been modified by oral statements to the contrary, which are difficult.

We have had experience, though, with improving the way they are communicated, and perhaps by putting them in plainer English and making them just a few critical questions and answers, like "Do you want more debt? Think about whether you want more debt," et cetera. I think we could do that without more legislation, and hopefully, we will move in that direction. In regard to legislation, at least on the packing, if legislation could clearly separate the loan and its costs from the credit insurance and other extras, I think that would be useful.

Finally—and I really have not thought it through, but since I am Senator for a day, I will take advantage of the position you have awarded me—I wonder if it is possible to have those in the secondary market, who are really infusing huge amounts of capital into this market—have some responsibility for assessing whom they are dealing with and whether or not they are dealing with people who have engaged in these practices. It is pretty easy to look at a group of loans and know whether there is equity stripping in them or not. If there were some responsibility and some liability before they purchased those packages, I think that that would go a long way toward at least putting a break on the flow of capital into those markets. I probably could think of others as well.

The CHAIRMAN. Mr. Brennan.

Mr. BRENNAN. Thank you. I also appreciate the opportunity to legislate. As a longstanding consumer attorney, Senator Breaux, I completely agree with you that disclosures, especially disclosures alone, simply do not work. However, we are always in favor of increased disclosure—the more people know, the better—but it is prohibitions that work. And let me say that the tools that we use, day in and day out, when we find a case where we can file a lawsuit, where there is a claim, are the Truth-in-Lending Act, the Real Estate Settlement Procedures Act, and the Home Ownership and Equity Protection Act of 1994. These are all Federal statutes—TILA, RESPA, and HOEPA, we call them—and we think those laws need to be preserved and kept in place so we can continue to use them as tools to protect our clients.

As far as the abuses that we are seeing, we would recommend a Federal UDAP statute, a Federal Unfair and Deceptive Acts and Practices statute, which would be similar to consumer protection laws that are in place in most States that prohibit and make illegal certain types of unfair and deceptive practices. If we had that kind of law on the Federal level, it would be most helpful for us.

Senator BREAUX. I thank all of our Senators for a day, and I will tell you that you all have five receptions that you must go to tonight. [Laughter.]

Thank you very much.

The CHAIRMAN. Senator Breaux, would you like to make a closing statement?

Senator BREAUX. I just did. Thank you, Mr. Chairman.

The CHAIRMAN. OK. I thank each of you for participating. I think that without our witnesses, particularly the people who have been hurt by this process, this would not have been a meaningful hearing. But we also thank our experts on this last panel who have dealt with this over a long period of time.

Second, I want to address what I will do about the problems that have been explored here today. Obviously, I want to work very closely with Senator Breaux on these issues as well.

I want to send a letter to both the Department of Justice and the Federal Bureau of Investigation to alert them to this problem and request that they make an effort to direct a portion of their resources to address the issue of predatory lending practices. To the best of my knowledge, these two organizations are pretty unaware of the situation, so lenders who are engaging in questionable and illegal practices—beware.

Second, I want to send a detailed letter to each of our 50 Governors, alerting them to the problem of predatory lending practices and sharing with them the "Top Ten Tips for Consumers" and, most importantly, to let them know of the model program used in the State of California which I have already referred to.

Third, I am presently looking into legislation that would make counseling mandatory under certain circumstances to avoid some of the predatory practices that were shared with us here today. It is my belief that we cannot legislate ethics, morality and compassion, and Senator Breaux has made that clearer than I can. But what I can do in my position is ensure that individuals who are served by the subprime market are fully aware of this situation before they sign on the dotted line.

Fourth, I am calling upon the industry to reflect upon some of the practices that it has come to accept and to reevaluate and take action. A few bad apples are giving the whole industry a black eye.

Finally, and perhaps most importantly, I want to close this hearing with a set of tips for every American dealing with the subprime market.

First, investigate carefully all the possibilities open to you before you decide to obtain a loan. Check with the Better Business Bureau in your State to assess the lender's reputation in your area.

Second, beware of entering into a loan transaction with anyone who comes to your door or with anyone whom you did not contact first.

Third, never sign any documents which you do not understand or which put your home on the line without first talking to someone. Ask questions; do not sign anything until you receive an answer, and ask what the options are.

Fourth, take a friend with you to review the documents, and always understand the role of the broker. The broker usually receives a commission from the lender.

Fifth, never, never sign blank documents or documents with any blank spaces.

Sixth, do not give in to high pressure tactics. If the lender does not give you a copy of the loan papers to read well in advance of your signing, look for one who will.

Seventh, always be prepared to walk away, even if you need to return to the lender's office another day.

Eighth, always remember that you have 3 days to get out of the contract for any reason—if you are concerned, if you have questions, or if you are just plain bothered by the whole thing.

Ninth, you are legally entitled to receive disclosures regarding the terms and cost of your loan. If the lender fails to provide you with all of these disclosures, you may have up to 3 years to get out of a contract.

Tenth, if you feel that you have been victimized, do not be embarrassed. Take action. Contact an attorney or your local legal aid office immediately, and inform the appropriate law enforcement agencies, the attorney general's office within your State, or your local police department. Advise the appropriate regulatory agencies, the department of corporations, real estate, or consumer affairs in your State.

I hope we can continue to work together. We are trying to decide what to do, but in the meantime, empower yourselves as best you can to understand all of these problems, and take action to the extent to which you can control.

This hearing is adjourned, and I thank everybody for their participation.

[Whereupon, at 3:55 p.m., the committee was adjourned.]

# APPENDIX

**HELLO**
**HOME EQUITY LENDER LEADERSHIP ORGANIZATION**

*1701 K Street, N.W. ♦ Suite 400 ♦ Washington, D.C. 20006*
*Phone 202/530-0666 ♦ Fax 202/223-6861*

March 26, 1998

Hon. Charles Grassley
Chairman
Special Committee on Aging
United States Senate
Washington, DC 20510

Hon. John Breaux
Ranking Minority Member

Dear Chairman Grassley:

I am writing regarding the Committee's investigation into alleged predatory lending practices directed toward the elderly in home equity lending, described at the March 16, 1998 Committee hearing. The Home Equity Lender Leadership Organization, which I chair, is an organization of major lenders and capital market firms with expertise in making home equity credit available to those with an impaired credit history. I ask that this letter and the attachment be made a part of the hearing record.

This letter has three purposes. First, we want to advise you in the strongest possible terms that the home equity lending industry is not characterized by the sort of clear abuses described at the hearing, that the industry honestly, ethically and competitively serves the growing credit needs of an increasing number of average Americans. Second, we want to provide some factual background on the industry lending record, and in particular about the role that securitization and market discipline play in deterring the conduct your Committee rightly condemns. Finally, we want to offer to join with you in promoting steps which can be taken to deter or prosecute these abusive practices, steps which do not necessarily depend upon the enactment of new laws but on education and utilization of existing legal standards.

**Home Equity Lending - Growing with an Expanding Consumer Economy**

It is clear that home equity lending has expanded at a rapid rate over the past decade. That expansion has been driven by three factors. First, the collapse of the savings and loan industry sharply curtailed availability of the traditional source of local credit. Many homeowners had credit needs, driven by consumer purchases, home improvements, college education costs and other typical consumer buying decisions. In the tough bank regulatory environment accompanying the S & L meltdown, non-bank providers of home equity loans became a significant source of consumer credit as bank lenders backed away from such lending. Businesses which could not find credit elsewhere may have had the Small Business Administration to turn to (SBA business lending has nearly tripled in 15 years), but individuals had to find new sources of credit. Home equity has been an affordable answer for many borrowers.

A second and related point is that borrowers have become more savvy. They realized that unsecured finance or credit card debt, which likely costs upwards of 20 percent, was unnecessary if a lender could have the loan secured by a residence. That security allows the loan to be made at much lower rates to a person with an uneven credit history. The industry's low delinquency rates (lower than comparable FHA/VA portfolios) prove that the borrower will responsibly repay a loan with more at risk. From the borrower's perspective, a monthly payment on an 11 percent loan (the current average rate for securitized home equity loans) secured by a residence is vastly better than a monthly payment on a 20 percent unsecured finance company or credit card loan.

Finally, home equity lending has been able to expand to serve increasing borrower demand for consumer credit because of the ability of capital markets to provide liquidity to these lenders (and without any assistance or safety net provided by Federal agencies, government sponsored enterprises or taxpayers). Capital markets link investors with capital with lenders who make loans to borrowers who regularly repay the loans. This process has to be predictable for all parties. The investors demand the vast majority of loans be repaid as projected, and interruptions to that process, whether because of borrower delinquency, dispute over loan terms, or even early prepayment, disadvantage the lender.

The important point is that home equity lending has grown because of changes in banking, because of growing consumer demand and smarter borrowing, and because of financial market ability to supply capital. The market has not grown because lenders seek out inappropriate borrowers and provide them with loans with egregious terms. We strongly object to an implicit subtext by some witnesses that rapid home equity lending growth is based on loans which are questionable, legally or economically. And we likewise object to the suggestion that borrowing for debt consolidation is somehow unfair or improper. It is in fact a highly rational economic decision made hundreds of times daily when the home equity lender can offer better credit terms than the borrower's current debt.

**Home Equity Subprime Lending - the Record**

The questions the Committee raises are important. But some press reports equate subprime lending with predatory lending. That interpretation is not only absolutely wrong, but could only be made in total disregard of the record of who this industry really serves.

The Committee is, naturally, concerned about issues affecting the elderly. But the home equity lending industry is not focused on the elderly. The demographics of home equity borrowers are very consistent with the average American homeowner. In fact, the home equity borrower is somewhat more likely to be a middle aged married male than would be predicted given their participation in home ownership in this country. The specific situations described by the Committee witnesses are tragic. But there is no basis, looking at the demographic data on lending to credit impaired borrowers, to conclude that home equity lending is targeted toward the elderly, much less targeted with such questionable sales practices.

A 1997 report of the Hudson Institute, written by Dr. John Weicher, a former Assistant Secretary of HUD for Policy, analyzed demographic information as to the characteristics of borrowers, terms and repayment record of home equity loans to credit impaired individuals. [Executive summary enclosed as attachment "A"] The Hudson report describes a "subprime" home equity borrower as essentially looking like an average American. The medians for the credit impaired home equity borrower, compared to the average US homeowner show:

— Median income of $34,000, ($ 37,000 for all homeowners)
— Median age of 48 (51 for all homeowners)
— 16 percent of loans to over 65 homeowners (vs. 26 percent of homeowner population)
— 19 percent of borrowers are female head of household (vs. 23 percent of home owning population).

Another charge made to the Committee is that home equity loans are made at terms "designed to fail" and thus force the borrower into bankruptcy or foreclosure. This is not and cannot be true given the volume to which home equity lending has grown. The Hudson report states, and Wall Street investors endorse every day, the excellent portfolio record of home equity lenders. Loans current in repayment exceed 93 percent, a better record than FHA and VA loans. And for those loans which must go into foreclosure because of repeated lack of payment, the lender is in trouble. Lenders lose funds on 93 percent of their foreclosures. To suggest that the loan is made with the intention of causing default, and that then the lender profits from the foreclosure is simply not true, according to common sense and the record of the industry.

One major reason this cannot be true is that capital investors, upon whom the industry depends, do not reward lenders with bad portfolios. Most major lenders "securitize" their loans, pooling a number of loans together, for purchase by investors who contract to receive a specified interest rate return over a specified period of time. If loans default, the profit the lender expected to retain is subordinated to pay the investor. If loans are refinanced (flipped) the lender is in the same bad position. His investor's pool has lost the promised flow of income from a loan, and the lender's subordinated interest in the pool must make up the difference. If a loan is poorly closed, not in compliance with the Truth in Lending Act or other relevant regulations, and the borrower rescinds the loan, the lender must repurchase the loan from the investor.

This securitization process brings a real numbers-driven discipline to the home equity lending market. Loans must be made properly; they must be made legally; they must be made at competitive interest rates that do not invite rapid prepayment. The lender must reveal all the details of the portfolio to the investor, and if the lender's portfolio does not perform, he pays a price, in the form of higher interest rates and more capital subordination.

The capacity of the securitization market has enabled the growth of home equity lending, and that growth itself has brought more competitive options for borrowers. An increasing number of lenders in the subprime home equity market is driving down the interest rates available to all borrowers. In today's environment, the chances of a borrower, especially a subprime borrower, finding a better deal are excellent if he or she is willing to make some calls, shop for credit, and ask some questions.

**"Predatory Practices"**

Whether home equity lending is $100 million or the more than $100 billion annually in today's economy, there are undoubtedly some lenders who do not play by the rules. HELLO firmly believes that Federal and state enforcement authorities should investigate and prosecute instances of illegality. We congratulate the Federal Trade Commission, for example, for pursuing the case it has recently announced against alleged fraud in the home loan process.

The complaint is made, however, that some current practices are unfair, "predatory" but not illegal. The committee should be very aware that HELLO has been working, as have other lender organizations, to come up with proposals for new legal standards to address some of these issues. In particular, we very much share the concern of the Committee and consumer groups on loan "flipping." As explained above, lenders have financial incentives not to want to flip loans. A short-sighted answer favorable to lenders would be to forbid borrower refinancing within certain time frames. That would obviously be unfair to borrowers, who may want a lower rate or additional funds. HELLO has proposed, therefore, that the ability to refinance a loan within twelve months be unlimited, but that the ability to include points and closing fees in the new borrowing be limited in various ways. This would retain flexibility for the consumer and limit the incentive of new fees to the lender or broker. But it is a complicated issue, and any proposal is likely to have unintended consequences. We will continue to try to refine an acceptable proposal.

The Committee focused on "packing," adding extra fees, usually various life insurance premiums, to the loan. We support requirements that borrowers be fully advised of any proposed insurance premiums, and be clearly advised before closing whether the lender requires insurance, or that it is optional. If this is a problem, it can be solved with broad support from the lending community. But the borrower should shop the cost and need for any insurance, before deciding on a loan.

A number of mortgage lending industry associations, including HELLO, are meeting with consumer groups to come up with proposals for changes in the law to deal with some of these problems. However, it is important to note that not all the charges by the AARP and other consumer groups involve, in our opinion, either illegality, unfairness or bad practice. Where consumers will improve their economic situation by consolidating their debts with a home equity loan, this is to be encouraged.

Finally, as I hope this letter makes clear, a better understanding of the economic and business reasons for the growth of subprime home equity lending should lead to a better dialogue, and ultimately to minimizing bad practices when they do occur. Some changes in the law may be appropriate. But as Senator Breaux stated, the government cannot legislate all aspects of every situation. Our association has adopted a Code of Ethics, reflecting its interest in setting high standards for lending. We will continue to work with all groups who want to improve the mortgage and consumer credit process. More intense shopping on the part of borrowers, taking advantage of competitive markets in loans, will greatly strengthen the borrower and minimize the response to the unscrupulous lender.

We appreciate the opportunity to inform the record of your hearing with this letter.

Sincerely,

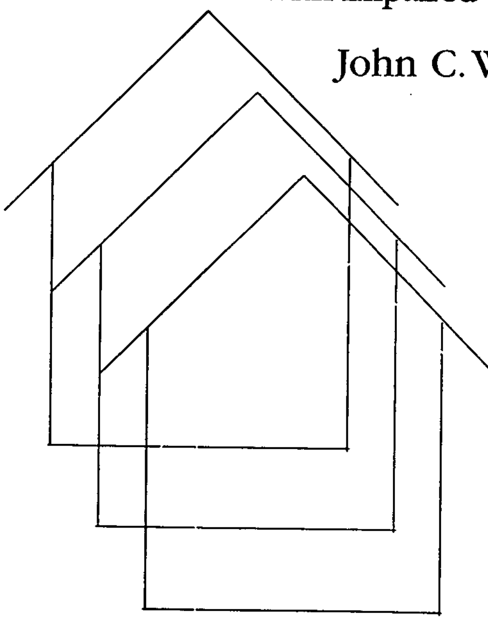
James Moore

James Moore
Chairman

# The Home Equity Lending Industry

## Refinancing Mortgages for Borrowers with Impaired Credit

John C. Weicher



Hudson Institute

# Executive Summary

This monograph is the first systematic study of the home equity lending industry from a public policy perspective. As defined in this study, home equity lending is the process of refinancing mortgages for homeowners whose credit ratings do not meet the normal underwriting standards of prime lenders. There are two dimensions to this definition: the nature of the loan, and the credit standing of the borrower. Home equity loans are first liens on homes already owned by their occupants. They are not purchase money mortgages, second mortgages, or home equity lines of credit, although the term "home equity lending" has sometimes been applied to the latter two instruments. The borrowers are individuals with some history of credit problems.

Home equity lending is a rapidly growing and changing sector of the home mortgage market but is not very well known or understood outside the industry itself. It is so new that there are no standard measures of its size. It appears to account for 5 to 10 percent of total mortgage originations in the U.S. Ten years ago, it was perhaps one-half to one-tenth its current size. Nor is there a standard descriptive terminology: the industry is variously called *subprime lending, B&C lending,* and *the nonconforming market,* as well as home equity lending. Similarly, the firms active in subprime lending are not readily identified in the public mind. They are best described as home equity lenders today, but in the past they have more often been termed finance companies.

Information for the study came from several sources: data provided by individual member firms of the Home Equity Lenders Leadership Organization (HELLO); aggregate information on subprime lending from the Mortgage Information Corporation (MIC), covering a large sample of prime and subprime lenders; the Mortgage Bankers Association of America (MBA); published reports of Wall Street analysts; securities prospectuses of HELLO member firms; and the trade press and general media. The data cover different firms, subjects, and time periods, and therefore are not always fully consistent. Nonetheless, they all present the same basic picture of home equity lending.

## The Process of Home Equity Lending

Credit standards in mortgage markets are effectively established by the two large government-sponsored enterprises (GSEs), the Federal National Mortgage Association (FNMA or Fannie Mae) and the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac). These firms buy or securitize loans that meet their underwriting standards, and these debts are known as *prime* or *agency* loans. Home equity lenders specialize in *subprime* loans, those to borrowers with impaired credit. Such borrowers are typically seeking to refinance a current mortgage at a lower rate or to take cash out of home equity for purposes important to them.

The loans may be initiated in several ways. The most common method is through a correspondent, a lender with a warehouse line of credit provided by a bank or other financial institution, which then sells the loan to another lender. Alternatively, loans are purchased wholesale from mortgage brokers. Approximately one-sixth are originated in retail offices which establish direct contact with potential borrowers.

The loans are then usually packaged as securities and sold to investors through Wall Street firms, in the same manner as traditional mortgage-backed securities issued by the GSEs or other prime lenders.

In sharp contrast to the prime mortgage market, there are no generally accepted underwriting guidelines for subprime home equity lenders. Individual firms set their own guidelines. They typically take the same factors into consideration but set different criteria to qualify for a given credit grade. Hence, one firm's B loans may look like another's C loans. Underwriting appears to be an art rather than a science. For this reason, subprime loans cannot be treated as a standard commodity, again in contrast to loans in the prime market.

The industry is not dominated by one or a few firms. Most firms concentrate their operations within a particular geographical region, although most also have at least a few loans from nearly every state.

Many are expanding their geographic range of operations.

## The Growth of Home Equity Lending

Home equity lending today probably exceeds $100 billion annually. It has grown rapidly for several reasons. The failure of many savings and loan associations (S&Ls) in the late 1980s resulted in legislation that strengthened the market position of the GSEs, along with new regulations curtailing the ability of S&Ls to take risks. Also, the unprecedented peacetime inflation of 1965-1980 drove home prices up in both nominal and real terms, and they have remained generally high even though the inflation rate has been much lower since 1982. Many homeowners have therefore enjoyed increases in their home equity, but because their credit rating does not meet GSE standards, they have not been able to refinance in the prime mortgage market. As a result, home equity lending to subprime borrowers has increased at an extraordinary rate during the last five to ten years.

## Demographic and Economic Characteristics of Borrowers

In most respects, subprime home equity borrowers are similar to other homeowners. Their median income is approximately $34,000, slightly below the $37,000 median for all homeowners and almost exactly the same as the $34,000 median for all U.S. households. The difference between home equity borrowers and all homeowners arises because there have been few high-income borrowers in the subprime home equity market. Otherwise, the income distributions are similar. Home equity borrowers are not concentrated among low-income homeowners.

Home equity borrowers tend to be slightly younger than all homeowners, even though it takes time to build up enough equity to borrow against. This pattern occurs because elderly homeowners are substantially underrepresented among home equity borrowers. The typical home equity borrower is forty-eight years old, compared to fifty-one for all homeowners. Single men are twice as common among subprime home equity borrowers as among all homeowners. Single women are somewhat underrepresented.

These data suggest that subprime home equity borrowers are basically the same sort of people as other homeowners and are able to make informed judgments about what is in their own best interests. They are not particularly concentrated among the elderly or families headed by a single woman, groups sometimes thought to be most vulnerable to predatory practices in housing-related transactions. Direct data on the education of subprime home equity borrowers are not available, but education tends to be correlated with income, and there is no evidence that subprime borrowers are concentrated among poor households. Thus there is no particular reason to think that subprime home equity borrowers are less well educated than all homeowners.

## Mortgage Rates and Terms

Interest rates in the subprime home equity loan market are higher than the rates on prime loans, because subprime lenders face higher servicing costs and assume more risk. Data from the Mortgage Information Corporation indicate that subprime loans carry an annual interest rate of approximately 11 percent, compared to 8 percent for prime mortgages.

For the same reason, interest rates vary among different credit grades within the subprime market: lenders charge higher rates on loans expected to be riskier. These rates tend to rise or fall together in response to conditions in the financial markets. Wall Street analysts estimate that the least risky loans run approximately 200 basis points above prime mortgages; the most risky, approximately 600 basis points. These spreads are not immutable; they vary from time to time and are likely to do so in the future.

HELLO member data also show that interest rates are higher on loans to borrowers with lower credit ratings. The spreads differ somewhat from the Wall Street estimate: HELLO members report a range of 500 basis points between their least risky and most risky loan, wider than the 400 basis point estimate of Wall Street analysis. HELLO data show that LTVs and loan amounts are both higher on higher-quality loans. The overall pattern is clear and not surprising: rates are higher, and terms less generous, on riskier loans.

Subprime rates typically lie between the rates on prime mortgages and those on credit card debt. Because even the highest interest rates on subprime home equity loans are lower than the interest rates charged on consumer credit cards, a homeowner who faces a high debt burden or unexpected costs may well find it in his or her best economic interests to refinance a mortgage rather than to borrow directly or indirectly against a credit card.

Subprime mortgages have an average loan-to-value ratio (LTV) of 72 percent. The typical loan amount is approximately $60,000 to $65,000. The LTV is slightly lower than the median LTV for prime conventional mortgages—75 percent—and much lower than the median, 97 percent, for government-guaranteed loans (FHA and VA). The loan amount is well below the typical prime conventional loan of $85,000, and close to the typical government-guaranteed loan amount of $60,000. Subprime loans also tend to have shorter maturities, most commonly fifteen years, with an average of approximately twenty years; conventional prime and government-guaranteed mortgages typically have thirty-year terms.

## Origination and Servicing Costs

Origination costs appear to be substantially higher for subprime mortgages, in the range of 4 to 8 percent, compared with an average of 2 percent for prime mortgages. Servicing costs are approximately one-third higher for subprime loans, largely reflecting the need for more intensive staffing. The typical servicing employee can handle approximately half as many subprime loans as prime mortgages.

## Mortgage Delinquencies and Defaults

Most home equity borrowers, like other mortgagors, are current on their mortgage at any given time. Approximately 94 percent are current, compared to 97 percent of prime mortgagors and 92 percent of mortgagors with government-guaranteed loans. Delinquency rates are thus higher for home equity loans than for prime mortgages, but somewhat lower than for government-guaranteed loans.

Default and foreclosure rates differ between prime and subprime lenders in much the same way as delinquencies. At a given time, fewer than 1 percent of all prime loans, fewer than 2 percent of all government-guaranteed loans, and approximately 3 percent of subprime loans are in foreclosure, according to data provided by MIC. Over the life of the loans, cumulative default rates are higher for home equity loans. Cumulative defaults run approximately 12 percent over the first six years for home equity loans, compared with 8 percent for FHA mortgages.

Mortgage terms and loan experience in the subprime market exemplify two facets of the same phenomenon of risk. Home equity lenders take greater risks than conventional prime lenders. They incur higher delinquencies and higher defaults. Because of the delinquencies, they incur higher servicing costs. For these reasons, they charge higher interest rates. They also attempt to manage risk in other ways, for example by offering lower LTV mortgages to protect themselves against the risk of loss.

Within the subprime market, the same pattern prevails. Delinquency and default rates rise with risk. They are systematically higher for subprime A or A- mortgages than for prime mortgages, higher for B than for A, higher for C than for B, and higher for D than for C. The greater the risk, as estimated by the lender when originating the loan, the greater the delinquency rate and the higher the foreclosure rate. What firms expect to happen does in fact happen.

Loans that are thought to be more risky when they are made, do turn out to be more risky.

**Real Estate Owned**

After home equity lenders take title to properties with defaulted loans, they attempt to sell the houses to recoup part of their losses on the loans. Data from HELLO members indicate that the holding period is approximately eight months, on average, longer than the average for defaulted FHA-insured properties to which HUD has taken title after paying a mortgage insurance claim.

Lenders incur substantial costs on their real estate owned (REO): the legal costs of foreclosure; continuing payment of interest on the mortgage-backed security even though the lender is no longer earning interest on the loan; maintenance; repairs; property taxes; and brokerage costs when the property is sold. On average, these costs add up to approximately 35 percent of the outstanding balance on the loan, and approximately 25 percent of the value of the house itself.

Home equity lenders incur losses on more than 93 percent of their REO. At the other end of the distribution, they get little or nothing back on some 30 percent of the properties. On average, they lose approximately 49 cents for each dollar of their investment in the property. By comparison, FHA loses approximately 34 cents per dollar on its insurance claims.

Thus it is clear that large subprime lenders do not make profits on their REO. Rather, the opposite is the case. Defaults are expensive for home equity lenders. They lose approximately half of their investment in the property, including both the loan and the costs of foreclosing and selling. In respect to both holding period and loss, their experience is worse than FHA's. It takes them longer to sell a property, and they lose more money.

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April 27, 1998

Hon. Charles E. Grassley
Chairman, Senate Special Committee on Aging
Dirksen Senate Office Building, G 31
U.S. Senate
Washington, D.C. 20510-6400

Re: *Comments to Senate Special Committee on Aging Hearing Titled Equity Predators: Stripping, Flipping and Packing Their Way to Profits*

Dear Senator Grassley:

At the invitation of the Senate Special Committee on Aging, and as counsel for Gael Carter, who appeared as a witness at your recent hearing, I am writing to submit my comments on the Committee's investigation of the growing problem of predatory lending. I applaud your efforts and those of the other members of the Committee in recognizing the urgent need to address predatory lending abuses and in taking the first steps toward finding solutions to the problem. As the Committee noted, predatory lenders frequently prey on the elderly and the poor. There can be no doubt that while the hearing was an important first step in the process of ameliorating the manipulative practices of predatory lenders, much work remains to be done.

As the Committee recognized, predatory lending includes practices such as equity stripping, flipping and packing. The victims of these practices are often either elderly or poor, or both. The problem, however, does not end there. Lenders that engage in the type of predatory activity addressed at the hearing do not discriminate amongst their victims. Citizens of all walks of life in this country are in danger of becoming entangled in the web of deceit spun by predatory lenders. While the elderly are easy marks for lenders who employ these deceptive practices, uneducated and blue-collar workers are also frequently targeted. As revealed during testimony at the Committee's hearing, finance company employees are taught sophisticated methods for trapping unsuspecting borrowers in deceptive loan transactions. Further, these employees, often struggling to keep their jobs and pay their own bills, face aggressive company-imposed insurance sales and loan production quotas that simply cannot be met absent insurance packing and loan flipping. Unsuspecting borrowers, who may have less than perfect credit or who simply may not understand the complex language of loan documents, find themselves quickly mired in a quicksand of debt and sometimes even lose their homes as a result. While it is valuable to discuss the problem of these predatory lending tactics and bring them to the attention of the American public, changes that reach even more broadly must be implemented.

I, again, applaud the efforts of the Committee and thank them for their timely response to this growing problem. Further, I am encouraged by the progress that has been made against the practices of predatory lending and hope that, as a result of the Committee's efforts, more Americans now know about the dangers of predatory lending practices. Education is an invaluable tool in the fight against predatory lenders. In my opinion, however, education alone is not sufficient to protect the citizens of this country who are in the most danger of falling prey to these tactics. Despite the education campaign initiated by your Committee and assisted by the media, the perpetrators of these deceptive practices continue to conduct business in the same manner and, further, continue to make huge profits at the expense of unsuspecting borrowers. As the testimony at your Committee's hearing so glaringly demonstrated, customers of these companies can not operate on a level playing field with employees who are trained to use deceptive practices to pad the corporate bottom line at the expense of hapless borrowers. Legislation to prohibit these practices is essential to the effective protection of American citizens.

The following are some suggestions for legislative changes that I believe would make substantial progress toward eliminating the types of deceptive lending practices your Committee is investigating:

*Legislation that would help eliminate loan flipping*

Loan flipping occurs for two primary reasons. First, predatory lenders flip loans because they receive a bonus on interest and insurance rebates through the use of a rebate formula known as the Rule of 78s. Second, some finance companies encourage their employees to flip their own customers' loans because they are not required to rebate loan origination fees (points) and other fees from the previous loan. Each of these loan flipping motives could be reduced or eliminated through legislation.

- **Eliminate the Rule of 78s.** When loans are refinanced, lenders must rebate unearned interest and unearned credit insurance premiums. Many subprime lenders accrue interest on loans of 61 months or less according to a rebate formula known as the Rule of 78s. Subprime lenders also frequently use the Rule of 78s to compute insurance premiums, regardless of the loan term. Financial experts and consumer advocates uniformly criticize the Rule of 78s because, unlike the actuarial or pro rata methods, the Rule of 78s front-loads so-called "earned" interest and insurance premiums into the earlier portion of the loan term. For example, an internal finance company document uncovered in Mrs. Carter's case revealed that by using the Rule of 78s, the finance company was able to accrue about one half of its interest income on personal loans after only one third of the loans' terms had expired. Hence, when these loans are refinanced, the lender is able to keep more of the interest and insurance premium than would be the case if actuarial or pro rata methods were used. Finance companies therefore instruct their employees to target loans for renewal (i.e., flip) after about a third of the loan term has expired. Prohibiting use of the Rule of 78s would eliminate this motive for flipping loans.

- **Require that lenders rebate loan origination fees when loans are refinanced in less than six months.** Finance companies often are not required to rebate loan origination fees when they refinance their customers' loans. Therefore, every refinancing provides the finance company an opportunity to earn new income from origination fees or points. For example, we uncovered internal finance company documents during Mrs. Carter's lawsuit that instruct company employees to refrain from rebating or waiving income from points and other loan origination fees when refinancing loans. Employees of this company told us that there were no rules requiring that points be waived or rebated, even if the loan were refinanced in as few as thirty days. As this company charges customers up to 10 points on a loan, the more often the loan is refinanced, the more often the company can earn new income from these fees. It should be no surprise that this encourages loan flipping. Legislation that would prohibit lenders from charging new loan origination fees or require rebates of such fees for loans that were refinanced within a short time after the previous loan (perhaps six months) would reduce or eliminate this motive for flipping loans.

*Legislation that would eliminate abuses in the sale of credit insurance*

Much of the testimony presented to the Committee pertained to insurance packing. As you no doubt know, finance companies earn enormous income from credit insurance sales. While the benefit of this type of insurance to the consumer is debatable, there is no question that the cost to consumers for credit insurance is outrageously high as compared to the minuscule loss ratios experienced by insurers. Because credit insurance is so profitable to finance companies, many employees try to pack it into loans by making the customer believe that it is mandatory, or simply by slipping insurance documents into the loan package even though the customer has never requested the insurance. The following proposals would help eliminate credit insurance abuses:

- **Amend TILA to require that voluntary credit insurance cannot be sold unless there is a written disclosure comparing the amount of the monthly loan payment with insurance, and without insurance.** At the Committee's hearing, one witness vividly described some of the deceptive tactics used by finance company employees to pack credit insurance into loans. This witness testified that finance company employees are trained to always avoid comparing the cost of the monthly payment on a proposed loan with and without insurance. Rather than disclosing the comparative cost, unscrupulous finance company representatives simply add credit insurance to the loan (without telling the customer) and include the cost of that insurance in the monthly payment quote that is provided to the customer. Although the loan documents disclose the total cost of the insurance for the entire loan, the customer is never given the information that is most meaningful; that is, how much the cost of insurance adds to the monthly payment. Almost every finance company employee we interviewed said the same thing: customers care most about the cost of the monthly loan payment - almost nothing else matters. While the current TILA disclosures about insurance are helpful, the most *meaningful* disclosure is not presently required. If Congress were to amend TILA to add one more disclosure, that amendment should require lenders to compare the amount of the monthly loan payment both with and without insurance before they are permitted to sell credit insurance. While I concur with Senator Breaux that adding more disclosure requirements may not necessarily eliminate all lending abuses, I do suggest that the Committee consider requiring this type of disclosure. It is clear that the cost of monthly payments is foremost in the minds of the consumers, and disclosing the effect of insurance on the monthly payment would allow consumers to make meaningful choices about purchasing credit insurance.

- **Encourage the States to eliminate the sale of credit insurance based on the total of loan payments.** I am, of course, aware that the regulation of insurance is left to the States by virtue of the McCarran-Ferguson Act. Unfortunately, almost every state currently allows what may be the most abusive credit insurance practice of all - basing the amount of coverage on the total of loan payments rather than the principal balance and earned interest. For example, Mr. Raymond White, a client of ours who was present at the hearing and recognized by the Committee, took out a loan for $63,304. The finance company sold Mr. White joint credit life insurance, without his knowledge, in connection with his loan. Instead of basing the amount of coverage on the principal balance of his loan (and consequently the finance company's risk of loss), the lender based the amount of coverage, $100,000, on the total of White's loan payments over the life of the loan. Hence, even though Mr. White never would have owed more than $63,304 plus one month's interest, the finance company sold him an insurance policy with coverage of $100,000. Finance companies do not sell customers extra insurance for altruistic reasons. In Mr. White's case, the finance company was able to collect an additional $12,835 solely as a result of insuring him on the basis of the total of payments instead of the principal balance of the loan. I urge Congress to assist states in recognizing the abuses that result from the lack of legislation in this area and to encourage states to eliminate this practice.

- **Create a national deceptive practices act.** At the Committee's hearing, one of the experts suggested that Congress create a national deceptive practices act. I agree. The current patchwork of state laws addressing the

FINKELSTEIN, THOMPSON & LOUGHRAN

Hon. Charles E. Grassley
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subject has resulted in a haphazard approach towards eliminating the lending abuses explored by your Committee. While some state laws have effective enforcement mechanisms, others are wholly inadequate. A uniform national standard would help finance companies, consumers and regulators identify and avoid inappropriate conduct. A national deceptive practices act would also provide regulators and consumer advocates with a more uniform and effective remedy to curb lending abuses.

These are only a few suggestions for possible reform and certainly do not represent an exhaustive list of the possible remedies to the practice of predatory lending. These suggestions are intended to demonstrate that even beyond consumer education, there is more that can be done to address this problem. While we cannot legislate morality, it is our job to ensure that consumers are protected, to the fullest extent that the laws of this country will allow, from the deceptive, manipulative practices of predatory lenders.

Thank you, on behalf of myself and my clients, for the opportunity to submit my comments to the Committee. I recognize the challenges that face the Committee in finding solutions to the growing problem of predatory lending and appreciate the consideration given to the aforementioned suggestions.

Respectfully,

William P. Butterfield

cc: Gael Carter
Raymond and Jean White
Richard Weiss, Esq.
Steve Hubbard, Esq.
Lynn Berry, Esq.
Patricia Ryan, Esq.

GREGORY THOMPSON
ASSISTANT DISTRICT ATTORNEY

OFFICE OF
THE DISTRICT ATTORNEY
COUNTY OF SAN DIEGO

PAUL J. PFINGST
DISTRICT ATTORNEY

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February 3, 1998

Senator Charles E. Grassley
United States Senate
Chairman of Special Committee on Aging
Washington, DC 20510-5400

Dear Senator Grassley,

It is my great honor to assist you and the United States Senate in your inquiry into predatory lending practices which target the aging community.

Here in San Diego, the District Attorney's Office has long been active in combating complex real property crimes.

We pride ourselves as being on the cutting edge of real estate fraud prosecution in California. In 1995, our office collaborated with the Los Angeles District Attorney's Office and the California Association of Realtors to pass Senate Bill 537. This legislation authorized each county in California to create, at their option, a Real Estate Fraud Prosecution Trust Fund. Our mission is simple: to investigate, prosecute, and deter real estate fraud. Revenue to support this program derives from a $2.00 surcharge on recording fees for certain real property documents. In San Diego, these fees generate approximately $600,000.00 a year. This funding has allowed the District Attorney to create a staff dedicated exclusively to fighting real estate fraud.

Currently, the assessed value of all real property in San Diego exceeds 150 billion dollars, or to be precise, $150,329,134,117. Thieves naturally find this real estate to be an attractive target for their scams and fraud. In particular, they seek to exploit and victimize the aging community. In San Diego it is fair to say that the majority of our victims of real estate fraud are members of the aging community. Our victims represent people who have dedicated their lives to working hard, to build up equity in their homes and to create a nest egg for their retirement.

Hard money lenders commit much of the damage to the aging community in real estate fraud in San Diego. Hard money lenders are typically mortgage brokers, licensed by the

Department of Real Estate. A hard money lender is the middle man between borrower and lender. Hard money lenders solicit borrowers or lenders and negotiate loans and collect money for borrowers or lenders on loans secured by deeds of trust on real property. The loans they broker usually involve other peoples' money. They arrange these loans, at high interest rates, to people with bad credit. They charge huge points or commissions that come out of the loan proceeds due to the borrower. This provides an incentive for a hard money lender to make as many loans as possible. Whether the loans prove to be bad or fraudulent is of little consequence to the hard money lender, who has already received his points or commissions at the outset.

The victim we most frequently encounter in San Diego is the aging investor who buys a loan from a hard money lender.

Of perhaps greater concern is the fact that many hard money lenders service their own loans; they collect the monthly payments from the borrowers and pay them to the investor. This loan servicing includes the final loan payoff, typically a balloon payment of tens of thousands of dollars. Frequently this payoff is done by way of a broker-exempt escrow in which there is no third party escrow and no supervision or regulatory agency overseeing the payoff. A common fraud scenario involves a broker taking this loan payment and diverting it to his or her own use. Hard money lenders then hide this theft by telling the victim the loan has been extended or rolled over. The hard money lender continues to service the loan as though it had been not paid back. This continues until the hard money lender runs out of money and winds up in state prison.

We have seen predatory practices in San Diego that target the aging community. We are currently investigating one predatory lending case involving a 75 year old woman. This woman is legally blind, cannot read even with prescription glasses and a magnifying glass, and had a leg amputated several years ago. This woman was solicited by a telemarketer for a refinance of her existing mortgage. The broker ultimately put her in a loan that cost her \$3,000.00 in prepayment penalties, as well as points to the broker of another \$2,000.00. She went from owing \$78,000.00, to owing \$91,000.00. The loan application listed her monthly income as \$3,000.00, when in fact she receives approximately \$850.00, primarily from social security. The loan benefited basically no one except the broker. The woman is now in default on this loan and faces foreclosure.

We received a referral involving this case from the Neighborhood Housing Association, a community group, and will likely subject the broker to civil litigation, involving unfair business practices. I must advise you that there appear to be no criminal statutes in California that directly forbid these predatory lending practices.

We encourage your inquiry for this reason. While there are an abundance of laws that allow us to effectively prosecute the predatory practices on the investor side of the equation, we have been helpless on the borrower side of the equation involving the predatory lending practices. There are no laws, no rules, no regulations to protect the vulnerable borrower, whether that borrower is aging, a minority, a non-English speaker--people who can't get money elsewhere and are sitting ducks for predatory lenders.

This is an important, serious problem. We welcome your attention to this very timely issue which is of great concern to anyone involved in real estate.

I have enclosed a book of documents which I hope will assist you in your inquiry. They include our legislative initiative creating the Real Estate Fraud Prosecution Trust Fund, several sentencing memoranda and articles on notorious real estate frauds in San Diego, as well as articles on real estate fraud from the perspective of a prosecutor. We believe that we have created in California and in San Diego an effective system for prosecuting real estate fraud.

We interact effectively with all facets of the real estate industry, to effectively investigate and prosecute real estate fraud, once it is discovered. However, greater attention should be placed on the extreme damage a single proficient thief can commit in real estate fraud, particularly where the victim is a member of the aging community.

I am available to testify as a witness, to provide additional information on our approach to real estate fraud, and to suggest legislative and practical remedies.

Sincerely,

Jeffrey Brodrick
Deputy District Attorney
Real Estate Fraud Subdivision

JB:vjb

Attachments

**Senate Bill No. 537**

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Passed the Senate September 12, 1995

*Secretary of the Senate*

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Passed the Assembly September 11, 1995

*Chief Clerk of the Assembly*

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This bill was received by the Governor this 5th day of September, 1995, at 11:00 o'clock a. M.

*Private Secretary of the Governor*

CHAPTER ______

An act to add Section 27388 to the Government Code, relating to recordation fees.

LEGISLATIVE COUNSEL'S DIGEST

SB 537, Hughes. Recordation fees.

Existing law requires the county recorder, upon payment of proper fees and taxes, to accept for recordation any instrument, paper, or notice that is authorized or required by law to be recorded.

This bill would provide that in addition to other recording fees, upon the adoption of a resolution by the county board of supervisors, a fee of up to $2 shall be paid at the time of recording of every real estate instrument, as defined. The bill would require that the fees collected be placed in the Real Estate Fraud Prosecution Trust Fund to be distributed by the county chief administrative officer, as determined by a Real Estate Fraud Prosecution Trust Fund Committee, to district attorneys and local law enforcement agencies for the purpose of determining, investigating, and prosecuting real estate fraud crimes, as specified.

*The people of the State of California do enact as follows:*

SECTION 1. Section 27388 is added to the Government Code, to read:

27388. (a) In addition to any other recording fees specified in this code, upon the adoption of a resolution by the county board of supervisors, a fee of up to two dollars ($2) shall be paid at the time of recording of every real estate instrument, paper, or notice required or permitted by law to be recorded within that county , except those expressly exempted from payment of recording fees. "Real estate instrument" is defined for the purpose of this section as a deed of trust, an assignment of deed of trust, a reconveyance, a request for notice, and a notice of default. "Real estate instrument" does not include any deed, instrument, or writing subject to the imposition of a documentary transfer tax as defined in Section 11911 of the Revenue and Taxation Code, nor any document required to facilitate the transfer subject to the documentary transfer tax. The fees, after deduction of any actual and necessary administrative costs incurred by the county in carrying out this section, shall be paid quarterly to the county auditor or director of finance, to be placed in the Real Estate Fraud Prosecution Trust Fund.

(b) Money placed in the Real Estate Fraud Prosecution Trust Fund shall be expended to fund programs to enhance the capacity of local police and prosecutors to deter, investigate, and prosecute real estate fraud crimes. After deduction of the actual and necessary administrative costs referred to in subdivision (a), 60 percent of the funds shall be distributed to district attorneys subject to review pursuant to subdivision (d), and 40 percent of the funds shall be distributed to local law enforcement agencies within the county in accordance with subdivision (c). In those counties where the investigation of real estate fraud is done exclusively by the district attorney, after deduction of the actual and necessary administrative costs referred to in subdivision (a), 100 percent of the funds shall be distributed to the district attorney, subject to review pursuant to subdivision (d). The funds so distributed shall be expended for the exclusive purpose of deterring, investigating, and prosecuting real estate fraud crimes.

(c) The county auditor or director of finance shall distribute funds in the Real Estate Fraud Prosecution Trust Fund to eligible law enforcement agencies within the county pursuant to subdivision (b), as determined by a Real Estate Fraud Prosecution Trust Fund Committee composed of the district attorney, the county chief administrative officer, and the chief officer responsible for consumer protection within the county, each of whom may appoint representatives of their offices to serve on the committee. If a county lacks a chief officer responsible for consumer protection, the county board of supervisors may appoint an appropriate representative to serve on the committee. The committee shall establish and publish deadlines and written procedures for local law enforcement agencies within the county to apply for the use of funds and shall review applications and make determinations by majority vote as to the award of funds using the following criteria:

(1) Each law enforcement agency that seeks funds shall submit a written application to the committee setting forth in detail the agency's proposed use of the funds.

(2) In order to qualify for receipt of funds, each law enforcement agency submitting an application shall provide written evidence that the agency either:

(A) Has a unit, division, or section devoted to the investigation or prosecution of real estate fraud, or both, and the unit, division, or section has been in existence for at least one year prior to the application date.

(B) Has on a regular basis, during the three years immediately preceding the application date, accepted for investigation or prosecution, or both, and assigned to specific persons employed by the agency, cases of suspected real estate fraud, and actively investigated and prosecuted those cases.

(3) The committee's determination to award funds to a law enforcement agency shall be based on, but not be limited to, (A) the number of real estate fraud cases filed in the prior year; (B) the number of real estate fraud cases investigated in the prior year; (C) the number of victims involved in the cases filed; and (D) the total aggregated monetary loss suffered by victims, including individuals, associations, institutions, or corporations, as a result of the real estate fraud cases filed, and those under active investigation by that law enforcement agency.

(4) Each law enforcement agency that, pursuant to this section, has been awarded funds in the previous year, upon reapplication for funds to the committee in each successive year, in addition to any information the committee may require in paragraph (3), shall be required to submit a detailed accounting of funds

received and expended in the prior year. The accounting shall include (A) the amount of funds received and expended; (B) the uses to which those funds were put, including payment of salaries and expenses, purchase of equipment and supplies, and other expenditures by type; (C) the number of filed complaints, investigations, arrests, and convictions that resulted from the expenditure of the funds; and (D) other relevant information the committee may reasonably require.

(d) The county board of supervisors shall annually review the effectiveness of the district attorney in deterring, investigating, and prosecuting real estate fraud crimes based upon information provided by the district attorney in an annual report submitted to the board detailing both:

(1) Facts, based upon, but not limited to, (A) the number of real estate fraud cases filed in the prior year; (B) the number of real estate fraud cases investigated in the prior year; (C) the number of victims involved in the cases filed; (D) the number of convictions obtained in the prior year; and (E) the total aggregated monetary loss suffered by victims, including individuals, associations, institutions, corporations, and other relevant public entities, according to the number of cases filed, investigations, prosecutions, and convictions obtained.

(2) An accounting of funds received and expended in the prior year, which shall include (A) the amount of funds received and expended; (B) the uses to which those funds were put, including payment of salaries and expenses, purchase of equipment and supplies, and other expenditures by type; (C) the number of filed complaints, investigations, prosecutions, and convictions that resulted from the expenditure of funds; and (D) other relevant information provided at the discretion of the district attorney.

(e) The intent of the Legislature in enacting this section is to have an impact on real estate fraud involving the largest number of victims. To the extent possible, an emphasis should be placed on fraud against individuals whose residences are in danger of, or are in, foreclosure as defined under subdivision (b) of Section 1695.1 of the Civil Code. Case filing decisions continue to be in the discretion of the prosecutor.

(f) A district attorney's office or a local enforcement agency that has undertaken investigations and prosecutions that will continue into a subsequent program year may receive nonexpended funds from the previous fiscal year subsequent to the annual submission of information detailing the accounting of funds received and expended in the prior year.

(g) No money collected pursuant to this section shall be expended to offset a reduction in any other source of funds. Funds from the Real Estate Fraud Prosecution Trust Fund shall be used only in connection with criminal investigations or prosecutions involving recorded real estate documents.

OCT - 4 1995

Approved ______________________________, 1995

Pete Wilson

______________________________

*Governor*

# COUNTY OF SAN DIEGO

CHIEF ADMINISTRATIVE OFFICE

AGENDA ITEM



DATE: April 16, 1996

TO: Board of Supervisors

SUBJECT: IMPLEMENTATION OF REAL ESTATE FRAUD PROSECUTION PROGRAM

**SUMMARY:**

**Issue:**
Should the Board of Supervisors authorize the establishment of a Real Estate Fraud Prosecution Program in the office of the District Attorney? Governor Wilson signed into law Senate Bill 537 which authorized an increase in recording fees for certain real property documents by up to $2.00. The legislation which was crafted by the California Association of Realtors and the California District Attorneys Association will enhance the District Attorney's ability to deter, investigate and prosecute real estate fraud crimes in San Diego County.

**Recommendation**

DISTRICT ATTORNEY:

1. Adopt a resolution requiring the Assessor/Recorder/County Clerk to implement section 27388 of the Government Code and begin collecting the $2 real estate fraud prevention fee to enhance the capacity of the District Attorney to deter, investigate and prosecute real estate fraud.

2. Establish appropriations of $51,371 in the District Attorney's budget for salaries and benefits ($26,763), services and supplies ($12,108 including $1,000 in travel) and fixed assets ($12,500), based on unanticipated real estate fraud revenue.

3. Approve the addition of 1 Deputy District Attorney V position, 1 District Attorney Investigator III position, 2 Real Estate Fraud Specialist positions, 1 Criminal Legal Secretary II position, and 1 Temporary Extra Help position, and authorize the Director of Human Resources to amend the Compensation Ordinance to reflect this approval.

SUBJECT: IMPLEMENTATION OF REAL ESTATE FRAUD PROSECUTION PROGRAM

4. Establish a Real Estate Fraud Prosecution Trust Fund pursuant to SB 537.

5. Waive Board Policy B-29, Fees, Grants, Revenue Contracts--Departmental Responsibility for full cost recovery.

Fiscal Impact

Funding of the Real Estate Fraud Unit will be from a $2.00 fee assessed on the recording of five specific documents as listed below, commencing in May 1996. If approved, this request will result in $51,371 current year cost and $55,142 current year revenue, $439,876 annual cost and $479,738 annual revenue and will require the addition of .65 current year staff years, 5.7 annual staff years. Direct costs are estimated to be 100% offset by revenues generated by the increase in recording fees.

Alternatives:

Do not take action to implement collection of a real estate fraud fee and deprive the citizens of San Diego enhanced deterrence, investigation and prosecution of real estate fraud crimes.

BACKGROUND

**This letter was originally considered by your Board on February 20, 1996 (minute order no. 33). At the Chief Administrative Officer's request, the item was continued until today. In the interim, it was discovered that in calculating the program revenue, the Assessor/Recorder/County Clerk had used a more expansive interpretation than intended by the legislation. Staff from the Assessor/Recorder/County Clerk and my Office have since met to refine the revenue estimates. The result is a reduced revenue projection. My Office has scaled back the program to fit within the revenue available. This letter and the attached resolution have been amended to reflect those changes.**

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Fraud in real estate transactions is a problem that is commonly ignored. It strikes at the heart of the American dream, and in San Diego harms some of our most vulnerable members of society: the elderly, members of the minority community, the middle class. The victims often lose their life savings, or their entire retirement funds, or the nest egg they saved for years for the house they dreamed of building. A single proficient thief can easily ruin two dozen victims, harming them so profoundly so that they will never recover. Restitution can and should be in the millions of dollars.

Senate Bill 537 enacted Government Code section 27388 to intensify efforts to combat real estate fraud crimes. Commencing on May 20, 1996, this legislation allows San Diego County to raise recording fees on every deed of trust, assignment of deed of trust, reconveyance, request for notice, and notice of default where a recording fee is required, by up to two dollars to enhance law enforcement efforts to investigate, prosecute and deter these crimes.

The bill enjoyed the support of the Senior Citizens Legal Services, the California District Attorneys Association, the California Association of Realtors, the California Escrow Association, Escrow Agents Fidelity Corporation, California Mortgage Bankers Association, Mortgage Guaranty Insurance Corporation, PMI Mortgage Insurance Company, Freddie Mac, the District Attorneys of Los Angeles,

SUBJECT: IMPLEMENTATION OF REAL ESTATE FRAUD PROSECUTION PROGRAM

Orange, Ventura and Contra Costa Counties, the California Police Chiefs, Peace Officers and State Sheriffs Associations. The program enjoys the support of the San Diego Association of Realtors, and the local title industry.

This office strongly supported Senate Bill 537. We provided testimony in legislative hearings in Sacramento, and worked with key industry figures, especially the California Association of Realtors.

In counties such as San Diego, where the District Attorney exclusively prosecutes real estate fraud, the money is to be allocated one hundred percent to the District Attorney, to deter, investigate, and prosecute real estate fraud. The legislation further provides for annual review of these expenditures and the work of the District Attorney by the Board of Supervisors.

The Assessor/Recorder/County Clerk has determined this legislation will generate $55,142 in the last six weeks of Fiscal Year 1995-96 and $479,738 in Fiscal Year 1996-97. These figures have decreased significantly from 1994. As the real estate market revives in the future, we can anticipate these revenues increasing. Senate Bill 537 allows for the deduction of any actual administrative costs incurred by the County in carrying out this section. The Assessor/Recorder/County Clerk has agreed to an administrative fee equal to 5% of the annual revenue generated from increased recording fees associated with SB537. Based on the Clerk's collection estimates, the administrative fees for FY 1995-96 will amount to $2,757 and $23,986 in FY 1996-97.

**This legislation provides significant revenues for law enforcement without burdening any industry or segment of the population. The cost is minimal; the net effect is powerful.**

This funding is instrumental to our work in deterring, investigating and prosecuting real estate fraud in San Diego. San Diego's active real estate market provides a few unscrupulous individuals the opportunity to take advantage of the average unsophisticated buyer. We currently have pending 25 real estate fraud investigations involving approximately 200 victims and an approximate theft or dollar loss of ten million dollars. Due to the current staffing level, we have been unable to give these cases the attention they deserve. In addition to effectively dealing with the current caseload, this funding will allow us to educate the public and thus deter future criminal activity. While we are unable to project the actual increase in caseload, we have confidence that the program will enable us to more aggressively prosecute an increased number of cases, many of which we would otherwise not have the resources to handle. Although neither the legislation nor the resolution require it, it is our intent to treat this project as a three-year pilot program.

The responsibility for the investigation and prosecution of real estate fraud in San Diego rests with the District Attorney. The office maintains a telephone line exclusively for citizens to phone in complaints, and we receive over two hundred real estate related complaints a year. We currently have the staff to handle only a fraction of these complaints. The overflow we refer to the Department of Real Estate or to other agencies, or suggest civil remedies. We also receive referrals from local law enforcement as well as the Department of Real Estate, and local civil attorneys retained by victims.

This office works a case from start to finish. Typically a deputy district attorney reviews the victim's complaint at the outset and works with an investigator or investigative specialist. We interview victims, draft search warrants, commission title research to verify what documents have been recorded

SUBJECT: IMPLEMENTATION OF REAL ESTATE FRAUD PROSECUTION PROGRAM

or not recorded against a property and in what priority; and ultimately arrest and interview suspects. These cases proceed at a very laborious pace: a single, highly complex case might take a year to fully investigate. The cases demand from an investigator and prosecutor a working knowledge of fundamental real estate law, customs, and protocols and frequently require research into specialized areas of law.

In addition to prosecuting a greater volume of the work we have been doing, we plan to take a creative approach to deterrence, and have set three initial goals: establishing educational and deterrence programs; developing a case referral system; initiating a computer data base of real estate fraud cases.

DETERRENCE / PUBLIC EDUCATION

We will work with both local law enforcement, the local real estate industry, and local news media to produce educational programs to educate the community on how to avoid real estate fraud. In particular, we are working with the Department of Real Estate to develop a specific educational, outreach program, involving speeches and presentations to community groups, brochures, and a video showing various fraud scenarios and how not to fall into them.

CASE REFERRAL

We will meet with and educate local law enforcement agencies and the industry trade associations, such as brokers, escrow companies, and title insurance companies, on what cases are suitable for our prosecution efforts: what to look for, what information to request of victims who complain, so that when the cases are forwarded to us for investigation and prosecution we will have a head start.

REAL ESTATE FRAUD DATA BASE

We are in the process of computerizing our data for real estate fraud cases. This data base will allow us to track how many instances of real estate fraud occur in San Diego County, how many victims are injured, what the dollar loss is, whether the case is suitable for criminal prosecution, and if not, for some other remedy. This statistical data base will help establish budget priorities by assessing the nature and extent of real estate fraud in San Diego.

The Real Estate Fraud Prosecution Trust Fund will currently fund one Deputy District Attorney, one Investigator, two Real Estate Fraud Specialists, one Criminal Legal Secretary, one Law Clerk, expert witness fees (primarily title research necessary to these cases), office space, and one-time start-up equipment. The newly created Real Estate Fraud Specialist position will be used to work these very complex cases and may well become a statewide model for real estate fraud enforcement. Training for investigators and prosecutors will be a priority, as will be developing an educational/deterrence program to protect citizens from becoming victims.

Respectfully submitted,

Paul J. Pfingst

PAUL J. PFINGST
District Attorney

NO. 96-64 TUESDAY, APRIL 16, 199

**RESOLUTION AUTHORIZING RECORDING FEE AND AUTHORIZING DISTRIBUTION OF THE REAL ESTATE FRAUD PROSECUTION TRUST FUND TO THE DISTRICT ATTORNEY**

On motion of Supervisor Jacob, seconded by Supervisor Slater, the following resolution is adopted:

WHEREAS, real estate fraud is a significant problem in San Diego County, causing irreparable harm to hundreds of citizens, resulting in the loss of millions of dollars a year to theft and fraud, frequently causing the loss of the entire life savings or retirement funds of many middle class and elderly citizens engaged in buying homes or investing in second or otherwise junior deeds of trusts secured by real estate. These crimes include but are not limited to: persons forging and selling forged deeds of trust; selling the same deed of trust over and over; misrepresenting the priority of a deed of trust, effectively leaving an investor with no security and no equity in the underlying property to foreclose on; servicing loans and diverting payoffs; rent skimming; selling fractionalized deeds of trust that are not properly qualified by the Department of Corporations; creative financing abuses; embezzling down payments out of fraudulent or non-existent escrows from would-be home buyers; and

WHEREAS, effective January 1, 1996, Government Code section 27388, a copy of which is attached hereto and incorporated herein, authorizes a fee of up to two dollars ($2) to be imposed on the recording of specified real estate instruments, papers, and notices, provided the Board of Supervisors adopts a resolution authorizing the fee; and

WHEREAS, Government Code section 27388 provides that the fees, after deduction of actual and necessary administrative costs incurred by the County in carrying out the section, are to be paid quarterly to the auditor or director of finance, to be placed in the Real Estate Fraud Prosecution Trust Fund; and

WHEREAS, in those counties where the investigation or real estate fraud is done exclusively by the district attorney, all of the funds placed in the Real Estate Fraud Prosecution Trust Fund shall be distributed to the District Attorney in order to deter, investigate and prosecute real estate fraud crimes, subject to review as specified in subdivision (d) of Government Code section 27388; and

WHEREAS, it is desired that a $2 recording fee be imposed on the following documents only: every deed of trust, assignment of deed of trust, reconveyance, request for notice, and notice of default, where a recording fee is required, and that all of the funds in the Real Estate Fraud Prosecution Fund be distributed to the District Attorney; NOW THEREFORE

IT IS HEREBY RESOLVED AND ORDERED that effective May 13, 1996, a recording fee of $2 shall be imposed in San Diego County on the following documents only: every deed of trust, assignment of deed of trust, reconveyance, request for notice, and notice of default, where a recording fee is required, as authorized by Government Code section 27388.

IT IS FURTHER RESOLVED AND ORDERED that the fees, after deduction of any actual and necessary administrative costs incurred in carrying out Government Code section 27388, shall be paid quarterly to the Auditor and Controller, to be placed in the Real Estate Fraud Prosecution Trust Fund.

IT IS FURTHER RESOLVED AND DETERMINED that investigation of real estate fraud is done exclusively by the District Attorney in San Diego County, and, in accordance with Government Code section 27388, 100 percent of the funds in the Real Estate Fraud Prosecution Trust Fund shall be distributed to the San Diego County District Attorney, subject to review as provided in subdivision (d) of Government Code section 27388.

IT IS FURTHER RESOLVED AND ORDERED that a copy of this resolution shall be transmitted to the District Attorney, the Assessor-Recorder-County Clerk, and the Auditor and Controller.

PASSED AND ADOPTED by the Board of Supervisors of the County of San Diego, State of California, this 16th day of April, 1996, Minute Order No. 11, by the following vote:

AYES: Cox, Jacob, Slater, Roberts, Horn

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STATE OF CALIFORNIA)ss
County of San Diego)

I hereby certify that the foregoing is a full, true, and correct copy of the Original Resolution which is now on file in my office.

THOMAS J. PASTUSZKA
Clerk of the Board of Directors

By A Gomez
Adair Gomez, Deputy

No. 96-64
4/16/96 (11)

Arne Hansen

EDWIN L. MILLER, JR.
District Attorney
Jeffrey Brodrick
Deputy District Attorney
7002 County Courthouse
San Diego, California 92101
531-3596

Attorneys for Plaintiff

FILED
KENNETH E. MARTONE
Clerk of the Superior Court
JAN 15 1993

MUNICIPAL COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SAN DIEGO

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|---|---|
| THE PEOPLE OF THE STATE OF CALIFORNIA, Plaintiff, v. RICHARD GILLELEN, Defendant. | No. F152913/DA P21042<br>STATEMENT IN AGGRAVATION PURSUANT TO PENAL CODE SECTION 1170(b) AND JUDICIAL COUNCIL RULE 437<br>Date: January 22, 1993<br>Time: 9:00<br>Dept: M-18 |

Comes now the plaintiff, the People of the State of California, by and through its attorneys, EDWIN L. MILLER, JR., District Attorney, and JEFFREY BRODRICK, Deputy District Attorney, and respectfully submits the following Statement in Aggravation relating to the above-named defendant, RICHARD GILLELEN.

STATEMENT OF THE CASE

In a complaint filed on November 20, 1992, the defendant was charged with 29 felony counts.

On this date, the defendant entered a plea of guilty to 9 counts of grand theft (PC 487.1) and admitted the great taking allegation (PC 12022.6). Defendant executed a waiver based on People v. Harvey (1979) 25 Cal.3d 754, agreeing to allow the facts

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underlying his prior history and the dismissed charges to be argued against him.

STATEMENT OF FACTS

Richard Gillelen was the sole owner and principal of El Capitan Investment Company, a licensed real estate broker which was doing business as All State Mortgage Company. Defendant brokered deeds of trust, locating investors, borrowers, and servicing the loans. Defendant typically charged ten points on each loan.

In June of 1992 the District Attorney's Office received numerous complaints from investors that Gillelen had stolen their money. After interviewing these victims, the District Attorney's Office executed a search warrant at defendant's business and home and seized his records. Defendant was interviewed.

Defendant confessed to approximately thirty thefts totalling about $450,000. He said, "Well, I guess I did steal the money. You know, there are no other words for it. I didn't put it in my pocket but I put it into other transactions. I don't know why other than it was probably benefitting me at the time to do this."

Defendant said he stole the money both to cover other investors' losses and to put money into his own investments.

On November 20, 1992, defendant pled guilty to nine counts of grand theft and a great taking allegation. He stipulated to a minimum restitution of $461,700.

Since his guilty plea, defendant and his lawyer have met on three occasions with the District Attorney and reviewed additional transactions. Defendant acknowledged misappropriating additional sums for a total taking of $1,351,500. (See attached

List of Principal Thefts). He said he converted payoffs or loan funds to his own use but said in many cases he replaced or substituted the deeds he stole with good deeds after the fact. Defendant claims a setoff for restitution purposes .

In his initial interview defendant was asked if he created any phony deeds by cutting and pasting documents; he denied this. Found in his records, however, was just such a document: a home-made cut and paste deed with a document number from the Recorder's Office taped to the top of a bogus deed. (See Court Exhibit 1)

PROBATION SHOULD BE DENIED

A review of the criteria affecting probation shows that the facts supporting a denial of probation outweigh the facts supporting a grant of probation:

Rule 414(a)(3). The vulnerability of the victim.

Many of the victims were elderly and unsophisticated in business matters. They trusted the defendant wholeheartedly. They believed defendant when he lied to them about late interest payments and never realized that the loans had long since been paid off. Defendant exploited this vulnerability to keep his scheme going and defraud more victims.

Rule 414(a)(5). The degree of monetary loss to the victim.

Gillelen's thievery was massive. He stipulated to a minimum restitution of $461,700 at arraignment. He now agrees he stole $1,351,500. Some victims lost over $100,000. Some lost their life savings.

Rule 414(a)(6). Whether the defendant was an active or passive participant.

Defendant ran the show. He solicited investors, found borrowers, sold the deeds and stole the money. He forged signatures and encouraged his escrow agent (sic) Betty Groves to falsely notarize dozens of signatures. He even stole $35,000 from Betty.

Rule 414(a)(7). Whether the crime was committed because of an unusual circumstance, such as great provocation, which is unlikely to recur.

There was no provocation whatsoever. The thefts continued over a five year period. Defendant has said repeatedly he doesn't know why he committed these crimes. By his own admission he used the stolen money in part in his own investments.

Rule 414(a)(8). Whether the manner in which the crime was carried out demonstrated criminal sophistication or professionalism on the part of the defendant.

Defendant used a variety of techniques to steal all this money. He caused escrow companies to pay him the principal sum of a loan even when the note dictated that the lender be paid personally. He then filed fraudulent reconveyances that falsely stated that the lender authorized the reconveyance when in fact the lenders had no idea their loans had been paid off to Gillelen.

Gillelen created wholly fictitious deeds by cutting and pasting. He took money from lenders when there was no borrower. He sold the same deed more than once. He forged victims' signatures on payoff checks. He forged borrowers' signatures to create what appeared to be valid deeds and assignments.

He told persuasive lies.

Rule 414(a)(9). Whether the defendant took advantage of a position of trust or confidence to commit the crime.

Defendant was entrusted with the responsibility of servicing the loans. He took advantage of this position by treating loan payoffs as his own money when the occasion suited him. Servicing the loans allowed the defendant to hide the status of the loans from the victims. Gillelen frequently pretended to service loans long after the borrowers had fully paid off the principal. He would continue to make monthly interest payments to deceive the victims into believing the borrower had not paid off the principal. He would also pretend the borrowers were having problems making payments even after they had paid off the loans.

Gillelen violated Department of Real Estate (DRE) regulations by failing to maintain the necessary trust accounts which were a condition of his servicing loans. DRE found that Gillelen's escrow trust fund account balance was $39.98 in April of 1992; it was underfunded by a minimum of $60,000.

Defendant also abused his position as an escrow by soliciting loans, putting the lender into escrow, taking their money and not funding the loan.

Rule 414(b). Facts relating to the defendant, including:

Rule 414(b)(1). Prior record of criminal conduct; whether as an adult or a juvenile, including the recency and frequency of prior crimes; and whether the prior record indicates a pattern of regular or increasingly serious criminal conduct.

Defendant managed to conceal his crimes for many years; for example, in count 3, he stole a $7,000 payoff from Barbara Anderson in 1987 but told her enough lies about the borrower's insolvency so that she did not discover the crime until 1992. The scope of this case is one of not merely regular but rampant criminal conduct lasting a minimum of five years.

Rule 414(b)(8). The likelihood that if not imprisoned the defendant will be a danger to others.

Defendant will always pose an economic danger to society by virtue of his facility for lying and his propensity for deception.

AGGRAVATION

An examination of the facts presently of record establishes that the circumstances in aggravation outweigh the circumstances in mitigation which are defined by Rule 423 of the California Rules of Court. The circumstances in aggravation are as follows:

Rule 421(a). Facts relating to the crime, whether or not charged or chargeable as enhancements, including the fact that:

Rule 421(a)(4). The defendant induced others to participate in the commission of the crime or occupied a position of leadership or dominance of other participants in its commission.

Defendant induced his employee, Betty Groves, to falsely notarize dozens of documents that were essential to his crime.

Rule 421(a)(6). The defendant threatened witnesses, unlawfully prevented or dissuaded witnesses from testifying, suborned perjury, or in any other way illegally interfered with the judicial process.

Defendant threatened to have one of the victims' son killed.

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<u>Rule 421(a)(8)</u>. The manner in which the crime was carried out indicates planning, sophistication, or professionalism.

Defendant used a variety of techniques to steal all this money. He caused escrow companies to pay him the principal sum of a loan even when the note dictated that the lender be paid personally. He then filed fraudulent reconveyances that falsely stated that the lender authorized the reconveyance when in fact the lenders had no idea their loans had been paid off to Gillelen.

Gillelen created wholly fictitious deeds by cutting and pasting. He took money from lenders when there was no borrower. he sold the same deed more than once. He forged victims' signatures on payoff checks. He forged borrowers' signatures to create what appeared to be valid deeds and assignments.

<u>Rule 421(a)(9)</u>. The crime involved an attempted or actual taking or damage of great monetary value.

Defendant stole over a million dollars.

<u>Rule 421(a)(11)</u>. The defendant took advantage of a position of trust or confidence to commit the offense.

Defendant was entrusted with the responsibility of servicing the loans. He took advantage of this position by treating loan payoffs as his own money when the occasion suited him. Servicing the loans allowed the defendant to hide the status of the loans from the victims. Gillelen frequently pretended to service loans long after the borrowers had fully paid off the principal. He would continue to make monthly interest payments to deceive the victims into believing the borrower had not paid off the principal. He would also pretend the borrowers were having problems making payments even after they had paid off the loans.

Gillelen violated Department of Real Estate (DRE) regulations by failing to maintain the necessary trust accounts which were a condition of his servicing loans. DRE found that Gillelen's escrow trust fund account balance was $39.98 in April of 1992; it was underfunded by a minimum of $60,000.

Defendant also abused his position as an escrow by soliciting loans, putting the lender into escrow, taking their money and not funding the loan.

Most significantly, defendant abused the trust that his many victims relied upon for him to do what said he would do with their money.

<u>CONSECUTIVE SENTENCING</u>

By examining the facts before the court in this case, the court will see that they establish certain facts relating to the crime that should be considered circumstances in support of the decision to impose consecutive rather than concurrent sentences pursuant to Judicial Council Rule 425(a). These facts are as follows:

<u>Rule 425(a)(1)</u>. The crimes and their objectives were predominantly independent of each other.

The commission of each theft allowed the defendant to steal a separate, discrete, specific sum.

<u>Rule 425(a)(3)</u>. The crimes were committed at different times and separate places, rather than being committed so close in time as to indicate a single period of aberrant behavior.

Defendant committed dozens of thefts over a five year span.

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CONCLUSION AND REQUESTED SENTENCE

We will, and do hereby request, based on the record in this case, this statement, and other argument, that the court impose a total prison term of ten years.

Therefore, based on the above analysis and rules, and in the face of overwhelming aggravating factors and the absence of mitigating factors, it is the position of the People that a proper sentence for this defendant is the term of ten years.

Dated:

Respectfully submitted,

EDWIN L. MILLER, JR.
District Attorney

By:

JEFFREY BRODRICK
Deputy District Attorney

Attorneys for Plaintiff

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Attorneys for Plaintiff

FILED
KENNETH E. MARTONE
Clerk of the Superior Court
DEC 27 1993
Deputy

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SAN DIEGO

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| THE PEOPLE OF THE STATE OF CALIFORNIA, Plaintiff, v. RICHARD PORTER STARK, Defendant. | F 157751 / DA P31588<br>STATEMENT IN AGGRAVATION PURSUANT TO PENAL CODE SECTION 1170(b) AND JUDICIAL COUNCIL RULE 437<br>Date: January 5, 1993<br>Time: 1:30<br>Dept: M-17 |

Comes now the plaintiff, the People of the State of California, by and through its attorneys, EDWIN L. MILLER, JR., District Attorney, and JEFFREY BRODRICK, Deputy District Attorney, and respectfully submits the following Statement in Aggravation relating to the above-named defendant, RICHARD PORTER STARK.

STATEMENT OF THE CASE

In a complaint filed on June 22, 1993, the defendant was charged with twenty-three counts, primarily grand theft, using false statements in the sale of a security, and one count of residential burglary. The offenses were alleged to have occurred between 1988 and 1991, against numerous victims.

On November 11, 1993, the defendant entered a plea of guilty to nine counts of grand theft and a great taking allegation.

Copy

Pursuant to a plea agreement, defendant executed a waiver based on People v. Harvey (1979) 25 Cal.3d 754, agreeing to allow the facts underlying his prior history and the dismissed charges to be argued against him.

STATEMENT OF THE FACTS

Richard Stark was president of Trust Deed Counselors, Inc. (TDC). TDC was in the business of buying, selling, and servicing deeds of trust. He also served as chief executive officer, secretary, chief financial officer, and officer. In a document filed with the Secretary of State, he described the business of TDC as that of mortgage broker.

Richard Stark ran TDC. He operated the business under the broker's license of John Nelson, whom he paid two hundred dollars a month. Stark made all the important business decisions, soliciting investors and choosing investments for them. He had a special list of investors that he kept private from other TDC employees.

Previously, Stark worked for many years at Security Pacific Bank as a vice-president. He solicited many of his bank customers to become investors at TDC. Stark left Security Pacific in 1990.

Beginning in 1988, Stark conducted a series of transactions in which he stole approximately $600,000 from his investors. Typically he sold the same deed of trust more than once, without the knowledge of his unsuspecting investors, who were unaware that the deeds they were buying from Stark had already been sold or assigned by Stark to other parties. Stark also unlawfully fractionalized deeds of trust and sold them in percentages. He failed to disclose to his investors that the interests he was selling had already been sold.

Stark committed four series of thefts: California RV Park IV; DA Counts; Whirleybird Tavern; and Paul Neilsen.

**CALIFORNIA RV PARK IV**

On approximately September 12, 1988, Trust Deed Counselors loaned California RV Park IV $125,000, secured by a deed of trust. On September 30, 1988, Richard Stark assigned this deed of trust to Grossmont Bank and provided to Grossmont Bank the original deed of trust, note, and assignment. The originals were logged in by the bank on October 6, 1988.

At the same time, Stark fractionalized the California RV Park IV deed of trust and sold it in pieces to five investors: Joseph and Josephine Pecoraro ($35,000); Lindsey and Irene Pickens ($15,000); Salvatore and Santina Pecoraro ($25,000); Thomas and Mary Anne Cannon ($20,000) and Salvatore and Rosella Cafiero ($30,000). Stark did not tell any of these investors that he had already assigned the entire California RV Park IV deed of trust to Grossmont Bank and that he had no legitimate interest to convey to them.

Stark arranged to have monthly payments made to the investors through National Land Services, a loan servicing company originally affiliated with TDC. He told neither the borrower nor the investors that he had assigned their deed of trust to Grossmont Bank and had in fact given to the bank all original documents reflecting this assignment: the original deed of trust, note, and assignment. The investors were unaware of Stark's theft until October 13, 1992, when they were notified by National Land Services that Stark "had pledged the note to Grossmont Bank within days of assigning the note to you."

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**DA COUNTS**

In late June, 1990, Stark loaned George Coladonato of DA Counts $200,000, secured by a deed of trust. On June 27, 1990 Stark sold this deed of trust to Frank Pecoraro for $200,000. Stark did not give Pecoraro any documents until July, 1991 when Pecoraro's attorney demanded the document file. The documents turned over included an assignment to Pecoraro of the DA Counts deed of trust. The assignment was dated June 27, 1990, notarized August 27, 1990. It was never recorded.

At the very same time Stark sold the entire DA Counts deed of trust to Frank Pecoraro. Stark again sold the same DA Counts deed of trust, this time in pieces, to six victims: Lorraine Keim ($25,000); Brian Bartindale ($5,500); Gaylord C. Swaim ($20,000); Howard and Pauline Brown ($63,500); James Dickinson ($20,000); and Paul Neilsen ($45,000). Stark did not tell any of these six victims that he had no interest in the DA Counts deed of trust to convey to them; nor did he tell them he had already assigned the entire DA Counts deed of trust to Frank Pecoraro.

Raymond Burg, Senior Corporations Counsel of the Department of Corporation, reviewed the California RV Parks IV and DA Counts transactions and concluded that Stark sold securities by means of written or oral communications which included untrue statements of material facts or omitted to state material facts, in violation of Corporations Code section 25401.

**WHIRLEYBIRD TAVERN**

On approximately September 28, 1990, Stark loaned $150,000 to Areanne Reynolds, secured by a deed of trust on the Whirleybird

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Tavern. On September 28, 1990 Stark sold this loan and assigned the deed of trust to Governor Financial.

On October 26, 1990, Stark called James Dickinson and told him he had a deed of trust for $150,000 on the Whirleybird Tavern for Dickinson to invest in. That same day Stark went to Dickinson's house, entered, and took from Dickinson a check for $150,000 which Stark said would be used to purchase the Whirleybird deed of trust. Stark did not tell Dickinson he had sold the deed of trust a month earlier. Stark told Dickinson the proper documents would be recorded. Dickinson called Stark repeatedly to get copies of his recorded documents. Stark told a number of lies and ultimately wrote a letter for Dickinson in which he falsely stated that an assignment "was recorded in the County of San Diego assigning our interest in the property described below to James and Gerta Dickinson." Stark himself made monthly payments on the deed for fourteen months then stopped.

**PAUL NEILSEN**

Stark told Paul Neilsen he had three deeds of trust for him to invest in, and on September 20, 1991 Neilsen gave Stark three checks for the three deeds of trust: $45,000, $35,000, and $30,000. Neilsen received three payments from National Land Services. He requested from Stark but never received documentation showing his money was invested as promised.

II

**DEFENDANT SHOULD BE SENTENCED TO PRISON**

Having the sentencing objectives in mind, the court must determine whether the defendant should be granted probation. Rule

414 presents the criteria the court should consider in determining whether to grant or deny probation. Under Rule 414, the court must decide whether any statutory provisions exist limiting or prohibiting the grant of probation. The following rules apply:

Rule 414(a). Facts relating to the crime, including:

Rule 414(a)(1). The nature, seriousness, and circumstances of the crime as compared to other instances of the same crime. Defendant stole a minimum of $600,000. He stole from the most vulnerable of victims: the elderly, the unsophisticated, victims who knew Stark for years and year and considered him family.

Rule 414(a)(3). The vulnerability of the victim. Virtually all the victims were unsophisticated investors. They met Stark through his bank, Security Pacific. Stark became their personal banker. The victims took trips with Stark. They cooked meals for him. They placed their total trust in Stark. They didn't know what documents they should receive or that they should have recorded copies of the assignments of the deeds of trusts.

Rule 414(a)(5). The degree of monetary loss to the victim. Stark stole $200,000 from Frank Pecoraro in one fell swoop; he went to James Dickinson's house and stole $150,000. For many of the victims, the money stolen by Stark represented their retirement savings.

Rule 414(a)(6). Whether the defendant was an active or passive participant. Stark ran the show at Trust Deed Counselors. He made all the decisions. He personally committed these thefts.

Rule 414(a)(7). Whether the crime was committed because of an unusual circumstance, such as great provocation, which is unlikely

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to recur. Stark committed dozens of fraudulent acts over a period of three years. Greed was the provocation.

Rule 414(a)(8). Whether the manner in which the crime was carried out demonstrated criminal sophistication or professionalism on the part of the defendant. Stark used his superior knowledge of financing to carry out his thefts. He used his charm to make it happen.

Rule 414(a)(9). Whether the defendant took advantage of a position of trust or confidence to commit the crime. Stark exploited the trust he had developed over many years in order to steal from his unsuspecting victims.

Rule 414(b). Facts relating to the defendant, including:

Rule 414(b)(1). Prior record of criminal conduct; whether as an adult or a juvenile, including the recency and frequency of prior crimes; and whether the prior record indicates a pattern of regular or increasingly serious criminal conduct. While employed at Security Pacific Bank, Stark defrauded at least one bank customer. A lawsuit against the bank was filed; Stark retired.

III

AGGRAVATION

An examination of the facts presently of record establishes that the circumstances in aggravation outweigh the circumstances in mitigation which are defined by Rule 423 of the California Rules of Court. The circumstances in aggravation are as follows:

Rule 421(a). Facts relating to the crime, whether or not charged or chargeable as enhancements, including the fact that:

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<u>Rule 421(a)(3)</u>. The victim was particularly vulnerable. The victims were elderly, unsophisticated investors whom Stark exploited and manipulated.

<u>Rule 421(a)(8)</u>. The manner in which the crime was carried out indicates planning, sophistication, or professionalism. The timing of the sales of the deeds of trusts shows that Stark knew he could sell a deed of trust twice before anyone had recorded it and gave notice to others.

<u>Rule 421(a)(9)</u>. The crime involved an attempted or actual taking or damage of great monetary value. Restitution exceeds two million dollars.

<u>Rule 421(a)(11)</u>. The defendant took advantage of a position of trust or confidence to commit the offense. Stark was the personal banker for the victims.

<u>Rule 421(b)</u>. Facts relating to the defendant, including the fact that:

<u>Rule 414(b)(8)</u>. The likelihood that if not imprisoned, the defendant will be a danger to others. Defendant represents a an economic danger to the public.

IV

<u>CONSECUTIVE SENTENCING</u>

By examining the facts before the court in this case, the court will see that they establish certain facts relating to the crime that should be considered circumstances in support of the decision to impose consecutive rather than concurrent sentences pursuant to Judicial Council Rule 425(a). These facts are as follows:

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Rule 425(a)(1). The crimes and their objectives were predominantly independent of each other. Each crime represented a separate theft and separate gain to the defendant.

Rule 425(a)(3). The crimes were committed at different times and separate places, rather than being committed so close in time as to indicate a single period of aberrant behavior. The crimes took place over a three year period.

Rule 425(b). Any circumstances in aggravation or mitigation.

CONCLUSION AND REQUESTED SENTENCE

We will, and do hereby request, based on the record in this case, this statement, and other argument, that the court impose a total prison term of ten years.

Therefore, based on the above analysis and rules, and in the face of overwhelming aggravating factors and the absence of mitigating factors, it is the position of the People that a proper sentence for this defendant is the upper term of ten years in prison to be served consecutively.

Dated: December 27, 1993

Respectfully submitted,

EDWIN L. MILLER, JR.
District Attorney

By: Jeffrey Brodrick

JEFFREY BRODRICK
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Attorneys for Plaintiff

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MAY 23 1996
Deputy

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SAN DIEGO

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| THE PEOPLE OF THE STATE OF CALIFORNIA, Plaintiff, v. CHARLES JOSEPH SALAS, Defendant. | SC NO. SCD 118151<br>DA NO. P 072403<br>**STATEMENT IN AGGRAVATION PURSUANT TO PENAL CODE SECTION 1170(b) AND JUDICIAL COUNCIL RULE 437**<br>DATE: May 29, 1996<br>TIME: 8:30<br>DEPT: S-8 |

Comes now the plaintiff, the People of the State of California, by and through its attorneys, PAUL J. PFINGST, District Attorney, and JEFFREY BRODRICK, Deputy District Attorney, and respectfully submits the following Statement in Aggravation relating to the above-named defendant, CHARLES JOSEPH SALAS.

**STATEMENT OF THE CASE**

In an information filed on 1/12/96, the defendant was charged with 22 counts of Grand Theft, in violation of Penal Code section 487(a). It was further alleged that victims' losses exceeded two and one half million dollars ($2.5MM), within the meaning of Penal Code section 12022.6(d). The offenses occurred between 1990 and 1995, against many victims.

On 4/10/96, the defendant entered a plea of guilty to all charges. Pursuant to a plea agreement, the defendant executed a waiver based on People v. Harvey (1979) 25 Cal.3d 754, agreeing to allow the facts underlying his prior history and the dismissed charges to be argued against him.

**STATEMENT OF THE FACTS**

CHARLES SALAS and Patricia Meyer were equal owners (50% share each) in Four Seasons Financial Services, Inc. (FSFS), and Four Seasons Mortgage Services, Inc. (FSMS). SALAS was the CEO of both corporations and Meyer was the vice president of FSFS, and president of FSMS. SALAS and Meyer shared responsibility for all of the Four Seasons' business transactions.

Four Seasons was a "hard-money" lender. They provided high-interest rate loans to borrowers, who pledged real estate in the form of deeds of trust as collateral. The loans were fractionalized and sold to investors. Four Seasons eventually put together limited partnerships to finance real estate investment projects in Calexico, Murrieta Hot Springs and Laughlin, Nevada.

According to the Four Seasons Company Profile, management was guided by a "conservative philosophy, stressing security over yield." The profile promised transactions that were "simple, clean, easy, low risk, short term, and quickly funded in a market [Four Seasons] understood." SALAS commented, "It is very important for an investor to see the property and documentation backing the trust deed before investing." SALAS claimed, "the loyalty of investors is the strongest endorsement . . . [Four Seasons] could receive." This philosophy was quickly abandoned when the defendant wanted more money and decided to steal from his investors.

Motivated by greed, SALAS ventured into real estate speculation for which he was totally ill-equipped, lacking both experience and expertise. SALAS projected his CM Ranch development project would yield eighty million dollars ($80MM) in profits. Defendant published glossy brochures depicting man made lakes in the middle of the desert. This farfetched scheme was never grounded in common sense or appropriate to the community of Calexico, which has a population of 20,000 people and a median income of $18,000.

The defendant diverted pay-off funds, oversold partnerships, and obtained investment funds under false pretenses. SALAS exploited the relationship of trust and confidence Four Seasons enjoyed with its investors. When the partnership money could not fund the costs associated with SALAS' speculative development, he stole more money from investors to cover checks he was writing. Defendant diverted money from various unrelated trust deed payoffs without investors' knowledge or consent. The money went into the Calexico project to help SALAS realize his hopes of making an eighty million dollar ($80MM) profit. Investors believed they were making secured investments, but SALAS stole the payoffs and used the funds to make unsecured investments. The defendant accounted for loans involved in the diversion scheme as "affected" loans. Meyer wrote false extension letters to investors in order to keep the truth from them and to mislead them. Meyer selected the victims. She made interest payments to the investors who inquired most often about the status of their investment. SALAS gambled on making money in Calexico; using other people's money.

The public image of Four Seasons was very important to SALAS. He preferred to divert investor funds than let it be known that Four Seasons was having financial difficulties. According to investors, SALAS enjoyed a lavish business lifestyle while courting investors who later became victims. This extravagance included limousine rides, frequent private plane rides to Calexico from San Diego, and parties costing tens of thousands of dollars, which included prostitutes provided by SALAS. Reports detailing CM Ranch project costs list airplane expenses exceeding $41,000.

CHARLES SALAS was motivated by greed. For the privilege of stealing from his investors, SALAS paid himself an annual salary of $150,000 plus bonus. Meyer received $100,000 a year plus bonus. SALAS took life savings, retirement savings, pension money, and trust money. He stole from scores of investors and promised them safe, secure investments and lofty profits. Although most of the money went into the Calexico speculation, a Department of Real Estate audit revealed one check for $120,000 to the defendant that has not been explained. Meyer described one transaction with Mexican investors in which more than one million dollars ($1MM) cash was delivered in shoe boxes.

The investors collectively lost more than four million dollars ($4MM). Many were elderly victims who lost their life savings and will never recover. The defendant has recently filed for bankruptcy and failed to provide the court with the necessary documents.

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## ARGUMENT

## I

## DEFENDANT IS NOT DESERVING OF PROBATION AND SHOULD BE SENTENCED TO PRISON

Having the sentencing objectives in mind, the court must determine whether the defendant should be granted probation. Rule 414 presents the criteria the court should consider in determining whether to grant or deny probation. Under Rule 414(a), the court must decide whether any statutory provisions exist limiting or prohibiting the grant of probation. The following rules apply:

Rule 414(a). Facts relating to the crime, including:

Rule 414(a)(1). The nature, seriousness, and circumstances of the crime as compared to other instances of the same crime. Defendant stole over four million dollars ($4MM) from the most vulnerable of people. Many of the victims were elderly people who entrusted the defendant with their life savings. SALAS used the money to support his lavish lifestyle.

Rule 414(a)(3). The vulnerability of the victim. Most of the victims became friends of the defendant. Some were elderly and unsophisticated in financial matters. Many were turned on to Four Seasons by family or friends. The defendant exploited the naivety of the victims for his personal profit.

Rule 414(a)(4). Whether the defendant inflicted physical or emotional injury. The victims have suffered both financially and emotionally. They have to cope with the loss of retirement savings. Some victims have lost family money and have had to confront the humiliation and shame of being involved in this loss. Many victims reported that they have suffered poor health as a result of the crimes. Some have suffered severe depression, ulcers, and loss of sleep. The defendant stole victims' peace of mind, happiness, and security for their future.

Rule 414(a)(5). The degree of monetary loss to the victim. Based solely on the twenty-two counts charged in the information, the victims lost more than four million dollars ($4MM). Some elderly victims lost their life savings and will never recover. Victims who lost their pension or retirement savings now face an uncertain future.

Rule 414(a)(6). Whether the defendant was an active or passive participant. SALAS and Meyer shared ownership in Four Seasons and responsibility for all business transactions. SALAS was the ringleader. He made the initial decision to steal money, and orchestrated dozens of thefts for the next four years.

Rule 414(a)(7). Whether the crime was committed because of an unusual circumstance, such as great provocation, which is unlikely to recur. There was no provocation. The crime was committed because of the defendant's greed for huge profits and appetite for an extravagant lifestyle, supported with money he stole from old people's retirement funds. The defendant preyed on unsuspecting clients who placed their trust, confidence, and substantial savings in the defendant's hands.

Rule 414(a)(8). Whether the manner in which the crime was carried out demonstrated criminal sophistication or professionalism on the part of the defendant. Defendant printed slick brochures to induce investors into his scam. He maintained detailed records of the loans involved in the diversion and managed to keep victims at bay for more than four years.

Rule 414(a)(9). Whether the defendant took advantage of a position of trust and confidence to commit the crime. Many of the victims believed they were friends of the defendant. The best example of how much trust the victims placed in the defendant is demonstrated by the tremendous amount of money victims invested with Four Seasons, including retirement, pension, and life savings.

Rule 414(b). Facts relating to the defendant, including:

Rule 414(b)(4). Ability to comply with reasonable terms of probation as indicated by the defendant's age, education, health, mental faculties, history of alcohol or other substance abuse, family background and ties, employment and military service history, and other relevant factors. Defendant has filed for bankruptcy and has no reasonable ability to pay restitution.

Rule 414(b)(8). The likelihood that if not imprisoned, the defendant will be a danger to others. Defendant poses a profound economic risk to society.

II

**AGGRAVATION**

An examination of the facts presently of record establishes that the circumstances in aggravation outweigh the circumstances in mitigation as defined by the California Rules of Court, Rule 423(a). The circumstances in aggravation are as follows:

Rule 421(a). Facts relating to the crime, whether or not charged or chargeable as enhancements, including the fact that:

Rule 421(a)(3). The victims were particularly vulnerable. Many of the victims were elderly. They lacked financial expertise and trusted the defendant. The defendant exploited his friendships and the inherent vulnerability of those relationships.

Rule 421(a)(4). The defendant induced others to participate in the crime or occupied a position of leadership or dominance of other participants in its commission. SALAS was the mastermind and made the initial decision to begin stealing from investors.

Rule 421(a)(8). The manner in which the crime was carried out indicates planning, sophistication, or professionalism. See above.

Rule 421(a)(9). The crime involved an attempted or actual taking or damage of great monetary value. SALAS stole more than $4,000,000. See above.

Rule 421(a)(11). The defendant took advantage of a position of trust or confidence to commit the offense. The defendant gained investors' confidence and then used it against them to cheat them of their life savings.

III

**CONSECUTIVE SENTENCING**

By examining the facts before the court in this case, the court will see that they establish certain facts relating to the crime that should be considered circumstances in support of the decision to impose consecutive rather than concurrent sentences pursuant to Judicial Council Rule 425(a). These facts are as follows:

<u>Rule 425(a)(1)</u>. The crimes and their objectives were predominantly independent of each other. Each theft gave the defendant separate, discrete amounts of money.

<u>Rule 425(a)(3)</u>. The crimes were committed at different times and separate places, rather than being committed so closely in time and place as to indicate a single period of aberrant behavior. The crimes occurred over the course of four years.

<u>Rule 425(b)</u>. Any circumstances in aggravation or mitigation.

**<u>CONCLUSION AND REQUESTED SENTENCE</u>**

We will, and do hereby request, based on the record in this case, this statement, and other argument, that the court impose a total prison term of twelve (12) years for the defendant.

The People request a proper sentence for the defendant is the maximum term of twelve (12) years in prison to be served consecutively.

Dated: May 23, 1996

Respectfully submitted,

PAUL J. PFINGST
District Attorney

By: ______________________
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KENNETH E. MARTONE
Clerk of the Superior Court

SEP 06 1995

By: ____________, Deputy

MUNICIPAL COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SAN DIEGO

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| THE PEOPLE OF THE STATE OF CALIFORNIA, Plaintiff, v. SYLVAN STEWART COOPER, Defendant. | No. CD113284/DA P63158<br><br>STATEMENT IN AGGRAVATION PURSUANT TO PENAL CODE SECTION 1170(b) AND JUDICIAL COUNCIL RULE 437<br><br>Date: September 8, 1995<br>Time: 1:30 PM<br>Dept: M-12 |

Comes now the plaintiff, the People of the State of California, by and through its attorneys, PAUL J. PFINGST, District Attorney, and JEFFREY BRODRICK, Deputy District Attorney, and respectfully submits the following Statement in Aggravation relating to the above-named defendant, SYLVAN STEWART COOPER.

STATEMENT OF THE CASE

In a complaint filed on 6/5/95, the defendant was charged with seven counts of Grand Theft. The offenses were alleged to have occurred between 1991 and 1994, against victims Vanthong Phrakonkham, Hubert Price, Johnny and Jack Favale, and Dr. Leland Fitzgerald.

On 7/6/95, the defendant entered a plea of no contest to all charges. Pursuant to a plea agreement, he executed a waiver based on People v. Harvey (1979) 25 Cal.3d 754, agreeing to allow the facts underlying his prior history and any dismissed charges to be argued against him. He further agreed to allow uncharged victims to be considered for purposes of restitution.

## STATEMENT OF THE FACTS

Sylvan Cooper stole over half a million dollars. He stole this money from a variety of victims, including Vanthong Phrakonkham, John and Jack Favale, Leo Bodin, Leland Fitzgerald, Hubert Price, and Beverly Holt. One of the victims, Mr. Phrakonkham, was a Laotian immigrant who spoke little English and lost his life savings to the defendant. Another victim, Leo Bodin, is eighty years old and lost a large part of his retirement savings to the defendant. Another victim, Beverly Holt, is a single woman in her sixties with a severe hearing loss and no way to make up the fifty thousand dollars she lost to the defendant.

Cooper stole this half a million dollars in a variety of ways: by false pretense, by trick or device, by embezzlement. Cooper held a consumer finance license from the Dept. of Corporations. This license allowed him to loan his own money but not to broker loans to third parties, unless they were institutional investors such as a bank or city or other public entity or political subdivision. Notwithstanding that he had no license to do so, Cooper routinely sold loans to his many victims, in violation of Financial Code section 24476/24653. He told his victims that their investments were protected by deeds of trust, but never recorded assignments in the victims' names. This allowed Cooper to steal the victims' money by collecting payoffs from borrowers and not turning the money over to the victims. To accomplish these thefts, Cooper caused fraudulent reconveyances to be filed, in violation of Penal Code 115, falsely stating that the debt owed to the holder of the beneficial interest under the deed of trust had been satisfied. In fact, the victims to whom Cooper sold these loans were NEVER paid. Cooper's thefts and the victims' losses had nothing to do with an economic downturn. Foreclosures had nothing to do with the victims' losses. Cooper stole PAYOFFS -- loans that were paid in full by the borrowers. In the Phrakonkham matter, Cooper converted the victim's deed of trust to his own use, by foreclosing, then trading the victim's property for an apartment building. Cooper himself valued the victim's deed of trust at $190,000 in this transaction.

During the several years that Cooper stole this half a million dollars, he constructed an ocean-view home in La Jolla. He put Vanthong Phrakonkham into bankruptcy and stole the retirement money of the elderly and infirm.

VICTIM: VANTHONG PHRAKONKHAM LOSS: $240,000

Cooper stole $240,000 from Vanthong Phrakonkham. He committed this grand theft by trick or device and embezzlement. The victim was an immigrant from Laos and spoke little English. Cooper made a loan to Phrakonkham and told him to bring the original deed of trust Phrakonkham held on a piece of land he had previously sold in Riverside. Cooper told Phrakonkham to leave the original deed of trust with him so he could make copies of it. After signing numerous loan documents and receiving his money from Cooper, Phrakonkham learned that he had unwittingly assigned the deed of trust to Cooper as collateral for his loan. Cooper loaned Phrakonkham $14,500; the deed of trust he tricked Phrakonkham into signing over to him as collateral had $190,600 owed on it. Cooper told Phrakonkham not to worry about the deed of trust, that the assignment was just a formality, and when he was paid back he would assign the deed of trust back to Phrakonkham.

Unfortunately, Cooper did just the opposite. Without Phrakonkham's knowledge or approval, Cooper foreclosed on Phrakonkham's deed of trust and converted it to his own use, trading the underlying property for another deed of trust on a sixteen unit apartment building located in downtown San Diego at 2350 Third Avenue.

The monthly rental roll for the complex showed that the complex generated $8,745 a month in rent, far exceeding the monthly payments on the deed of trust, and the property taxes. During the past three years, Cooper never paid a penny of these profits over to Phrakonkham.

Phrakonkham called Cooper over a hundred times trying to speak to him about the deed of trust that Cooper had tricked him out of and now converted to his own use. Cooper did not reply. Finally Phrakonkham waited one morning for Cooper at his office and told him he wanted his Riverside property back and had the money to pay back Cooper. Cooper said everything was okay and he would get back to Phrakonkham. He didn't.

Phrakonkham retained Attorney Jerry Schaefer. Schaefer discovered that Cooper foreclosed on the property and took title by way of trustee's deed upon sale on June 8, 1992. On this date, Cooper traded the Riverside property for an existing note and deed of trust on an apartment building at 2350 Third Avenue, San Diego. The note and deed of trust had an existing value of $190,000, according to the purchase/sale agreement between Cooper and the buyer. Cooper ultimately took title to this apartment building by way of a grant deed from Avenue Associates, which issued him the deed in consideration of, and in full cancellation of the debt secured by the deed of trust Cooper traded the land for. Cooper now owns the apartment building under his business, Desert View Financial. Desert View Financial took title on August 20, 1992. Phrakonkham and his wife lost their trust deed note on the Riverside property and with it all their life savings.

In December 1992, Attorney Schaefer sued Sylvan and Irene Cooper in the Superior Court in San Diego County (Case No. N58231) on Phrakonkham's behalf. In March 1994, Judge J. Morgan Lester ruled in favor of Phrakonkham. The judge awarded Phrakonkham $190,600 for his losses on the $205,100 trust deed. The judge further ruled that Cooper should pay him the interest earned on his losses. And the judge ordered Cooper to pay for Phrakonkham's attorney fees. Furthermore, Judge Lester declared the $22,000 loan note to Phrakonkham from Cooper void. Finally, Judge Lester awarded Phrakonkham $500,000 in punitive damages. Judge Lester commented:

> "It's apparent to the court that a gross fraud was perpetrated upon the plaintiff by Sylvan Cooper; the type of activity which, if appraised by the Fraud Division of the District Attorney's Office, would easily lead to a state prison sentence."
>
> "He took advantage of someone who did not speak English well, and then went and took the property away from [Phrakonkham], which was only given to him to hold as security."

**VICTIM: AMERICAN SAVINGS BANK**

After Cooper took possession of the apartment complex at 2350 Third Avenue, San Diego, that he acquired by stealing Phrakonkham's deed of trust, Cooper collected and skimmed the rents, in violation of his deed of trust. The lender and beneficiary of the deed of trust on the property, American Savings Bank, successfully sought appointment of a receiver on June 2, 1995. The bank alleged that Cooper collected the rents from the property, yet failed to make his monthly installment payment due the bank. Judge Gamer issued a preliminary injunction that forbid defendant from collecting rent on the property. Cooper had failed to pay his mortgage from February 1, 1995.

**VICTIM: HUBERT PRICE LOSS: $25,000**

Cooper stole $20,00 from Hubert Price on September 23, 1992. He did so by collecting a payoff on a loan he had sold to Price without telling the borrower he had sold the loan and without turning the money over to Price.

Hector Arteaga borrowed $25,000 from Cooper in approximately July, 1991, secured by a deed of trust on Arteaga's condominium in La Jolla. Unbeknownst to Arteaga, Cooper sold the loan to Hubert Price for $25,000. When the note was due, Arteaga went to Cooper and asked him if he could pay Cooper $20,000 plus the monthly interest on the remaining balance. He asked if Cooper would mind if Arteaga paid him the remaining $5,000 in a couple of months. Cooper said, "Sure, no problem. What are friends for?" On September 23, 1992, Arteaga paid Cooper $20,000 as a partial paydown of principal.

In 1994, Arteaga got a call from Hubert Price, who told Arteaga that Arteaga owed him money. Arteaga didn't know who Price was, but Price told him about buying Arteaga's loan from Cooper. Arteaga explained to Price that he had already paid most of the money to Cooper. Price showed Arteaga papers which showed that one month

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after Arteaga got the loan from Cooper, Cooper assigned the note to Price. Arteaga had no idea that Cooper assigned the note to Price.

Cooper did not give Price any of the $20,000 of the principal that Arteaga paid off on September 23, 1992. Price continued to receive monthly payments from Cooper until April of 1994; but never received any of his $25,000 from Cooper.

VICTIM: JOHNNY FAVALE LOSS: $22,500

Cooper stole $22,500 from Johnny Favale by false pretense and embezzlement.

Johnny Favale works with his father as a tow truck driver. He had received some money as a result of an accident and was looking for some type of investment. Leo Bodin, an old family friend and another victim of Cooper, told Favale of Cooper and arranged a meeting. Favale was impressed with Cooper and his presentation. Cooper said:

> "I will be tied in this with you. I will take care of you. I will show you the ropes. You will make a lot of money, then you can go out on your own."

Favale had a sense of comfort in that Cooper was going to "be with him" on this investment.

Favale gave Cooper a check for $30,000 on March 5, 1991. The money was for two deeds, one for $10,000 and one for $20,000.

On January 18, 1991, Cooper had lent $15,000 to Joe and Aracel Hernandez, owners of 648 Sea Vale Street, Chula Vista. Cooper wrote Favale and told him that $10,000 of his money was invested in the Hernandez deed of trust on Sea Vale, and that $20,000 of his money was invested in a deed of trust secured by Phrakonkham's property.

In fact, Cooper never recorded anything in Favale's name. Contrary to the lies he told Favale when he took his $30,000, Favale's investments were never secured by deeds of trust. This deception allowed Cooper to steal payoffs from borrowers who were unaware Cooper had sold their loans. When the Hernandez deed of trust paid off, Cooper gave Favale $7,500 but stole $2,500. Cooper never assigned Favale an interest in the Phrakonkham deed of trust and in fact this deed of trust was ordered reconveyed by Judge Lester after he made a finding that Cooper had committed fraud.

Tom Best, President of Secured Equity Management, Inc., was the trustee on the Hernandez Sea Vale property. Best recorded the reconveyance of the trust deed for Cooper on February 26, 1992. Best stated that he would not have recorded a reconveyance if he was aware of an existing assignment by the beneficiary on the property.

Favale has made many efforts to contact Cooper in an effort to recover his money. Cooper refused to return his calls. Favale is now out the remaining $22,500.

**<u>VICTIM: JACK FAVALE LOSS: $10,000</u>**

Cooper also stole $10,000 from Jack Favale, Johnny's father. Jack Favale was present at the initial meeting with Cooper and his son Johnny and Bodin, and he was also impressed with the presentation by Cooper. Jack gave Cooper $10,000. Cooper sent Favale a letter telling him his $10,000 was going into a deed of trust on 1215 Via La Ranchita, San Marcos. This was a lie. Cooper never gave Favale any interest in this deed of trust. Cooper assigned this deed of trust to another party.

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Jack Favale received interest payments for a short period of time. He never received any of his principal. Jack is still out his original $10,000 investment.

**VICTIM: DR. LELAND FITZGERALD LOSS: $164,000**

Cooper stole approximately $164,000 from Dr. Leland Fitzgerald. He did so by collecting payoffs on deeds of trust he had sold Fitzgerald and keeping those payoffs for his own benefit. He also took Fitzgerald's money by false pretense and tricked him into making investments without telling him of the precarious financial situation of the borrower.

A dentist, Fitzgerald began to invest in deeds of trust through Cooper, in 1989. Fitzgerald had no experience in real estate and relied upon Cooper's advice. In 1991, Fitzgerald told Cooper he did not want to invest in any more trust deeds. Despite this instruction, Cooper refused to return Fitzgerald's money. Fitzgerald sent a letter to Cooper telling him not to reinvest any of his money in trust deeds. The letter was dated September 3, 1991. Fitzgerald wrote:

> "Please, when any of my notes come due, do NOT reinvest the money. Please send or I will pick up the check. I do not desire to invest in Trust Deeds anymore."

Cooper continued to take payoffs of deeds of trust owed to Fitzgerald and gave him assignments of deeds of trust instead of the money owed to Fitzgerald and requested by him. Cooper took the proceeds of three deeds of trust and converted the money to his own uses. Ultimately he told Fitzgerald he was giving him a deed of trust for $125,000 on some property he owned on Nautilus Street in La

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Jolla. This deed of trust was nothing more than a worthless piece of paper; there was no equity in the house to cover it.

Cooper came to Fitzgerald after work one day and said, "Look, here's what I'm going to do, I'm giving you this deed of trust." Fitzgerald said he didn't know if he wanted to do this. He talked to his wife and they agreed they didn't want the deed of trust. He called Cooper to tell him, but Cooper wouldn't return his phone calls. He wrote Cooper a letter and told him he didn't want the deed of trust. Cooper sent three checks on this deed of trust. At first Fitzgerald didn't cash them because he didn't want to authorize the deed of trust. He then cashed the three checks and wrote Cooper that he was not accepting the deed of trust. The payments stopped.

Six months or so later, the bank (who held a deed of trust senior to Fitzgerald) foreclosed on the Nautilus Street property, wiping out Fitzgerald's deed of trust. Fitzgerald said he did not foreclose on the Nautilus property because his lawyer told him not to, and because there was no equity in the property.

<u>**435 ROUS STREET, SAN DIEGO**</u>

On or about March 26, 1990, Fitzgerald invested $45,000 in a deed of trust on 4235 Rous Street, San Diego. He sent Fitzgerald an original assignment transferring the interest in the deed of trust from Cooper to Fitzgerald. He never told Fitzgerald to record this assignment. The deed of trust was paid off on September 25, 1991. Lynn Matella of United Title stated that the escrow file showed that Cooper was paid $45,813.81.

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Despite Fitzgerald's letter of September 3, 1991, telling Cooper not to reinvest, Cooper sent Fitzgerald an assignment of another deed of trust on 713 Third Street, Ramona.

**713 THIRD STREET, RAMONA**

Without permission, Cooper gave Fitzgerald an assignment of this deed of trust in lieu of paying him the $45,813.81 on Rous Street. He wrote Fitzgerald a letter and stated he was assigning him a percentage of this deed of trust and keeping $15,000 for legal fees. The borrower on Third Street was Robinson. The deed of trust was paid off on March 15, 1993.

On May 2, 1995, Marina Romeri, Escrow Manager, Coronado Financial Services stated that Coronado Financial Services paid off the existing loans on the property at 713 Third Street, Ramona, as a result of a purchase by Shepard, Inc. A check in the amount of $39,524.21 was issued to Sylvan and Irene Cooper on a draft from Pacific Commercial Bank on March 15, 1993. This money belonged to Fitzgerald; but Cooper kept it for himself.

**16780 HIGHLAND VALLEY ROAD, RAMONA**

Fitzgerald had previously invested $40,000 in a deed of trust on 3620 Quimby Street, San Diego. The borrower was Fischer. The deed of trust paid off on or about September 24, 1990. On this date, Cooper wrote Fitzgerald stating, "the Fischer account funds were transferred to a new 2nd Trust Deed, Brechbill in the sum of $43,500." According to his letter, he sent Fitzgerald an original assignment of deed of trust from Donald Brechbill to Sylvan and Irene Cooper. The borrower was Edwin and Sarah Youngman.

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The Brechbill deed of trust was paid off on July 23, 1992, through escrow. A check for $40,395.75 was drawn on the Bank of America and delivered by Fed Ex to Cooper on July 23, 1992. The deed of trust was reconveyed on September 22, 1992, by Donald Stevens. The reconveyance filed by Donald Stevens stated, "having been requested in writing by holder of the obligations secured by said deed of trust." The holder of this obligation was in fact Fitzgerald, and he had made no such written request for a reconveyance because he was never paid off. Stevens stated he would not have paid Cooper this money had he known that Cooper had assigned his interest in the deed of trust to Fitzgerald. Cooper did not pay this money to Fitzgerald.

**4742 ORCHARD AVE., SAN DIEGO**

In June of 1989, Fitzgerald invested $27,913 in 60 percent of a deed of trust on 4742 Orchard Ave, San Diego. The deed of trust was owned by Richard Morss, who assigned his interest to Cooper. The borrowers were the Hardistys. On June 14, 1989, Cooper sent Fitzgerald a letter saying he was including the original assignment from Cooper to Fitzgerald. Cooper never recorded the assignment to Fitzgerald. He never instructed Fitzgerald to record it.

The Hardistys paid off this deed of trust through escrow on February 26, 1993. Cooper received a check for $40,090.54. He never paid any of this money to Fitzgerald. Fitzgerald still believed he had an interest in this deed of trust, and on June 9, 1994, Fitzgerald recorded the assignment of the deed of trust from Cooper to himself. He wrote a letter to the Hardistys on July 22, 1994, demanding that they pay off the loan. He was unaware that the deed

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of trust had been reconveyed over a year earlier and that Cooper had taken the proceeds.

**1363 TORREY PINES ROAD, LA JOLLA**

Fitzgerald invested in this deed of trust on January 17, 1991 for $55,000. Cooper didn't tell Fitzgerald that the Marks were approximately $40,000 in default on a senior deed of trust; a notice of default was filed on January 30, 1991 by California Real Securities, Cooper's corporation. Per the notice of default, the Marks owed Cooper $37,000 as of December 23, 1990. Cooper did not tell Fitzgerald. Had he known that the Marks owed Cooper this money, Fitzgerald would not have invested his money. Cooper then subordinated Fitzgerald's deed of trust on May 31, 1991 without asking approval of Fitzgerald.

Ultimately, Cooper took title to the property via trustee's deed upon sale on December 23, 1991 based on a full credit bid on Fitzgerald's deed of trust. Cooper sold the property on December 30, 1991 to Lauren Anderson. Fitzgerald received none of this money.

Cooper stole Fitzgerald's $55,000 by negative fraud: he concealed the fact that the Marks were already in default on $40,000 when he tricked Fitzgerald into investing $55,000. Essentially, what Cooper did was to trick Fitzgerald into buying Cooper's bad loan.

**VICTIM: LEO BODIN LOSS: $70,000**

Cooper stole over $70,000 from Leo Bodin. Cooper obtained the money by telling Bodin a series of lies. He told Bodin his investments would be secured by a deed of trust. In fact, Cooper never recorded assignments to Bodin in all but one transaction, leaving Bodin without any protection against Cooper's greed and thefts. When the borrowers paid off three of the deeds of trust

Bodin thought he owned, Cooper collected the payoffs and used them for his own purposes. Cooper never told the borrowers that he had sold their loan to Bodin and the money was Bodin's. Cooper recorded fraudulent reconveyances to accomplish his theft, in violation of Penal Code section 115. In one transaction, Cooper took $7,000 from Bodin for the Terry Schaefer deed of trust, in January of 1991. Cooper never recorded an assignment to Bodin and instead assigned the deed of trust to Martin Enterprises. The deed of trust paid off in 1993 and Bodin never received his money. In January of 1991, Cooper took $22,000 from Bodin for the Honda deed of trust. He assured Bodin there was sufficient equity in the property to protect Bodin in the event of foreclosure. There wasn't. Cooper didn't record an assignment of the deed of trust to Bodin. The property was foreclosed on in November of 1992. Bodin's investment was wiped out.

In December of 1991 Cooper took $15,000 from Bodin for the Beaumon deed of trust. He committed negative fraud by failing to tell Bodin that Beaumon was going through bankruptcy. Had Bodin known this vital information, he would not have given Cooper his money. Cooper never recorded an assignment to Bodin -- until September of 1994 -- almost three years later. Beaumon defaulted on Bodin's loan four months ago. Bodin didn't foreclose because he couldn't carry the first, which was also in default.

Cooper stole $70,000 from Bodin. These thefts profoundly affected Bodin's health and severely impacted his retirement possibilities.

**VICTIM: BEVERLY HOLT LOSS: $50,000**

Defendant stole $50,000 from Beverly Holt. He did so in the same fashion he stole money from virtually every other victim.

He promised her an investment secured by a deed of trust. Instead he took her $50,000 and gave her an unsigned assignment of a deed of trust which could not be recorded. When the deed of trust paid off in January of 1993, defendant collected and kept Beverly Holt's $50,000. He never told the borrower he had assigned $50,000 of the loan to Beverly Holt. Cooper has continued to pay Holt interest as though the principal owed on the loan was still outstanding.

Beverly Holt is in her sixties. She suffers from an extreme hearing disability and has no way to make up the money Cooper stole from her.

**ARGUMENT**

I

**DEFENDANT IS NOT DESERVING OF PROBATION AND SHOULD BE SENTENCED TO PRISON.**

Having the sentencing objectives in mind, the court must determine whether the defendant should be granted probation. Rule 414 presents the criteria the court should consider in determining whether to grant or deny probation. Under Rule 414, the court must decide whether any statutory provisions exist limiting or prohibiting the grant of probation. The following rules apply:

Rule 414(a). Facts relating to the crime, including:

Rule 414(a)(1). The nature, seriousness, and circumstances of the crime as compared to other instances of the same crime. Defendant stole over half a million dollars from the most vulnerable of people: from an immigrant, from the elderly.

Rule 414(a)(3). The vulnerability of the victim. Mr. Phrakonkham spoke little English. He saved for many years to acquire his property in Riverside, and lost his life savings to Cooper. All of the victims were inexperienced in real estate investments. Cooper exploited this inexperience. One of the victims, Leo Bodin, is eighty years old.

Rule 414(a)(4). Whether the defendant inflicted physical or emotional injury. The victims have suffered both financially and emotionally.

Rule 414(a)(5). The degree of monetary loss to the victim. Defendant stole over one half million dollars, in some cases the victim's entire life savings.

Rule 414(a)(6). Whether the defendant was an active or passive participant. Defendant was the mastermind and profiteer, the only participant.

Rule 414(a)(7). Whether the crime was committed because of an unusual circumstance, such as great provocation, which is unlikely to recur. There was no provocation. Defendant was motivated by his own greed. The thefts went on for at least three years.

Rule 414(a)(8). Whether the manner in which the crime was carried out demonstrated criminal sophistication or professionalism on the part of the defendant. Defendant committed grand theft by trick or device, by false pretense, by embezzlement. According to his secretary, Davita Counsel, Cooper kept two sets of files so that when auditors came from the Dept. of Corporations they would not learn that Cooper had been violating his consumer finance lender license by brokering loans to unqualified third parties. Cooper set up all his thefts by not recording assignments to the victims. This gave Cooper the power to divert payoffs and steal the victim's money.

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<u>Rule 414(a)(9)</u>. Whether the defendant took advantage of a position of trust or confidence to commit the crime. The victims all trusted Cooper and relied upon his expertise in real estate. Cooper exploited this trust by stealing hundreds of thousands of dollars.

<u>Rule 414(b)</u>. Facts relating to the defendant, including:

<u>Rule 414(b)(1)</u>. Prior record of criminal conduct; whether as an adult or a juvenile, including the recency and frequency of prior crimes; and whether the prior record indicates a pattern of regular or increasingly serious criminal conduct. Defendant's conduct shows an ongoing pattern of decisive criminality.

<u>Rule 414(b)(4)</u>. Ability to comply with reasonable terms of probation as indicated by the defendant's age, education, health, mental faculties, history of alcohol or other substance abuse, family background and ties, employment and military service history, and other relevant factors. Defendant has no ability to pay restitution.

<u>Rule 414(b)(8)</u>. The likelihood that if not imprisoned the defendant will be a danger to others. Defendant poses a profound economic risk to society.

II

**AGGRAVATION**

An examination of the facts presently of record establishes that the circumstances in aggravation outweigh the circumstances in mitigation which are defined by Rule 423 of the California Rules of Court. The circumstances in aggravation are as follows:

<u>Rule 421(a)</u>. Facts relating to the crime, whether or not charged or chargeable as enhancements, including the fact that:

<u>Rule 421(a)(3)</u>. The victim was particularly vulnerable. The victims were elderly and unsophisticated.

Rule 421(a)(8). The manner in which the crime was carried out indicates planning, sophistication, or professionalism. See above.

Rule 421(a)(9). The crime involved an attempted or actual taking or damage of great monetary value. Over half a million dollars.

Rule 421(a)(11). The defendant took advantage of a position of trust or confidence to commit the offense. Defendant exploited his expertise in real estate to defraud the many victims.

## III

## CONSECUTIVE SENTENCING

By examining the facts before the court in this case, the court will see that they establish certain facts relating to the crime that should be considered circumstances in support of the decision to impose consecutive rather than concurrent sentences pursuant to Judicial Council Rule 425(a). These facts are as follows:

Rule 425(a)(1). The crimes and their objectives were predominantly independent of each other. Each theft had its own objective and reward: more money for the defendant.

Rule 425(a)(3). The crimes were committed at different times and separate places, rather than being committed so close in time as to indicate a single period of aberrant behavior. The thefts took place over several years.

Rule 425(b). Any circumstances in aggravation or mitigation. See above.

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**CONCLUSION AND REQUESTED SENTENCE**

We will, and do hereby request, based on the record in this case, this statement, and other argument, that the court impose a total prison term of 9 years, and that restitution be set at $581,500.

Therefore, based on the above analysis and rules, and in the face of overwhelming aggravating factors and the absence of mitigating factors, it is the position of the People that a proper sentence for this defendant is the maximum term of 9 years in prison to be served consecutively.

Dated: September 6, 1995

Respectfully submitted,

PAUL J. PFINGST
District Attorney

By:

JEFFREY BRODRICK
Deputy District Attorney

Attorneys for Plaintiff

**DISTRICT ATTORNEY'S OFFICE**
**SAN DIEGO COUNTY**
**BUREAU OF INVESTIGATION**

**FRAUD DIVISION**

CASE NO: 92 H 0760

DATE: July 17, 1995 INVESTIGATOR James Martin

DEF. COOPER, Sylvan C.W. People

## RESTITUTION

The victims in this case are listed below with the amount of their losses.

| | |
|---|---|
| FAVALE, Jack | $ 10,000 |
| FAVALE, John | 22,500 |
| BODIN, Leo | 70,000 |
| FITZGERALD, Leland | 164,000 |
| HOLT, Beverly | 50,000 |
| PHRAKONHAM, Van | 240,000 |
| PRICE, Hubert | 25,000 |
| TOTAL | $581,500 |

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# Ten-year prison term for trust-deed lender

**ANNE KRUEGER**
Staff Writer

**23-Jan-1993 Saturday**

A 54-year-old La Jolla man who admitted that he fraudulently operated his trust-deed lending company was sentenced yesterday to 10 years in prison and ordered to pay more than $2 million in restitution.

Municipal Court Judge Frank A. Brown ordered Richard L. Gillelen to pay the restitution even though he acknowledged that Gillelen's 31 victims will probably never get their money back from him.

"I can't fix it," Brown told Gillelen's victims who packed his courtroom. "I can't give you back your money. I can punish him, but that still won't fix it."

Gillelen, who had been charged with 29 counts of grand theft and filing false instruments, pleaded guilty in November to nine charges of grand theft. His Old Town-based business, All State Mortgage Co., also known as El Capitan Investment Co., loaned money to borrowers who pledged their property as collateral. Investors provided the money for the loan and, in turn, got a trust deed on the real estate.

Gillelen admitted that he took money from some trust deeds to pay off other investors to cover up his losses. Deputy District Attorney Jeff Brodrick said Gillelen forged signatures on trust deeds and used money from investors to buy an expensive condominium and make his own investments that then failed.

In an emotional hearing, people who had done business with Gillelen -- many of them elderly or infirm -- told how they had been financially ruined.

One woman told Brown she had lost $71,000 with Gillelen and will now have to sell her home because she no longer has any money to live on. Nelson

Solomon, 81, said he lost $52,000 that he and his wife had planned to use for nursing-home care.

Brown said other victims included a 79-year-old blind woman and Gillelen's stepmother. Attorneys who are representing many of the victims in civil suits against Gillelen also attended the hearing.

Gillelen's attorney, Robert Rose, told Brown that Gillelen tried to pay back some of his investors and that Gillelen's home is now owned by a man who invested with him. He asked that Gillelen be shown leniency because he admitted his guilt in an early stage of the court proceedings.

"I'm sorry that it happened," Gillelen said in court. "I have no money. I didn't take it. I didn't keep it."

Brown ordered that any wages Gillelen earns in prison go toward his restitution, and he gave Gillelen the maximum possible sentence under the terms of his plea bargain.

"These people are going to be miserable," Brown said, referring to Gillelen's victims. "I want to make him as miserable as I can make him."

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# Stark returns to town, under probe for TDC

**Don Bauder**
**10-Jan-1993 Sunday**

## Richard P. Stark

Former banker **Richard** P. Stark has returned to San Diego as quietly as he departed.

His real estate trust deed activities are now being probed by both the U.S. Attorney's Office and the district attorney's fraud unit.

Irate investors who have lost at least $4 million want to talk with him.

His former company is in Chapter 7 bankruptcy. He did not show up for the first three trustee-creditor meetings. If he doesn't show up for the next session Jan. 25, "we will go to the bench warrant to force him to appear," says Harold Taxel, trustee in the bankruptcy of Stark's trust deed operation, Trust Deed Counselors (TDC).

Taxel and lawyers looking into the case believe Stark was -- among other things -- putting more debt on property than it was worth; putting multiple trust deeds on the same property; selling trust deeds without recording them properly; selling the same loan more than once; and putting new investors in line ahead of old investors without the old investors' permission.

Stark retired in 1986 after 32 years with the former Security Pacific Bank. He had been manager of the Clairemont branch, and made many friends -- some of whom he put into trust deed investments yielding 14 to 16 percent, according to lawyers and investigators trying to piece together the picture.

Prominent in the community

In 1985, he served as jury foreman in the second conspiracy and perjury trial of former Mayor Roger Hedgecock, whose conviction was later overturned.

Trust Deed Counselors went into Chapter 7 in August 1992. On Oct. 28, Stark's wife, Alice K. Stark -- who had worked for Trust Deed Counselors -- reported him missing to the police.

John Doucette of the adult missing-persons detail says he started working on the case, but Alice Stark didn't return his phone calls. Then around Thanksgiving, Alice Stark called and said her husband had been found, and asked that the case be canceled, he says.

"He returned home around Thanksgiving time," says his daughter, Linda Axelson. "He is planning on attending the bankruptcy hearing," but hasn't wanted to talk about the company's collapse. "When somebody is distraught enough to disappear, and has normally been a responsible human being, we don't want to push him over the edge," says Axelson.

She refused to reveal his whereabouts. She said she would ask him if he would be interviewed by The San Diego Union-Tribune, but he has not responded.

He has a lot of explaining to do.

"We're doing an investigation," says Jeffrey Brodrick, deputy DA in the fraud division.

"We're looking into it," says David Katz, assistant U.S. attorney.

Both Taxel and his lawyer, James P. Hill, say they have cooperated with the DA and U.S. attorney investigators.

Attorney Jay Stoffel has one civil case against Stark. His client lost $150,000, allegedly because of Stark's "duplicity of selling a promissory note twice," says Stoffel.

Now Stoffel is representing other people who lost money in Trust Deed Counselors. "There are problems with the documentation on numerous loans -- he didn't record assignments of deeds of trust or endorse the notes properly over to the purchaser," says Stoffel.

Now there is a dispute between investors claiming ownership of notes and the trustee who must assert ownership of the notes on technical legal grounds, says Stoffel.

"There are over-encumbrances of property, multiple trust deeds on the same piece of property, possibly sale of trust deeds without recordation," says

Taxel.

"The loans would be sold several times without the knowledge of the people. Those are charges we have heard over and over again," says Hill.

Taxel says that more than $4 million seems to be missing, but he doesn't know the number of investors. Hill spoke at one investor meeting attended by more than 50 people.

"One of the things we are starting to do is to enforce the notes. Borrowers may have taken advantage of the bankruptcy and not paid on the notes," says Hill.

Many investors who lost money in Stark's operation are longtime friends. Frank and Alice Pecoraro met Stark when he was at Security Pacific. The Pecoraros and Starks became personal friends. But the income on the Pecoraros' trust deeds stopped in May. At the time, they got a brusque letter from Stark's attorney, telling them of the plan to file for bankruptcy.

"We lost quite a bit," says Alice Pecoraro. "We knew the family. We feel anger; that can sum it up. We had trust in this person."

Romney Hayden was once Stark's jeweler. Hayden had a 163-acre ranch in Jamul -- his lifelong dream. In 1987, according to Hayden, Stark induced him to take a 50 percent interest in an office building. They set up a Stark/Hayden partnership. Stark told him that rents would rise 6 percent and the building's valuation 15 percent each year.

Hayden says he believes he put up his ranch for collateral on a line of credit from Security Pacific. "However, he (Stark) went out and sold trust deeds on the property (the ranch) to 13 investors. I didn't know about it," says Hayden, who filed a breach-of-contract and fraud suit against Stark in Superior Court in 1990.

"I don't ever remember signing this note that he says that I signed. I suspect the signature is phony," says Hayden. "I have never gotten one penny from that building," and Stark has never given him an accounting of what happened, he says.

Hayden eventually lost the ranch to foreclosure and filed for bankruptcy. "It was a case of non-disclosure. He doesn't tell anybody anything," says Hayden.

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# Stark arrested after missing 4th meeting

**29-Apr-1993 Thursday**

Former banker **Richard** P. Stark, whose trust deed operation collapsed into Chapter 7 bankruptcy last year, was arrested briefly Tuesday after failing to show up for four consecutive trustee-creditor examinations.

After Stark, long-time branch manager with the former Security Pacific Bank, missed a meeting March 17, bankruptcy trustee Harold Taxel got a bench warrant to have him arrested, according to Michael MacKinnon, Taxel's attorney.

Tuesday, the U.S. Marshal's Office took him into custody, and then released him, according to MacKinnon. A hearing is scheduled Wednesday.

Stark, who disappeared for several weeks last fall, is being investigated by both the U.S. Attorney's Office and the district attorney's fraud unit. Investors are believed to have lost at least $4 million in his Trust Deed Counselors operation.

Taxel said he believes Stark was putting more debt on properties than it was worth, selling trust deeds without recording them properly and selling the same loan more than once.

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# Two missing bankruptcy figures return

**Don Bauder**
**30-Jun-1993 Wednesday**

Two prominent, once-missing San Diegans have returned to face harsh music.

Steven Allen Berkowitz, a collections/bankruptcy attorney and former bankruptcy trustee, fled San Diego in mid-April and returned just days ago . . . showing up to play basketball at the downtown YMCA, a former haunt.

Yesterday, at the request of the state bar, Superior Court assumed control of his law practice. Berkowitz's earlier four-month disciplinary suspension by the bar had ended April 10, just before he abruptly departed.

The U.S. Trustee's office, for whom he worked while he was a bankruptcy trustee, has many questions for him. He had resigned his 135 trustee cases before fleeing in April.

Meanwhile, former longtime banker **Richard** P. Stark was reported missing in October, two months after his Trust Deed Counselors went into Chapter 7 bankruptcy.

He returned early this year, but continued to miss bankruptcy hearings, and was arrested and briefly jailed April 27. He was released after posting $50,000 bail.

Yesterday, he was back in the downtown county jail -- this time on $750,000 bail. The district attorney charged Stark with 23 counts of grand theft and using false statements in the sale of securities, said Jeffrey Brodrick, deputy DA in the fraud division.

His arraignment yesterday was continued until July 12. Stark had been with the former Security Pacific Bank for 32 years before retiring in 1986.

In a declaration in support of an arrest warrant, DA investigator Barbara J. Hall relayed numerous instances in which Stark sold the same trust deed more than once without investors' knowledge, and also took money for trust deeds that he never delivered.

Typical transactions

In one typical series of transactions, Hall related, Stark "sold this entire note and trust deed to Frank Pecoraro and then sold percentages of the trust deed to other investors (who) were unaware that Stark had already sold the trust deed. (Then) Stark also assigned it a third time to Grossmont Bank as collateral for a line of credit."

Because Berkowitz abandoned his practice, "the State Bar is requesting that this court assume jurisdiction over (the law practice). There is probable cause to believe that Mr. Berkowitz is incapable of maintaining his law practice," said the bar in its filing to the court.

The court will take possession of Berkowitz's records and suggest that clients seek other representation, according to the bar. It launched the action under a code justifying such action "for any reason, including but not limited to excessive use of alcohol or drugs, physical or mental illness, or other infirmity or other cause."

Berkowitz will have a chance to defend himself at a hearing July 23.

Patrick Boyl, assistant U.S. trustee, said his office, which has been reviewing Berkowitz's former cases, wants to talk with Berkowitz on a number of matters. Boyl wouldn't say whether his office has found any irregularities.

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# Trust-deed case jails ex-banker

**Don Bauder**
**06-Jul-1993 Tuesday**

**Richard** P. Stark looked and acted so much like a banker that he gained people's trust -- as well as their trust-deed investments.

But his trust-deed machine collapsed, wiping out the investors. Last week, Stark was charged with 23 counts of grand theft and making false statements in the sale of securities. He was sent to the downtown county jail on $750,000 bail.

Stark was indeed a banker. In 1986, he retired after 32 years with the former Security Pacific Bank.

But his Trust Deed Counselors (TDC) was in operation long before he left Security Pacific, his TDC victims did business with Security Pacific -- and now there are questions about the bank's role in the fiasco.

To prepare a declaration in support of Stark's arrest, investigator Barbara J. Hall of the District Attorney's Office talked to numerous Stark victims. "All of the investors I spoke with told me they knew of Stark's long history as a banker," said Hall in the declaration. "Because of Stark's business background, they trusted him to invest their monies in valid trust deeds."

Stark's victims got to know and trust him while he was an officer of Security Pacific's South Clairemont branch and, later, the North Clairemont branch, according to a lawsuit filed last Friday.

Complaint filed

Investors Frank and Alice Pecoraro filed a complaint against Stark and his wife, Alice -- and against Bank of America, which has absorbed Security Pacific.

Security Pacific "knew about Stark's improprieties with (Security Pacific) customers at least as early as 1985 and deliberately concealed that information from its own customers," charges the suit, filed in Superior Court.

The bank learned of Stark's dubious dealings with one victim, hustled Stark into retirement, paid a huge settlement, "then took steps to make sure those wrongful activities were forever concealed from its own customers, solely in an attempt to avoid its liabilities for the acts of Stark and Security Pacific," alleges the suit.

Bank of America would not comment because it has not yet seen the suit.

"Security Pacific knew back in 1985 and 1986 that Stark was involved in improper activities with bank customers and Trust Deed Counselors," the Pecoraros' attorney, Michael L. Kirby, said in an interview.

However, the bank had reason to look the other way, according to the suit: While at Security Pacific, Stark conceived and implemented a broker referral program. "Trust Deed Counselors was referring loan brokers to Security Pacific," said Kirby. "In return, Security Pacific continued to allow Stark to operate TDC and to solicit Security Pacific customers to invest with TDC," the suit charges.

A list of offenses

The D.A. accuses Stark of many instances of selling the same trust deed more than once and taking money for trust deeds that he never delivered. The Pecoraro suit charges him with those offenses and several others, including not recording trust deeds, inflating market values, piling excessive debt on property and misleading investors on the status of their trust deeds.

While he was working at the bank, Stark repeatedly told investors they could make more with a TDC trust deed than they could make in a bank certificate of deposit, according to the suit. He sometimes communicated with TDC investors on Security Pacific stationery, says the suit.

In late 1985, a physician who had been stung in Stark's trust deeds complained to Security Pacific. The bank studied the matter and told the doctor that it did not find irregularities. But after the doctor sued, the bank paid him $155,765.20 -- an amount 600 percent larger than the loan the doctor had with the bank, according to the suit.

Then the loan to the doctor was wiped off the books in a deceitful way, according to the suit, "allowing Security Pacific to avoid disclosing to any bank auditors or examiners that it had completely written off a customer's loan due to the wrongful conduct" of Stark and bank management, according to the suit.

The settlement agreement between the bank and the doctor had a confidentiality clause mandating that the arrangement be kept secret, according to the suit.

As an outgrowth of the incident, the bank "insisted upon Stark retiring," says the suit. Because the information was hushed up, Stark's subsequent victims were denied knowledge that would have kept them from investing, alleges the suit.

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# Ex-banker Stark admits grand theft | Pleads guilty to nine counts in multiple sale of trust deeds

**DONALD C. BAUDER**
Financial Editor

**02-Nov-1993 Tuesday**

**Richard** P. Stark, a former prominent banker who briefly disappeared a year ago when his trust deed operation collapsed, yesterday pleaded guilty to nine counts of grand theft.

He faces 10 years in prison, and the District Attorney's Office will ask for the maximum sentence, said Jeffrey Brodrick, a deputy district attorney in the fraud division.

Stark has been in custody since June 29. His sentencing will be Dec. 13 before Judge Charles Rogers in Municipal Court, where he entered his guilty pleas yesterday.

"Essentially, the charges involve his selling the same deed of trust more than once," Brodrick said. "A few days after assigning a deed of trust to a bank, he went over to one of his investors' houses and picked up a check for $150,000 for the deed of trust he had just assigned days earlier to somebody else."

The monetary size of that confessed misdeed expands the number of years in prison that he can receive, Brodrick said.

"We estimate that he stole more than $600,000 from mid-1988 to 1991," he added.

In 1986, Stark retired after 32 years -- much of it as a branch manager -- with the former Security Pacific Bank. While at the bank, he steered customers into his Trust Deed Counselors (TDC) trust deed operation, according to a civil suit. Investors were told they would make 14 percent to 16 percent interest on the trust deeds.

Then came the San Diego real estate collapse. With his trust deed operation in tatters, Stark disappeared in late October 1992, reappearing around Thanksgiving. However, he continued to miss trustee-creditor examinations related to TDC's Chapter 7 bankruptcy. Later, he was arrested.

In 1985, Stark served as jury foreman in the second conspiracy and perjury trial of former Mayor Roger Hedgecock, whose conviction later was overturned.

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## *Business Briefing*

## SAN DIEGO

Compiled from staff and wire reports

**06-Jan-1994 Thursday**

Heilig-Meyers Co. of Richmond, Va., completed its purchase for $55 million of 92 McMahan Furniture Co. stores in a previously announced deal. Another party purchased Carlsbad-based McMahan's accounts receivable for about $100 million and a third party bought real estate operations for 70 stores for $57 million.

Richard P. Stark, a one-time prominent banker whose Trust Deed Counselors trust deed operation collapsed in 1992, was sentenced yesterday to 10 years in state prison on nine counts of grand theft and ordered to pay $2.2 million restitution to investors. Many investors lost their life savings to Stark, said Jeffrey Brodrick, deputy district attorney.

Jack White & Co. said it agreed to offer brokerage services to clients of Shareholder Services Corp. Transfer of client accounts is expected to be completed by the end of the month. Shareholder Services Corp. employees will become employees of Jack White & Co.

John S. Goodreds of New York, former president of the Ottaway Newspapers division of Dow Jones & Co., was elected a director of Kendell Communications Inc. of El Cajon, publisher of The Daily Californian newspaper and Senior World Newsmagazine, a monthly publication.

Standard & Poor's Corp. raised its rating on Burnham Pacific Properties Inc.'s $42 million convertible debentures to BBB-from BB+ and gave the same rating to the company's recent $200 million shelf registration, citing BPP's improved capital structure and more focused acquisition strategy.

UCSD Healthcare Network said it has affiliated with Alvarado Hospital

Medical Center and three physician groups, Encompass, Alvarado Associates and NOVA Healthcare. While remaining autonomous, Alvarado said it will work cooperatively with UCSD in purchasing partnerships, regional coordination of services and combined contracting with health plans.

Restaurant Enterprise Group (REG) of Irvine will seek bankruptcy court approval Friday of its plan to be purchased by three partners and merged with the Chi-Chi's Mexican restaurant chain. REG would pay about $205 million to buy Chi-Chi's from San Diego-based Foodmaker Inc., which would then join with Apollo Advisers L.P. and Green Equity Investors L.P. to buy the merged company out of bankruptcy.

John Moon, an executive with Copley News Service who had worked for the Copley corporation for 44 years, retired Dec. 31. He had worked as managing editor of the South Bay Daily Breeze and at other Copley properties before joining the news service in San Diego.

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*Don Bauder*

# Four Seasons Financial officers expected to admit guilt in fraud

**Don Bauder**
**18-Jan-1996 Thursday**

The district attorney's fraud unit yesterday charged Charles Joseph Salas and Patricia Ann Meyer, former top officers of defunct Four Seasons Financial Services, with 22 counts of grand theft.

The so-called "hard-money lending" company, which abruptly departed its Mission Valley office last May, fleeced investors of about $4 million, according to Jeffrey Brodrick, deputy D.A. in the fraud division.

Both Salas and Meyer pleaded not guilty yesterday before Judge Gale Kaneshiro in felony arraignment court. However, their lawyers say there will probably be guilty pleas when the prosecution and defense can agree on appropriate sentencings.

"He (Salas) will plead guilty," says Salas' attorney, Peter Hughes. But the prosecution wants a maximum sentence of 14 years. By contrast, Ponzi scheme perpetrator J. David "Jerry" Dominelli emerged from prison this week after spending 10 1/2 years in prison for a swindle 20 times as large, says Hughes.

Even more to the point, Gary Naiman of failed Pioneer Mortgage ran a hard-money lending/trust deed operation quite similar to Four Seasons. And Pioneer investors were shorn of $200 million. Naiman was sentenced to 6 1/2 years in prison last year, says Hughes.

When things fell at apart at Four Seasons, "Funds were diverted, but not to his (Salas') pockets," says Hughes. His client was trying to save the business -- not buy yachts, says Hughes.

Tom Warwick, attorney for Meyer, says, "There is no reason for the case to be tried. There will probably be a guilty plea." However, "There has been no meeting of the minds between prosecution and defendants."

Hard-money lenders such as Four Seasons lend money at extremely high rates to high-risk borrowers who pledge their assets as collateral. Pieces of the loans are then sold to investors, who make very high rates of return -- at least, until the whole thing comes asunder, as it normally does when real estate values turn south.

Like many other San Diego hard-money lenders who wound up in prison, Salas and Meyer of Four Seasons "oversold the loans -- took in more money than the value of the loans," says Brodrick.

Also, long after borrowers had paid off the loans, investors still did not receive their money, says Brodrick. And money was diverted to development projects, largely in Calexico, rather than to the projects investors believed they were putting money in.

"They were also maintaining their lifestyle," says Brodrick of Salas and Meyer, who had started with the firm as a clerk, but worked up to second in command.

Brodrick asked for $100,000 bail on Salas, but the judge allowed both defendants out without bail, provided they agree to searches of their premises. The next court hearing is March 1.

Audre's Casey out

At the requests of the boards, Thomas F. Casey has stepped down as president of software firm Audre Inc. and its parent, Audre Recognition Systems. Last November, he had stepped down as chief executive but had remained as president of the two related enterprises.

On an interim basis, James Fiebiger and Donald Lundell will share duties of president and chief executive of both concerns.

The Audre enterprise is in Chapter 11 bankruptcy because a court decided it and Casey are liable in an $11 million divorce suit won by Casey's ex-wife. (The ex-wife is receiving $8 million and a law firm $3 million.) Audre is fighting the decision.

Robert Ames, reorganization executive officer of the company, says Audre hopes that Casey will agree to be a consultant.

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*Don Bauder*

# Four Seasons hard-money lenders on way to doing some hard time

**Don Bauder**
**11-Apr-1996 Thursday**

Two more San Diego trust deed operators are headed to prison -- prompting the question of whether there is enough confinement capacity to house our hard-money lenders.

Yesterday in Superior Court, **Charles** Joseph Salas and Patricia Ann Meyer of defunct Four Seasons Financial Services pleaded guilty to 22 charges of grand theft. They will be sentenced by Judge David Danielsen on May 29.

All told, they fleeced three dozen investors of more than $2.5 million, according to Jeffrey Brodrick, deputy district attorney in the fraud division.

Four Seasons, which abruptly closed its lavish Mission Valley office about a year ago, both sold and serviced trust deeds as a so-called hard money lender. The company would lend money at a high rate to high-risk borrowers who would pledge assets as collateral. Investors would take pieces of the loans.

The company was also involved in limited partnerships in Calexico, Murrieta Hot Springs and other places. All told, the Four Seasons entities were about $20 million in size prior to their Chapter 7 bankruptcy last year.

As has been typical with San Diego hard-money lenders, the company diverted investors' funds without their knowledge, according to government charges. When loans became due, and were paid, Salas would divert the funds to his real estate projects instead of paying off his investors, says Brodrick. Salas and Meyer "would write them false letters showing false account balances," says Brodrick.

Much of the money went into Bravo Ranch near Calexico, which Salas never got off the ground. Other money was steered into his other projects there, some of which have been taken over by other developers, according to Brodrick.

Like other trust deed operators who are now in the hoosegow, Salas and Meyer -- as the operation got into deeper trouble -- would "put more loans on a property than it was worth," says Brodrick, "or sell the same loan more than once."

In January, Salas and Meyer had pleaded not guilty, but their lawyers had said they would change their pleas if Brodrick would stop asking for the maximum sentence for Salas. "I will not back down," Brodrick still says. The D.A.'s office will request that Salas get 12 years.

"He (Salas) is the heavyweight," says Brodrick. "She (Meyer, who rose through the ranks from a clerical position) was the lightweight. He gave the orders. She followed them. I anticipate we will ask for a lesser sentence for her."

Peter Hughes, attorney for Salas, says that he suggested in court that Salas might spend six to eight years behind bars. "The judge (Danielsen) said that was not an unrealistic target," says Hughes, cautioning that the judge did not commit himself to that range.

"There are scams that are scams from start to finish," says Hughes. The perpetrators are "living in Fairbanks Ranch, with yachts and Mercedes."

But Four Seasons was not such a caper, argues Hughes. Salas lived in a $340,000 Scripps Ranch home and had modest autos. "He was diverting money to make the thing (Four Seasons) go," insists Hughes. "Nothing was going into his pocket."

However, this columnist has reported that Four Seasons airplanes returned from business trips with suitcases full of cash. Hughes says that in two real estate deals, buyers paid for property in cash, and the money was placed in legitimate bank accounts.

Consumers: dry

Some think the sinking bond market is fretting that consumers are about to go off on another spending toot, pushing up the economy and interest rates.

Nah. The sudden lack of foreign buyers, and perhaps a whiff of inflation, are clobbering the bond market. The consumer just isn't likely to go on a spree any time soon.

Economist Jack W. Lavery of Merrill Lynch points out that personal income is growing at its slowest rate since 1991, when the nation was in a recession. The credit card delinquency rate got to 3.34 percent in last year's fourth quarter, "matching the levels of the 1990-1991 recession," says Lavery. Auto loan delinquencies at finance companies are above their levels of the last recession, and personal bankruptcies are back to their recession highs.

Tony Riley of Springfield, N.J.-based A. Gary Shilling & Co. says that the ratio of consumer installment debt service to disposable income has passed its peak level following the 1980s spending binge. Adjusted for auto leasing -- an increasingly important substitute for auto loans -- the ratio is even worse.

A year ago, mortgage rates were falling. That set off a refinancing boom, notes Riley. But now rates are back up -- "ending that boom with a vengeance."

And homeowners equity -- the part of a home owned by the consumer, not the mortgage company -- is at record lows, says Riley. That inhibits future borrowing, too.

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*Don Bauder*

## Clients hurt by La Jolla Trust Deeds

**Don Bauder**
**04-Sep-1994 Sunday**

Sylvan and Irene Cooper were once very visible in La Jolla society.

Now they are quite invisible -- particularly from people who invested in their trust deed operation.

Their company, La Jolla Trust Deeds, is in shambles. The office is closed. Sylvan Cooper is listed as head of Desert View Financial (the Coopers live on Desert View Drive in La Jolla), but that business can't be located. He recently did business on Market Street, but the phone has been disconnected.

Investor lawsuits are piling up heavily. People who have lost money in trust deeds can't get through to Sylvan Cooper.

"We have received a number of complaints, and we are actively investigating his operation," says Jeff Brodrick, deputy district attorney in the fraud division.

Aug. 12 through Aug. 14 may have been the low point for Sylvan Cooper. After refusing to show up for a debtor's examination, following a court decision in which a judge lashed him for committing a "heartless fraud," Cooper spent three days in the Vista jail.

His wife, Irene, "was crying her eyes out when he was in jail," recalls Vista attorney Jerry I. Schaefer.

Laotian investors

But Cooper's victims really deserve the sympathy. In this case, they are Laotian immigrants named Phrakonkham, Schaefer's clients. They had come to this country in 1979, eventually purchased land in Riverside County, and later agreed to carry back a $205,100 first deed of trust on the property.

Vanthong Phrakonkham went to borrow $14,000 from Cooper, and unknowingly signed papers that assigned the deed of trust to Cooper. After learning about it, he still trusted Cooper -- who kept assuring him that he would make everything straight. Subsequently, Phrakonkham learned that Cooper had long since sold the property.

Cooper did not return phone calls. Nearly penniless, the Laotian family went back to Kansas to work in a family restaurant.

On March 25, Schaefer spelled out the situation before Judge J. Morgan Lester in Superior Court in North County. Schaefer asked for Phrakonkham's original principal back, plus some costs, and $100,000 in punitive damages.

An enraged Lester upped the ante. Charging Cooper with gross fraud, Lester said, "He (**Sylvan** Cooper) took advantage of someone who did not speak English well, induced him to sign documents that were not as represented, and then went and took the property. It is outrageous and unjustified behavior. He has destroyed the plaintiff, taken almost all his property."

Continued Lester, "The court grants punitive damages in the amount of $500,000 -- one half a million dollars punitive damages for some of the most outrageous fraud I have seen since I've been on the bench going on 16 years."

Schaefer said he believes Cooper has assets, including a trailer park, a duplex, a 16-unit apartment and two homes. However, after Cooper was jailed for missing a debtor's exam over the $742,000 he owes the Laotian family, Schaefer interviewed him: "He (Cooper) said he doesn't have any money, everything is gone, he doesn't have a job. He said he has no assets."

Cooper had missed depositions throughout the proceedings, and didn't file anything to protest the decision. His original lawyer, Michael T. Pines, successfully sought to be relieved from the case while it was in process.

In some of the lawsuits, Cooper has been representing himself.

Cooper's investors say he cannot be reached: "In my computer file I have 19 letters I wrote to him, and I have telephone bills for four months in which I called him practically every day, and he never answered a letter and never returned a phone call," says 80-year old Leo Bodin of Lemon Grove, who lost $60,000.

"I must have called him every day for almost a year; he never responded to mail or registered letters or answering machines. I went to his house, and he didn't open the door," says a La Jollan who lost around $170,000 and has sued.

"He convinced me it would be safe, because he only wrote secured trust deeds on properties in which there was high equity," says the sadder-but-wiser investor.

This come-on is typical for San Diego trust deed operators: Most claim that the underlying real estate is gilt-edged and the investor's principal is safe. Of course, with the real estate downspiral of the 1990s, trust deed operators like Cooper have been collapsing in scandal.

Like the others, Cooper paid his investors around 15 percent -- until the checks stopped coming in, of course.

To keep the operation afloat, Cooper had several juggling tricks -- none new -- according to victims and their attorneys. "He loans money on second trust deeds, then sells the second trust deeds off" without informing the investor, says attorney Timothy Rutherford, representing two investors, one quite elderly. "He collects the money from the homeowner, but doesn't pay (the investor)."

In the case of Rutherford's clients, the assignment of trust deed was never recorded. That's also the complaint of others.

"Cooper takes the (investor's) money, puts it into an investment, gives you a copy of the assignment and deed of trust, and doesn't record the assignment," says attorney Bernie Porter. "So when the note gets paid off, Cooper gets the money, reinvests it someplace else without the investor's permission."

Says the La Jolla investor, "He (Cooper) took the trust deeds and apparently sold them, pocketed the money without my permission, and substituted another trust deed that was worthless."

Says attorney David Nugent, "It appears from our investigation that in a number of situations, he has failed to record an assignment of a trust deed."

Nugent said he is considering various options for his client, including putting Cooper into involuntary bankruptcy.

Several attorneys and victims said they were able to confirm that Cooper does not have a license from the California Department of Real Estate.

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*Don Bauder*

## La Jolla Trust Deeds operator faces charges

**Don Bauder**
**21-Jun-1995 Wednesday**

Still another San Diego trust deed operator faces charges from the district attorney's fraud unit.

**Sylvan** Cooper -- once prominent in La Jolla society -- has been charged with seven counts of grand theft totaling $300,000, according to Jeff Brodrick, deputy D.A. in the fraud division.

Along with his wife, Irene, Cooper ran La Jolla Trust Deeds. People would borrow money at high interest rates. Investors then would buy portions of the loan.

But when lenders paid off the loans, Cooper "was collecting the payoffs, and rather than remitting them to the investors, he was using the money for his own use," says Brodrick. This is typical conduct in trust deed scams.

Cooper has pleaded not guilty to all seven counts, according to his lawyer, Tom Warwick.

According to the D.A.'s complaint, the investors' money was long overdue -- sometimes by a matter of years -- but investors didn't complain, because they trusted Cooper implicitly.

The collapse of Cooper's empire was first covered in this column last September. That same month, aggrieved investors put Cooper and his wife into bankruptcy. They are in Chapter 7.

But tragically, also in Chapter 7 is the family of Vanthong Phrarkonkham, Laotian immigrants who owned Riverside land on which they agreed to carry back a $205,100 first deed of trust.

They went to borrow $14,000 from Cooper. Unknowingly, they signed papers that assigned that deed of trust to Cooper. They learned of the ruse -- but continued to trust him. Finally, they learned that Cooper had long since sold the property.

In a North County civil suit in which the Laotians won a big judgment, Judge J. Morgan Lester heatedly said that Cooper had taken advantage of people who didn't speak English well. Lester called the episode "some of the most outrageous fraud I have seen."

The $190,000 allegedly stolen from the Laotian family is the largest part of the D.A.'s suit.

"Cooper destroyed the Phrarkonkhams' lives," says Jerry I. Schaefer, Vista-based lawyer for the family.

A preliminary hearing in the Cooper criminal case is set for June 28 in Municipal Court.

San Diego stocks zoom

This time, San Diego stocks are joining in the general up-orgy. Just in the last 30 days of trading, the index of local stocks compiled by San Diego Stock Report has zoomed by 13.5 percent. For the year, it's up 18.8 percent.

The weighted index of 40 of San Diego's most heavily capitalized stocks is now at 467.56. It was around 370 in early April, after dropping while the overall market climbed sharply. (Still, it was at 560 in October of 1993.)

"Everything just kicked in in one month," says Bud Leedom, publisher of the stock report. Qualcomm, which got critical new business commitments, soared above the $30 barrier. Takeover rumors spurred Callaway Golf, squeezing shorts. Cobra Golf moved up, too. Long-depressed biotechs started to move -- Advanced Tissue Sciences, for one. San Diego Gas & Electric hit a new 52-week high as interest rates went down and fears of California utility regulation ebbed. Pyxis moved up on continuing solid reports. ThermoLase shot up on good product news, and the company that still owns most of the stock, ThermoTrex, also benefited.

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***Don Bauder***

## A Wells Fargo takeover of Interstate hostile to jobs | Mega-banks good deal for shareholders

**Don Bauder**
**19-Oct-1995 Thursday**

Wells Fargo wants to pay an astonishing $10 billion for First Interstate Bancorp.

Who will pay if this deal goes through? Employees and customers of each institution, certainly. There will be waves of layoffs and more waves of customer complaints about service, if past bank mergers are any guide.

But customers and employees don't count any more. Only shareholders. And yesterday, analysts were saying that the deal would eventually go through, despite First Interstate's hesitation, because there is no other pending deal that would create such shareholder value for First Interstate.

Of course, the analysts were talking about very short-term shareholder value -- not long term -- because this deal could really strain Wells Fargo. At $133.50 a share, it's for more than three times First Interstate's 1994 book value per share. If you assume this year's book value per share will be a little under $50, then it's a mind-boggling 2.7 times book.

And this will be paid for a bank that already has downsized severely because of Wall Street pressure.

First Interstate revealed yesterday that it has been "exploring strategic alternatives." Translation: It has been entertaining other suitors. Certainly, it has been behaving as if it is for sale. That should be obvious: Wall Street's Kohlberg, Kravis & Roberts, architects of the 1980s madness, own 6.1 million of the 77.5 million shares.

Wells Fargo noted that the fabled Warren Buffett supports the deal. Buffett owns 13.3 percent of Wells Fargo's stock. Generally, Wall Street believes that if Buffett likes it, it must be a smart deal.

Keep in mind that Buffett bought his 19.9 percent stake in San Diego's PS Group for above $30 a share. Yesterday, PS Group closed at $10.75. Buffett is astute, but not infallible.

The argument for all the big bank mergers is that U.S. banks must get as big as their world competitors to compete in a global market.

But the really big banks are Japanese. And they are so laden with bad debts that the U.S. Federal Reserve is poised to provide them liquidity in case of an international crisis.

After the disastrous 1970s, regulators told U.S. savings & loans to expand rapidly to grow out of their problems. Thus, trying to grow swiftly, they abandoned standards of prudence -- and calamity hit.

So the conventional wisdom of the day is often misguided. Encouraging U.S. banks, stymied by a slow domestic market, to pay outrageous prices for acquisitions could backfire.

Amtel: trustee?

On Tuesday at 10 a.m. in Judge Louise Adler's bankruptcy court chambers, there will be a decision on whether to appoint a trustee for Amtel, the collapsed $57 million pay telephone investment program that is looking more and more like a Ponzi scheme.

Attorneys Howard Finkelstein and William S. Lerach charge that it is a Ponzi scheme -- money from new investors went out to pay off early investors. They want a trustee.

"There is prima facie evidence of fraud. There should be an independent court-appointed trustee plus an examiner to investigate," Finkelstein says.

Amtel's chief executive, Randy S. Kuhlmann of Rancho Santa Fe, also served as chief financial officer. But when he was asked in a declaration if Amtel had ever made a profit, Kuhlmann's attorney objected on the ground that he lacked the competence to answer, Finkelstein says.

Already, it has been noted that Amtel, which did not have an outside auditor, did not follow generally accepted accounting principle. The Securities and Exchange Commission earlier charged that Amtel was losing money massively while it was touting its profitability.

Finkelstein notes in his brief that a former employee says a former Amtel financial official was paid $140,000 over three months to keep his mouth shut.

U.S. Trustee Harry A. Sherr wants a trustee. He cites "overwhelming evidence of fraud, dishonesty, incompetence and gross mismanagement." The SEC also wants a trustee.

Kuhlmann and his lawyer did not return calls.

Attorney Jeffry A. Davis, who represents Amtel investors, wants a new general manager, but not a trustee. Davis agrees there has been wrongdoing but would keep Kuhlmann on a new board.

Cooper sentenced

**Sylvan** Cooper, who owned La Jolla Trust Deeds. was sentenced to seven years in local custody yesterday by Judge Bonnie Dumanis in Municipal Court. He had earlier pleaded no contest to seven counts of grand theft.

Victims yesterday told the court how they had lost their life savings.

"He (Cooper) expressed no remorse," says Jeffrey Brodrick, deputy D.A. in the fraud section, who thought the sentence was appropriate.

The revolutionary new way

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*Don Bauder*

# Euphoric investors wonder how much higher stocks, bonds can go

**Don Bauder**
**07-Jul-1995 Friday**

Will the Dow go to 6,000? 8,000?

Will the yield on the 30-year Treasury bond go to 6 percent? 5.5 percent?

Euphoric investors were debating the point yesterday. The Federal Reserve's lowering of short-term rates sparked a continuation of this year's fantastic stock and bond market rally. It's a fast-moving freight train, fueled by Fed liquidity, and anyone who stands in front of it (short sellers) may be mowed down as money pours into mutual funds and 401(k) plans and is poured right back into financial assets.

The Dow Jones industrial average jumped 48.77 points yesterday to a record 4,664. Bonds also rallied, with the yield on the 30-year Treasury dipping just below 6.5 percent.

If there is a recession this year -- and that's doubtful -- it might be the first one in which equities zoom right ahead. Possibly, profits -- other than for consumer companies -- will no longer be stymied by recessions. Give the credit to massive downsizing, stock buybacks and a Fed and White House devoted to keeping bonds and equities surging forward.

Representing the consensus, Ed Williams of Clutinger, Williams & Verhoye expects the yield on the 30-year Treasury to drop to 6.25 or 6 over the next six to nine months. He likes bonds -- but loves stocks: "Stocks are overbought now, and sometime we will get a correction, but from what level: 4,800? 5,000?" asks Williams, who is buying technology stocks.

But Alan Fine of RealSource takes a very contrarian position. Actually, yields across the spectrum (short-term to 30 years) are headed up, he says. It's been the trend since early June. The orgies of yesterday and perhaps today will only be counter-blips. The 30-year bond will yield 7.75 in six to nine months -- the same as last December -- he says, acknowledging that he is in a tiny minority.

Same old story

Still another San Diego trust deed operator is on the criminal rolls.

La Jolla moneylender Sylvan Cooper pleaded no contest yesterday to seven counts of grand theft of about $400,000. Cooper will be sentenced at 1:30 p.m. Sept. 8 by Municipal Judge Bonnie Dumanis.

Says Jeffrey Brodrick, deputy district attorney in the fraud section, "We anticipate asking for a maximum (nine-year) prison sentence," as well as restitution to investors who have been wiped out. Most are elderly.

Prison time would cramp Cooper's lifestyle. During the post-1991 period in which Cooper was fleecing the public, he was building a La Jolla house on a view lot, says Brodrick. Cooper is now out on $25.000 bond and presumably living there.

However, the house has multiple liens against it because of a welter of lawsuits against Cooper, who is in Chapter 7 bankruptcy.

Cooper's was the same old story of the trust deed business: Borrowers paid their loans, but Cooper did not send the money on to investors, says Brodrick. "He also told victims he was putting their money into particular deeds of trust, but never did," says Brodrick.

Then Cooper took over a building downtown: "It appears he may have committed rent skimming by collecting rents and not paying the mortgage," says Brodrick, who also believes taxes were not paid.

As earlier revealed, Cooper fleeced a Laotian family of $190.000, forcing it into bankruptcy, according to Brodrick.

Upside down

San Diego County has 27,366 homeowners -- 4.7 percent of the total -- whose homes are worth less than the mortgage balance, according to Riverside-based TRW-REDI. That's slightly less than the Southern California average of 5.2 percent, which is swollen by San Bernardino and Riverside percentages above 10. In part, that's a function of first-time buyers in those counties putting down only 5 percent or so, says TRW's Nima Nattagh.

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*DON BAUDER*

## 3 held in postal raid on Mail Boxes Etc. outlet

**DON BAUDER**
**16-Jan-1997 Thursday**

U.S. postal inspectors yesterday raided an El Cajon Mail Boxes Etc. outlet and arrested a man and his two sons, who were charged with perpetrating a scheme to use counterfeit postage stamps and postage meter impressions.

Postal investigators arrested Peter P. Chirimbes Jr., and his two sons, Peter Chirimbes III and Jason Chirimbes. The elder Chirimbes ran for mayor of El Cajon in June of 1994, and came in third.

Mary E. Schmidt, national public relations manager for San Diego-based Mail Boxes Etc., said the company "had experienced problems before" with the El Cajon outlet owned by the family, and is considering terminating it. She would not say what problems the company has had with the Chirimbes operation.

"Our centers are independently owned and operated; we have 3,200 around the world, 2,700 in the U.S. and 60 in San Diego County," says Schmidt. "This is an isolated incident" that runs counter to training the operators receive, she says.

Postal inspectors say the Chirimbes family charged customers for U.S. postage and then used counterfeit stamps and meter impressions on letters and parcels.

Postal inspectors raided the office at 1093 E. Main St. and also the residence of the senior Chirimbes. Four vehicles were seized, along with records. The inspectors have retrieved more than 400 pieces of mail bearing the allegedly counterfeit stamps.

Investigators say they caught the outlet in a sting of sorts. Inspectors posed as customers and presented nine separate parcels and letters for mailing through U.S. mail. All nine showed up with counterfeit stamps or meter impressions.

Last year, nationally, the U.S. Postal Service lost more than $20 million from such counterfeiting.

Cooper's lifestyle

Former real estate trust deed operator Sylvan Cooper, who was sentenced to seven years in local custody in late 1995, will have to remain in jail, Municipal Court Judge Bonnie Dumanis ruled yesterday.

However, she ruled that the District Attorney's Office had insufficient evidence to show that Cooper knowingly violated the law by receiving Social Security payments to which he was not entitled.

Jeffrey Brodrick, head of the D.A.'s real estate fraud subsection, noted that when Cooper was sentenced, he was told to pay $723,559.31 restitution to his victims at the rate of $749.00 per month. He was told to turn over life insurance proceeds, and has not done so. And he was supposed to use monthly Social Security checks to pay his victims.

However, the D.A.'s Office concluded that Cooper was pulling a fraud while in jail, using a false Social Security number and making sure the payments got to his wife. The Social Security Administration did not know Sylvan Cooper was in custody, according to Brodrick.

People in jail for the length of Cooper's sentence may not receive Social Security payments, said Brodrick. Social Security field representative Marie Floto said the Cooper case is being referred to a local office to suspend Sylvan Cooper's benefits. "This is also being looked at for possible fraud," she said.

Sylvan Cooper's attorney said his client suffers from prostate cancer and heart problems. However, "He has received virtually no medical treatment" at the Central Detention Facility, said attorney Thomas J. Warwick.

Also, Cooper's wife, who has moved in with her parents since her husband went to jail, has breast cancer, argued Warwick, asking that the court release Sylvan Cooper so he can care for his wife and her elderly mother.

Dumanis turned down that request, noting that Cooper had fleeced numerous people on his way to riches. Among other things, former socialite Cooper, who had pleaded no contest to seven grand theft charges, had fleeced a Laotian family of $190,000, driving the family into bankruptcy.

# A Prosecutor's Perspective on Real Property Crimes (And Why Your Next Closing May Cost $2 More)

By Jeffrey Brodrick*


## I. INTRODUCTION

Due diligence reveals prowlers on Blackacre. Query: What to do? The next time you unearth apparent real estate fraud, consider whether your client—and the public—might benefit from a referral to the District Attorney for possible criminal prosecution. The recent enactment of Senate Bill 537 has provided substantial financial resources for the prosecution of real estate fraud in California.

This article will discuss several criminal statutes that impact real estate fraud, how they are used by prosecutors to build a case, and how prosecutors collaborate with the civil bar. Finally, the article will explain how Senate Bill 537 provides potential funding for local prosecutors.

## II. AN OVERVIEW OF REAL PROPERTY CRIMES

Most real estate fraud cases generate charges based upon one of the four common law forms of theft, which are now codified in Penal Code section 487(a): (1) embezzlement, (2) theft by false pretense, (3) theft by trick or device, or (4) theft by larceny.[1]

Embezzlement and theft by false pretense are the techniques most favored by practitioners of real estate fraud. A frequent embezzlement scheme involves the use of broker-exempt escrows,[2] in which a hard-money lender steals trust deed payoffs, but continues to make interest payments to the unwitting investor, who is advised the loan has been extended or rolled over into another property. The scam continues until the thief runs out of payoffs to "Ponzi." In brief, an embezzler has exploited a relationship of trust or confidence; accepted property entrusted to him; and with the intent to deprive, converted it to his own use or purpose.[3]

More common, however, is theft by false pretense, which a thief accomplishes by knowingly making material, false statements that are believed and relied upon by the victim and cause the victim to part with his money or property. Typical fact patterns involve a thief who pretends to own property he does not, lies about the priority of a deed of trust he is selling, or commits negative fraud by failing to disclose material information about the transaction. The false pretense or representation must be made with the specific intent to defraud.[4] Or, the thief falsely promises to a distressed homeowner that, upon receipt of a quitclaim to him of the property, he will cure all defaults and pay off the existing mortgage, thus salvaging the victim's credit. What the thief really intends to do is install a renter and skim the rent.[5]

In theft by trick or device, an individual, by fraud, artifice, or false promise, causes the victim to unwittingly surrender possession of property without intending to transfer ownership. A suspect might effectively steal title to a house by slipping a grant deed into a stack of documents he is having an elderly person sign, then use that indicia of ownership to refinance the property, effectively turning a legally worthless deed into cash.

Larceny rarely applies to real estate; given the requisite element that a suspect must take the property of another and *carry* such property away by obtaining physical possession and control of the property.

For a prosecutor, the beauty of a theft charge is that a jury need not agree on the particular form of theft the thief has accomplished; it needs only to agree that a theft occurred.[6]

Although theft is the most prevalent real estate crime, it does not occupy the field. Forgery often plays a role, in two fashions. The first involves knowingly signing the name of another without authority, with the specific intent to defraud.[7] The second involves uttering or publishing as true, a false or counterfeited instrument, such as a wholly fictitious deed of trust on a nonexistent property.[8]

Rarefied statutes such as Penal Code section 115 (Attempt to Record False or Forged Instrument) are useful in prosecuting a suspect who records a wild deed after conveying his interest in the property, leaving the victim with a deed that is outside the chain of title, and therefore providing no constructive notice or protection.[9] This section also applies when a hard-money lender diverts the payoff from a deed of trust out of escrow and, to do so, records a fraudulent reconveyance.

Foreclosure fraud might be prosecuted as both grand theft, under Penal Code section 487(a) and as an equity purchase fraud under Civil Code section 1695.8.[10] Such fraud is often staged in three acts: in the first, the equity purchaser approaches a distressed, "upside-down" equity seller and offers to take title to the property in exchange for curing the defaults and saving the equity seller's credit. Perhaps the equity purchaser will sweeten the deal by agreeing to carry back paper he has no intention of paying. By knowingly making these false promises, he commits fraud upon the equity seller. In the typical second act, the criminal commits grand theft by marketing the property to any number of unsophisticated victims—say, recent immigrants who lack any knowledge of escrow, let alone title insurance. The victim is told the house is owned free and clear by the suspect and/or that the suspect will act "as the bank." The victim pays a cash down payment; receives an unrecorded grant deed; moves in; pays monthly payments to the suspect; and is evicted several months later by the legitimate purchaser at the foreclosure that was looming when the scam started. Act three occurs during the several months in which the suspect is collecting and skimming rent.

Creative financing abuses—leveraged transactions where the buyer uses the seller's equity to buy the property—are the exotica of real estate fraud. This may become criminal when the buyer seeks to cash out this equity through refinancing or reselling the property just purchased, for example in a double escrow. Here, the thief conceals from the lender the fact that the seller has extended credit through a purchase money deed of trust. The lender funds the loan, unaware that the down payment "paid" by the buyer is in reality nothing more than a promissory note. Or the lender may be unaware that the buyer in the second half of the double escrow is a straw buyer who has been paid a fee, and has signed a loan application that includes pumped-up, falsified assets. These false statements to obtain a loan may constitute a violation of Financial Code section 5308.[11]

Finally, real estate fraud may be prosecuted as residential burglary even when the victim invites the thief in. The lack of forced entry is immaterial to the burglary; the elements of burglary; are satisfied upon proof of entry of an inhabited dwelling committed with the intent to steal or commit a felony.[12] Residential burglary appeals to prosecutors, at least from a charging perspective, because it radically increases the maximum prison exposure a defendant might face from twelve to twenty years.

Other obscure statutes apply and are helpful in providing probable cause for search warrants, even if they are not used in the actual criminal complaint.

## III. BENEFITS OF INTERACTION BETWEEN PROSECUTORS AND THE CIVIL BAR

Prosecutors and attorneys who represent defrauded victims, frequently interact with, and often can provide assistance to, one another. From the prosecutor's perspective, the civil real estate bar is an invaluable source of crime reporting and initial case investigation. Frequently, a civil cause of action includes all of the elements of a crime; virtually all the prosecutor has to do is draft a complaint. Indeed, a diligent criminal investigator will routinely search court records for judgments against a suspect in the course of building his criminal case.

On occasion a prosecutor can accomplish results that a private attorney cannot and vice-versa. For instance, prosecutors can seize records from a suspect's home or business pursuant to a search warrant.[13] Although the district attorney will not disclose the facts of an ongoing investigation until that investigation is completed, upon conclusion of the criminal case, a civil attorney may subpoena records from the district attorney.[14]

Civil attorneys nevertheless have their own discovery edge. Prosecutors require probable cause before they seize records. Assuming there is a reasonable basis to initiate a civil action, private attorneys have the power to discover information in the absence of probable cause. Civil discovery often will unearth evidence of criminal wrongdoing otherwise beyond the reach of the district attorney, which can ultimately form the basis of criminal charges.

Perhaps most important, the district attorney has the power to secure a civil restitution order, which is as valid as any monetary judgment a private litigant might obtain after enduring a costly trial. How? "The Victim's Bill of Rights," enacted June 8, 1982, pronounced that, "It is the unequivocal intention of the People of the State of California that all persons who suffer losses as a result of criminal activity shall have the right to restitution from the persons convicted of the crimes for losses they suffer."[15] The restitution order in a criminal case is mandatory, unless the court finds clear and compelling reasons to not order restitution.[16]

The bad news, however, is that collecting upon this civil order is not the function of the district attorney except when the defendant violates a probation order to pay restitution and becomes subject to revocation of probation. Unfortunately, a victim of a criminal real estate fraud will, in most instances, not see any restitution; the criminal has long since squandered the victim's assets. Thus, actual restitution is the exception to the rule. If, however, the defendant is a real estate licensee, the victim may take his civil judgment and apply to the Real Estate Recovery Fund administered by the Department of Real Estate.[17] Recovery is limited by statute to $20,000 for any one transaction and $100,000 for any one licensee.[18]

Still, prompt reporting to either law enforcement or the district attorney generally increases the odds of the client obtaining restitution and helps prevent further victimization. The prosecutor reaps the benefit of learning of crimes that otherwise might not be brought to his attention, and the civil attorney reaps the benefit of whatever *de facto* leverage the district attorney may exert by filing charges.

## IV. SENATE BILL 537 LAYS GROUNDWORK FOR GENERATING FUNDS TO PROSECUTE REAL ESTATE FRAUD

Transactional lawyers, your next multimillion dollar closing may cost two dollars more. *Two* dollars?!!?

Blame it on Gil,[19] blame it on Paul,[20] blame it on the California Association of Realtors, on that excellent prosecutor from Los Angeles, Don Tamurura.

Blame it on Senate Bill 537.

On October 15, 1995, Governor Wilson signed Senate Bill 537 into law, adding Section 27388 to the Government Code. This section establishes a Real Estate Fraud Prosecution Trust Fund, which is to be used to deter, investigate, and prosecute real estate fraud.

This new statute provides that—in addition to other recording fees—upon the adoption of a resolution by the county board of supervisors, an additional fee of up to two dollars may be assessed for the recording of every "real estate instrument, notice or paper."[21] Without question, "real estate instrument" includes deeds of trust, assignments of deeds of trust, reconveyances, requests for notice, and notices of default, but not deeds, instruments, or writings subject to the documentary transfer tax. This leaves a grey area—some counties, such as San Diego, have chosen to interpret this statute as imposing the fee on only the five specifically identified instruments; other counties, such as Los Angeles, have imposed the fee on a myriad of documents, including notices and papers, and excluding only the transfer tax documents. In any event, San Diego County anticipates revenues from this fee to exceed half a million dollars a year; Los Angeles County expects over two million dollars a year.

These new fees are collected by the County Recorder. After administrative costs are deducted, the funds are paid quarterly to the County Auditor or Director of Finance and placed in the Real Estate Fraud Prosecution Trust Fund. The money is then allocated to the District Attorney, as well as to local law enforcement agencies, to deter, investigate, and prosecute real estate fraud. In San Diego, where real estate fraud is investigated exclusively by the district attorney, all of this revenue goes to that office.

How will the funds be used? In San Diego, for example, the district attorney hopes to establish a higher profile in the real estate industry to encourage real estate professionals to report fraud when they encounter it. Guidelines will be distributed to alert industry professionals regarding the types of cases that are suitable for prosecution and the documents and information needed by a district attorney to initiate an investigation. In this fashion, it will be possible to uncover frauds more quickly than in the past, so that additional crimes by the same criminal can be preempted.

Other possible uses for the Real Estate Fraud Prosecution Trust Funds include grants for educational and proactive efforts, involving cooperation with local community groups, title companies, realtors' associations, and bar associations. These efforts probably will include forums and speeches to teach people how to avoid becoming real estate fraud victims.[22]

All-in-all, publicity remains the best deterrent. A headline and article in the newspaper, highlighting the misdeeds of a local thief, invariably results in phone calls and cryptic, anonymous letters to the district attorney reporting similar scams by the same suspect or reports of somebody else doing "the exact same thing."

While prowlers will always plague Blackacre, collaboration between the civil bar and prosecutors can provide a remedy, particularly given the added resources of Senate Bill 537.

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**Endnotes**

1. Cal. Penal Code § 484; 1 Witkin & Epstein, Calif. Crim. Law (2d ed.), § 562; *see* CALJIC 14.00.
2. Mortgage brokers licensed by the Department of Real Estate to make, sell, or broker loans secured by deeds of trust may handle escrows without being separately licensed by the Department of Corporations. Cal. Fin. Code § 17006.
3. Cal. Penal Code §§ 487, 503, 506.
4. *People v. Randono*, 32 Cal.App.3d 164, 172 (1973).
5. Civil Code §§ 890, 891, and 892 define criminal rent skimming as five acts of using revenue received from the rental of residential property during the first 12 months after acquisition, without first applying the revenue to all mortgages and deeds of trust encumbering the property.
6. *People v. Vineberg*, 125 Cal.App.3d 127, 139 (1981).
7. CALJIC 15.00.
8. *People v. Prantil*, 169 Cal.App.3d 592, 605-06 (1985); *see* CALJIC 15.01.
9. *Far West Sav. and Loan Ass'n v. McLaughlin*, 201 Cal.App.3d 67 (1988).
10. Civil Code § 1695.1 defines "Equity Purchaser" as any person who acquires title to any residence in foreclosure, except a person who acquires title as follows: (1) for the purpose of using such property as a personal residence, (2) by a deed in lieu of foreclosure, (3) by a deed from a trustee acting under the power of sale in a deed of trust or mortgage at a foreclosure sale, (4) at any sale of property authorized by statute, (5) by order or judgment of any court, (6) from a spouse, blood relative, or blood relative of a spouse. An "Equity Seller," on the other hand, is the distressed seller of a property in foreclosure.
11. Cal. Fin. Code § 5102. Such transactions also may duplicate federal criminal statutes, which are beyond the scope of this article.
12. *People v. Barry*, 94 Cal. 481, 482 (1892); *People v. Salemme*, 2 Cal.App.4th 775, 781 (1992).
13. Cal. Penal Code § 1536.
14. Until conclusion of the criminal case, prosecutorial and law enforcement agency records are exempted from disclosure if it would endanger the successful completion of the investigation. Cal. Gov't. Code § 6254(f).
15. Cal. Const., Art. I, § 28(b).
16. Cal. Gov't. Code § 13967(c).
17. Bus. and Prof. Code § 10471(a).
18. *Id.* § 10474(c).
19. Garcetti, District Attorney of Los Angeles County.
20. Pfingst, District Attorney of San Diego County.
21. Must a county participate in this program and fee increase? No. Absent an enabling resolution or ordinance by the board of supervisors, recording fees in a county will remain at current levels.
22. One "Jaded Prosecutor" has seen the downside of such efforts: At a luncheon of senior citizens, he spotted several con artists he had previously prosecuted—the wolves, seeking sheep to be shorn. "I know you're out there," said the Jaded Prosecutor. "I can see your red eyes."

The San Diego Union-Tribune.
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# New fee helps the law put the squeeze on real estate fraud

Lori Weisberg
STAFF WRITER

02-Jun-1996 Sunday

## Jeff Brodrick | Cynthia English

Cynthia English is not one to spend her money wantonly, especially considering she has a developmentally disabled son who will forever be financially dependent on her.

But here she is, out $65,000, swindled by a man she entrusted to invest her retirement savings in what turned out to be a fraudulent second-trust-deed scheme.

Her money was never recovered, but the man who stole it is now sitting in jail, thanks to the efforts of the San Diego District Attorney's Office.

"I spent a lot of sleepless nights, a lot of worrying; I had a lot of anger. As a single parent, I didn't know where to turn," said English, a widow. "This was insurance money from my husband's death that I was saving for my son, who is physically and mentally challenged and will need care for the rest of his life. The money's gone and you can't get it back.

"But am I gratified (by the sentencing)? Definitely. All the lies and deceit that went on, it's finally come to an end and justice is now prevailing."

News of real estate fraud may not command the attention garnered by more high-profile crimes, but it nonetheless is an all-too prevalent activity in San Diego County, where victims have been bilked out of millions of dollars, according to the District Attorney's Office.

Frustrated by a shortage of funds and staff, the office frequently has had to turn away cases it simply lacked the resources to investigate and prosecute.

Now, thanks to a new $2 recording fee levied on certain real estate documents, the county will raise up to half a million dollars annually to prosecute real estate fraud. The new fee went into effect last month.

Although the District Attorney's Office already prosecutes such fraud, the new, state-authorized funding will help finance a special unit that will deal exclusively with fraud. The money will help pay for an additional prosecutor, one investigator, two fraud specialists and a legal secretary.

The program was enacted as a three-year pilot project, to be reviewed annually by the county Board of Supervisors.

"Fraud in real estate transactions is a problem that ... strikes at the heart of the American dream, and in San Diego harms some of our most vulnerable members of society: the elderly, members of the minority community, the middle class," wrote District Attorney Paul Pfingst in a report to the Board of Supervisors seeking approval to begin assessing the new fee, which was established by state legislation.

"The victims often lose their life savings or their entire retirement funds .... A single proficient thief can easily ruin two dozen victims, harming them so profoundly that they will never recover."

Pending are 25 investigations involving some 200 victims and losses totaling $10 million, according to Deputy District Attorney Jeff Brodrick, who oversees the real estate fraud program. Because of the complexity of many of the cases, it can take up a year to investigate just one scam, he pointed out.

"I've done lots of murder and gang cases, but these fraud cases are very emotional," said Brodrick, who does little to hide his contempt for those who perpetrate fraud. "The victims always come to court and make poignant statements about how it's devastated their lives, left them with a feeling of loss, shame and anger. But I think they're grateful that the system has in some fashion worked."

That certainly was the case with English, who never doubted the word of mortgage-company owner John Lewis when he offered to invest her $65,000 in a second trust deed that would yield monthly interest payments to her at a rate of 12 percent. Trouble was, he already had sold the same second trust deed to another investor.

For a year, English received the interest payments from Lewis, who used his own funds to make it appear he was legitimately servicing the trust deed. It was not until the note came due that the scam fell apart and it was discovered that Lewis had sold the same deed to two people.

"I got an original trust deed, but what I found out was that he had told the (borrowers) that he'd lost the original paperwork, and he had them re-sign everything again," English said. "He knew all the angles to be one step ahead of me, to keep me appeased."

According to Brodrick, the District Attorney's Office was instrumental in helping rewrite and lobby for the state legislation that authorizes counties to charge the additional $2 recording fees.

Specifically, the new fee applies to the recording of financing documents used to purchase a home, obtain a home-equity loan or refinance a home loan. Other financing documents trigger the fee as well, including assignments of trust deeds, reconveyances (when a trust deed is paid off), notices of default and requests for notice, which allow investors in second trust deeds to be notified if there later is a default on the property in which they invested.

It should be noted that the fee does not apply to transfer documents, as in the case of someone selling or conveying property to another person by way of a grant deed or quitclaim deed, explained Brodrick.

Passage of the special legislation required negotiations and compromise with both the state and local Realtor associations, he noted.

"Realtors typically do not want to support fee increases or anything that can be construed as a tax, so philosophically they were reluctant to begin with," he said. "But we worked really closely with them and got their support, which was invaluable to passage of the bill."

Initially there was a reluctance locally to support the legislation because of a poor experience with a fraud notification program initiated in Los Angeles that relied on a $7 recording fee to fund it. That program, however, dealt only with notifying people by mail if a grant deed or quitclaim had been filed on their property and did not involve prosecution of real estate fraud.

"They (the realty agents) were concerned that the $7 wasn't being used efficiently, but if the $2 goes just to prosecution, they feel that's a good use of the money," said Don Tamura, who heads the real estate fraud unit in Los Angeles County. "They're just as concerned as anyone else that bad people are prosecuted.

"There's always been a problem with real estate fraud because the crooks gravitate to where the money is. The problem is, in the past we've only been able to get a tiny tip of the iceberg, and now with this program I think we can get more of the iceberg."

There's no question that the real estate industry supports aggressive prosecution of fraud, because such nefarious activity reflects badly on everyone, even the most scrupulous in the industry, noted Walter Baczkowski, executive vice president of the San Diego Association of Realtors.

"Any way we can help prevent fraud is not only good for the consumer, but it's also good for the industry," he said. "On a transaction as big as buying a home, $2 is not that much to pay. I just bought a home and I certainly wouldn't mind paying the fee. It just helps keep confidence in the industry."

Typically, the kinds of cases most frequently prosecuted in San Diego involve what are known as hard-money lenders, who not only solicit investors but also service the loans secured by real estate in the form of a trust deed.

Because they have total control over all aspects of such transactions, it makes it easier to perpetrate fraud -- either by selling the same deed of trust to multiple investors, forging deeds of trust or simply misrepresenting to the investors the priority they have on the loans in which they've invested, explained Brodrick.

He cited one case he prosecuted in which a La Jolla lender defrauded unwitting investors of $700,000 by pocketing the payoffs on loans rather than passing the money on to the investors. Sylvan Cooper, who ran La Jolla

Trust Deeds, ultimately pleaded guilty to seven counts of grand theft and was sentenced to seven years in jail.

Suffering the biggest single loss was a family of Laotian immigrants who lost $200,000 on a piece of property that Cooper tricked them into signing over to him as collateral for a $14,000 loan he made to the family. Cooper effectively appropriated the property as his own and ultimately traded it for an apartment complex in downtown San Diego. explained Brodrick.

It is unlikely the family ever will recover any money from Cooper, despite a ruling in a civil suit that awarded the family $250,000 in actual damages and $500,000 in punitive damages. said Brodrick.

"Oftentimes the suspects in these cases are articulate, charming, outwardly wealthy, and they present the elements of stability," said Brodrick. "Sylvan Cooper, for example, lived in La Jolla and his wife was president of a theater organization. "The gentleman from Laos ultimately lost his life savings in a very cruel transaction."

In larger cases, a defendant can go to prison for up to 10 years and be forced to make restitution, although typically it is rare for victims to recover any money, Brodrick said.

In addition to investigating and prosecuting real estate fraud, the District Attorney's Office also plans to concentrate on deterrence through public education, presentations in the community, distribution of brochures and videos.

"We're hopeful that we can reduce real estate fraud with this program," said Brodrick, "and by creating a higher profile and taking a more aggressive approach, we should be able to deter more crimes."

How to contact DA's fraud office

If you suspect you are a victim of real estate fraud, you can contact the District Attorney's Real Estate Fraud Subdivision at 531-3552 or write to: Jeff Brodrick, Office of the District Attorney, Real Estate Fraud Subdivision, P.O. Box X-1011, San Diego, CA 92112.

Written complaints are preferable to phone calls.

# Real Estate Fraud

*by Don M. Tamura & Jeffrey Brodrick*

## INTRODUCTION

Senate Bill 537, sponsored by the Los Angeles District Attorney's office, was signed into law in 1995 and became effective January 1, 1996. The bill added $2 to the recording fee for real estate instruments. The money is designated to go to law enforcement and prosecutors for the investigation and prosecution of real estate fraud — crimes perpetrated upon the elderly, unsophisticated and most vulnerable members in our communities.

## REAL ESTATE FRAUD UNIT

The problem of real estate fraud has loomed large in the last few years, partly due to the failure of financial institutions and the recession. Moreover, as lending by institutions has tightened, homeowners have had to turn to hard-money lenders as a source for money. This is particularly true in minority and low-income areas which are often the targets of unscrupulous con artists.

The Real Estate Fraud Unit of the Los Angeles County District Attorney's Office has prosecuted a variety of cases which might be placed under the rubric of "real estate fraud." In general, the cases break down into three areas:

## HOME EQUITY FRAUD

A large number of cases prosecuted by the Real Estate Fraud Unit are related to home equity fraud. A typical victim of this type of crime is an elderly widow who has owned her home for some time. Often, this victim is approached by an individual who convinces her to take out a home improvement loan. A loan is secured by the victim's real property and is usually larger than the victim can afford. When the victim cannot afford the payments the property goes into foreclosure, or another even larger loan is created. The criminal suspects continue to bleed the equity out of the home until foreclosure proceedings finally divest the victim of her home.

Sometimes a loan is taken out on the property without the knowledge of the victim. This scam is perpetrated by forging a grant deed, quitclaim deed or deed of trust. The holder of the forged deed uses it to obtain a loan or sells it on the secondary loan market. Either method results in the conversion of a homeowner's equity into cash.

## SECURITIES FRAUD TIED TO REAL ESTATE

With interest rates falling in the last five years, many have turned to the second-trust-deed market to get a greater return on their money. Second deeds of trust when sold as securities promise a large rate of return in a short span of time. Perpetrators of this crime package small loans into larger loans and pass on payments from the borrowers of the large loans to the lenders of the small loans. The sellers of these securities are often relying on the equity of the secured real property to provide a cushion against defaults.

With the downturn in the real estate market, however, the margin of equity that could support a small number of loan defaults disappeared. Many of the companies selling these securities turned into large-scale "Ponzi" schemes, using money from new investors to pay the interest on loans from old investors. Unfortunately, the perpetrators of the scheme can maintain it for a long period of time. When the company finally collapses, there is usually little, if any, money left for the victims.

## LENDER FRAUD

Although a majority of lender-related fraud is handled by the Federal authorities, local prosecutorial agencies are taking an ever-increasing role in the investigation and filing of these cases. Lender fraud is a crime in which false information or manipulated data is used to induce a lender to make a loan. This can be accomplished in a variety of ways.

The easiest method is to falsify or create documentation to make it appear as though a borrower qualifies for a loan. Tax returns, verifications of deposits, verifications of employment or other employment documents are altered to submit with a loan package. Usually this scheme involves a loan broker, escrow agent or tax accountant, and in many cases involves all three working in concert. Lender fraud may also involve a "straw buyer" posing as a legitimate borrower, but there are cases in which borrowers are unaware of the forged documents.

Inflated appraisals can also be used to commit lender fraud. It is rare, however, for a criminal case to be filed solely on the basis of an inflated appraisal. In most lender fraud cases, the loan application serves as the most important false token for a case of theft by false pretenses.

The key to prosecuting real estate fraud cases is preparation of the case prior to filing. By the time a defendant is arrested and arraigned, it is too late to gather the relevant evidence to prosecute. With this in mind, the Los Angeles District Attorney's Real Estate Fraud Unit relies on several important investigative tools to prosecute the foregoing schemes.

## SEARCH WARRANTS

The most important weapon in attacking real estate fraud is the search warrant. It is safe to say that a search warrant was used in almost all of the real estate fraud cases prosecuted by the Los Angeles District Attorney's Office. Besides the traditional targets of a search warrant, such as the suspect's home and business, a search warrant should include the locations involved in the real estate transaction.

In any real estate fraud case, it is imperative that the district attorney have complete records on the real estate transaction. This includes the lender file, the escrow file, and documents relating to the chain of title. All search warrants should be executed as promptly as possible. A right of real estate fraud operators will co-opt all segments of the real estate transaction chain. Therefore, execution of a search warrant must serve all escrow offices, title offices, real estate brokerage offices, and loan brokerage offices simultaneously in order to insure complete seizure of all relevant material.

The only exception to the aforementioned rule is a regulated banking institution. Banks usually need as much as ninety days to comply with a search warrant. It is advisable to prepare an extension for the judge's signature at the time the search warrant is signed. This puts the judge on notice that the return will be delayed and saves the serving officer the trouble of getting the extension at a later date.

The search warrant should also include probable cause for records kept on the suspect's company computer. Important data concerning the real estate transaction, as well as similar transactions, are often contained on the hard drive of the main computer platform. Moreover, computer records often contain scanned versions of original or altered real estate documents. Usually, seizure of the entire computer is necessary to download all data. Therefore, the affidavit of the search warrant should contain probable cause to take the entire computer system.

## ACCOUNTING

Once information has been produced pursuant to search warrant, an accounting tracing the flow of money is essential to an effective prosecution case. In many real estate fraud cases, money is "churned" through several accounts. A forensic account, particularly one employed by a law enforcement agency, can determine where and when money was converted to the personal use of the suspect. Converted money is often used to pay off legitimate debts and loan payments and does not always end up in the pocket of the suspect. Therefore, a careful examination of all business and personal accounts must be completed prior to filing.

A forensic accountant should also be able to serve as an expert witness at trial. White-collar crime cases are difficult to communicate to jurors. Few people have the financial expertise to be able to judge accounting evidence. An expert accounting witness can simplify the "paper trail" and make accounting evidence more understandable.

Charts and graphs should be used to assist the jury in tracing funds. A pie chart or graph will often crystallize the disposition of stolen funds in the minds of the jurors. These same charts should be used throughout the examination of the expert forensic accountant.

## COMPUTER RESOURCES

Fortunately, much of the information used in the real estate industry can be found on computer databases which are accessible to the public. Several investigative agencies are hooked up to nationwide databases that provide information on property ownership, real estate transactions, and title documents. Much of this same information is also available in CD-ROM format and can be purchased for a nominal price. These sources allow investigators to trace the chain of title in a transaction, and find the recordation numbers for title documents.

The most important reason to use computer resources is that computers assist in focusing a growing investigation. Real estate fraud cases, as well as most white-collar crime cases, enlarge as an investigation progresses. Rather than waste resources on cases that will never be filed, let alone prosecuted, a computer database can be used as a screening mechanism. A computer database may show that a property has been sold numerous times. This is a stronger case than one reliant upon oral misrepresentations made to a buyer or seller.

Investment in at least one database will save substantial investigative time and pay significant dividends in real estate fraud prosecution. These databases will be more accessible and cheaper in the coming years. It is imperative that each District Attorney's Office in California use the money garnered from the Real Estate Fraud Prosecution Fund for access to computer databases.

In conclusion, thorough preparation of a case prior to filing is the key to success in a real estate fraud prosecution. The investigative tools noted above bring all prosecutorial agencies closer to meeting that goal. Fortunately, the passage of Senate Bill 537 has given local prosecutors a start toward effective and meaningful prosecution of real estate fraud cases in California

## HUNGRY REALTOR SNACKS ON EQUITY — THEN GOES TO JAIL

Early morning in the pricey foothills of Vista, a realtor stirs. He's hungry — there's that debt service on his $700,000 house. Realtor of the

Year and member of the Department of Real Estate's ethics committee, Manley B. is no ordinary realtor.

80-year-old Geraldine S. sips her tea in Encinitas. This morning she needs money to pay her nursing home costs, and her condo which is for sale is not moving.

Enter Manley B. touting creative financing. "You loan me the downpayment of $32,000, but we won't tell the bank." Somehow the downpayment jumps up to $64,000 and Manley walks out of escrow with title and possession of Geraldine's condo and $64,000 in cash!

Investigator Joe Maggio dives into the mind-boggling legerdemaine of creative financing. He begins with a brief, scholarly foray into the Corporations Code, the Finance Code and regulations of the Department of Real Estate.

As Joe glares at an investigative service request listing several steps to the investigation he is to conduct, he thinks — isn't there an old article cataloging creative financing abuses of the seventies floating around the office? Isn't the key the recording of the financing documents per the escrow instructions? Isn't creative financing just a leveraged buyout with the buyer financing his purchase of the property using the seller's equity?

Step one should be to talk with the victim. Geraldine is in a nursing home, so Joe relies on her friend and personal representative, who provides him with a stack of papers. Joe unravels the deal: Geraldine's condo was free and clear of debt. Manley agreed to buy it for $130,000 and paid $40,000 into escrow. To finance the $90,000 balance, he applied to World Savings for a loan. The loan was secured with a first deed of trust — conventional financing.

Manley didn't tell World Savings of the creative financing, or that he was taking out the equity as soon as their loan was funded and escrow closed. Instead of paying off the seller, the $90,000 would go to Manley and World Savings knew nothing of the $64,000 "second" deed of trust from Manley to Geraldine. Manley made token payments to Geraldine on the "second" deed of trust and a few payments to World Savings — then went bankrupt. Manley "gave" Geraldine her condo back and she hired a lawyer to force a reaffirmation of the debt in bankruptcy court. After the downpayment, Manley netted $25,000 from his theft.

Manley got money out of escrow by having a $64,000 check issued to his underling, Bill Getty. The $64,000 became a "settlement charge" to Geraldine although she didn't know Getty. Now Joe wants to talk to Getty! Easy Joe, get your search warrants first!

Joe has a title company run a property profile. Geraldine's "second" deed of trust is recorded two days and 4,000 documents after the deed to Manley and the first deed of trust to World Savings. This recording chronology concealed from World that Manley had taken money out of escrow and over-encumbered the property — with no intention of paying back either loan.

Next Joe reviews the World Savings deed of trust. He had already agreed to put a "second" deed of trust on the property to secure Geraldine's downpayment loan to him when he promised not to further encumber the property by signing the World Savings deed of trust. He lied — violating Penal Code Section 115, Recording a False Document — probable cause for a search warrant or two.

Joe briefs a dozen investigators and investigative specialists and they fan out across North County — to a couple of escrow offices, a title company, Manley's office, his car and home. The escrow officer vehemently denies any wrongdoing. Joe is ordered to the next search warrant. The escrow officer insists the recording of the second was an accommodation to Manley and had nothing to do with the escrow. The escrow files are damaging to both Manley and the escrow company.

Joe and Investigator Ted Snoddy, go next to Manley's home. Ted has written out 200 questions for Manley. Several hours later, Manley admits "No way the bank would have given me money to buy the condo had they known the true financing arrangements." He also admits he knew it would be hard to pay back the bank loan and Geraldine — because the combined debt was double what the condo would rent for.

The elements of theft by false pretense have been supplied. Manley deceived World Savings to get a loan, violating the Finance Code. By signing a promissory note he didn't intend to repay to Geraldine he made a false promise: a misrepresentation virtually impossible to prove, absent a confession.

Joe talks to Getty last. Getty simply signed the $64,000 check over to Manley without question, because he was told to — so much for money laundering.

Charged with grand theft, making false statements to obtain a loan and recording false documents, Manley pleads guilty to a couple of felonies and wants to give scuba lessons to the disadvantaged, in lieu of custody. Scuba? Judge Frank Brown, ex-cop, ex-prosecutor and savvy real estate entrepreneur, knows the score. "I think within all of us there is a bit of larceny," he tells Manley. "You're not dealing with someone here who doesn't know what you were doing."

No scuba lessons — Manley is sentenced to a year in custody and is allowed to serve his time in a private work furlough facility, so he can work and make payments to Geraldine. The condo is going into foreclosure, but payments to Geraldine are current and she remains in her nursing home. Joe exhales and readies himself for his next creative financing fraud — one of double escrows and straw buyers.

*Don M. Tamura is a Deputy District Attorney in Los Angeles County and Jeffrey Brodrick is a Deputy District Attorney in San Diego County. Both are heads of two well-established and successful real estate fraud prosecution departments. Tamura's portion of this article provides an overview of real estate fraud and Brodrick's portion explores the issue of real estate fraud with a "San Diego flavor."*

**REDACTED INTERVIEW OF 75 YEAR OLD VICTIM OF PREDATORY LENDING PRACTICES**

I interviewed Victim at her home on November 17, 1997, and she told me the following:

Victim is 75 years old. Victim suffers from diabetes and high blood pressure. She had a leg amputated a few years ago and has a prosthesis. Victim uses either a wheelchair or a cane to walk. Victim is legally blind and cannot read with her prescription glasses. Victim uses a large magnifying glass to try to read paperwork, but was unable to read any of her loan documents I asked her to review.

Victim received a refinance solicitation from the Loan Broker in late 1996. Victim considered refinancing because her existing loan had an adjustable rate and the payments were increasing. Victim also wanted to paint her house and make minor repairs of about $1,500.00.

The Loan Broker's Agent visited Victim at her home to discuss the new loan. Victim told the Agent she received a total monthly income of $848.00, consisting of $671.00 from social security and $177.00 from her pension. Victim's daughter also lived in the house and occasionally paid rent, but Victim did not tell the Agent to include the occasional payments in her income. Victim told the Agent she needed to keep her payments fairly low because of her limited income.

The Agent told Victim that her new loan would have an adjustable interest rate. Victim wanted a fixed rate loan and the Agent told her the Loan Broker would convert the adjustable rate loan to a fixed rate loan if Victim made her first three (3) payments on time.

The Agent brought the loan documents to Victim's home for her signature. Victim could not read the documents and signed each document presented after the Agent explained the contents. I showed Victim the following loan documents:

**Loan Application-** Victim said she never met the Loan Broker for a face to face interview. She said the handwriting on the application was not hers, but she did sign the last page. Victim said she did not date the application. She could not read any of the writing on the loan application, even using her magnifying glass. Victim did not know why her monthly income was listed as $3,000.00.

**Payoff Statement-** Victim could not read the payoff statement. She said the signature on the bottom of the document was hers. She did not know what a prepayment penalty was and did not know she paid her old mortgage company $3,302.00 because she paid their loan off early. Victim said the loan Agent did not tell her about the prepayment penalty or why she needed to sign the bottom of the payoff statement. Victim could not read the statement "The undersigned borrower approves this demand and is aware there is a prepayment penalty as mentioned above."

**Addendum to RESPA-** Victim could not read the addendum.

**HUD1 Settlement Statement-** Victim did not receive a loan proceeds check for $1,163.56 when the $91,000.00 refinance closed.

Victim left San Diego shortly after signing the documents and called the loan Agent for her $1,500.00 loan proceeds when she returned. Victim says she never received the loan proceeds from the Loan Broker. Victim called the Broker's office many times and asked for the loan Agent, but the Agent never answered her calls nor returned messages.

The Loan Broker never responded to Victim's requests to convert the loan to a fixed rate and sold the loan to a Mortgage Company in January 1997, three weeks after they closed the loan.

Victim could not make her November 1997 payment because she needed to pay her homeowners insurance. The loan is currently $1,694.59 in arrears according to the last Mortgage Company statement.

Written Comments to

SENATE SPECIAL COMMITTEE ON AGING

to be included in the record of the hearing

# EQUITY PREDATORS: STRIPPING, FLIPPING, AND PACKING THEIR WAY TO PROFIT

March 16, 1998

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Written Comments to
SENATE SPECIAL COMMITTEE ON AGING
to be included in the record of the hearing
**EQUITY PREDATORS: STRIPPING, FLIPPING, AND PACKING THEIR WAY TO PROFIT**

March 16, 1998

Members of the Senate Special Committee on Aging, on behalf of our low-income clients, the **National Consumer Law Center**[1] thanks the Special Committee for this opportunity to provide comments on the issue of predatory lending. Our comments include specific recommendations for action to address the widespread problems caused by equity predators.

Fifty eight percent of older Americans who are below the federal poverty level[2] own their homes.[3] (Exhibit 1.) This reflects the declining income of a large portion of the homeowner population following retirement. As elderly people often have need for more income, yet have substantial equity in their homes, they are popular targets for home equity fraud scams.

***THE CAUSES***

Though home equity lending abuses are not new, the 1980s and 1990s witnessed a major upswing. In the past fifteen years, "equity-skimming," or "equity-theft" has become a major threat to many homeowners -- particularly to the elderly. A number of marketplace and policy factors have converged to contribute to this problem:

**Deregulation:** In tandem with the appreciation of real estate values, the deregulation of consumer lending in the 1980s left the door wide open for unscrupulous operators. Federal laws passed in 1980 and 1983 preempted both state usury ceilings on mortgage lending secured by first

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1 The National Consumer Law Center is a nonprofit organization specializing in consumer credit issues on behalf of low-income people. We work with thousands of legal services, government and privates attorneys around the country, representing low-income and elderly individuals, who request our assistance with the analysis of credit transactions to determine appropriate claims and defenses their clients might have. As a result of our daily contact with these practicing attorneys we have seen examples of predatory lending to low-income people in almost every state in the union. It is from this vantage point--many years of dealing with the abusive transactions thrust upon the less sophisticated and less powerful in our communities--that we supply this testimony today. *Cost of Credit* (NCLC 1995), *Truth in Lending* (NCLC 1995) and *Unfair and Deceptive Acts and Practices* (NCLC 1997), are three of twelve practice treatises which NCLC publishes and annually supplements. These books as well as our newsletter, *NCLC Reports Consumer Credit & Usury Ed.*, describe the law currently applicable to all types of consumer loan transactions.

2 In 1996, the federal poverty level for a family of four was just $16,050.

3 Nationally, 39% of households below the federal poverty level own their homes. (Exhibit 2.) There are more than 5,000,000 low-income homeowners in the United States. The home ownership rate is particularly significant for low-income older Americans.

liens (whether purchase money or not),[4] as well as state limitations on risky "creative financing" options, such as negatively amortizing loans.[5]

Federal deregulation also set the stage for many states to remove rate caps and other limitations on other home lending -- including second mortgage lending. Whatever the overall merits of economic deregulation, it undeniably unleashed the greedy instincts of unscrupulous operators all over the country. In keeping with the conventional wisdom of free market theory, "the market" was supposed to take care of any problems. Unfortunately, there are market failures, and predatory home equity lending provides a good example of one. Even though interest rates have declined, these lenders have not lowered their rates, and for a number of reasons, competition and market forces do not operate according to theory on these loans.

**The rise in real estate values:** The inflation in real estate values in the 1980s created much new wealth -- the equity pool. While real estate values have remained stable in the 1990's (or declined in a few areas of the country), the equity acquired from the brisk rise in values in the 1980s continues to make aging homeowners a prime target of predatory lenders.

Since real-estate secured lending -- particularly owner-occupied residential real estate -- has historically been among the safest kind of lending, creditors of all stripes strove to develop or increase their portfolio of real-estate secured loans.[6] Legitimate lenders simply sought increasingly secure loans. The marginal lenders -- the equity skimmers -- looked to this new equity pool as something to enrich them.

In turn, the appreciated value of the property led to "asset-based lending" -- that is, loans made based on the value of the security, rather than on the borrower's ability to repay. This has been common in commercial lending, but is generally unsuitable for consumer loans. Most borrowers are simply wage-earners who look to their regular income to repay their debts. The amount of equity in the collateral is only relevant to the ability to repay a loan if the borrower intends to liquidate the collateral. In short, "asset-based lending" is a legitimate-sounding justification to ignore sound underwriting principles, and make unaffordable loans.

Equity skimmers generally write loans with repayment terms which borrowers could not hope to meet over the long haul: monthly payments which are 70% or more of monthly income[7] (or,

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4 Depository Institutions Deregulation and Monetary Control Act of 1980, § 501 (DIDA), codified at 12 U.S.C. § 1735f-7a.

5 The Alternative Mortgage Transaction Parity Act of 1982 (AMTPA). 12 U.S.C. § 3800, *et seq.*

6 The portion of homeowners with home equity loans more than doubled between 1977 and 1988. In 1977, 5.4% of homeowners had such loans; in 1988, 11% (6.5 million families) had home equity loans. Canner & Luckett, "Home Equity Lending," 75 Fed. Reserve Bull. 333 (May, 1989).

7 *See e.g., Family Financial Services v. Spencer*, 677 A.2d 479 (Conn. App. 1996)(predatory second mortgage had a monthly payment of $733.33 where the borrower already had a first mortgage with a monthly payment of $1011.00 but monthly *income* of only $1126.67).

in one case we have seen, monthly payments more than monthly income[8]); or large balloon payments which the borrower has no realistic hope of making. The loans are made because the lender cannot lose: either the borrower will repay the loan at a high interest rate or be forced into refinancing into a new, profitable loan; or, too often, the lender will recoup the amount of the loan and costs through the foreclosure process.[9] It is significant to note that the number of foreclosures in the United States has *tripled* since 1980.[10]

**The rise in the secondary mortgage market**: Some high-rate mortgage lenders, particularly home improvement contractors, have historically operated by assigning installment contracts they write to other lenders, such as finance companies or banks. But the 1980s added a new wrinkle -- bundling mortgage loans into large portfolios and selling them on the secondary mortgage market. This enabled mortgage companies specializing in home equity lending -- unregulated in many states -- to operate much more profitably. Since there was a "back-end" income stream, they could operate with little capitalization base. They could obtain a line of credit from a major bank; originate predatory loans, taking out very high up-front fees; then dump the loans onto the secondary market.

The secondary market structure is good for an equity-skimmer who originates the loans. This lender can charge enormous up-front fees, be careless about underwriting, and then pass the consequences along to the buyers on the secondary market. If the loan defaults it is the new creditor's problem. Buyers on the secondary market have found this is a profitable business scheme as well: they save the expense of originating loans; and, in the rare case where the borrower has the wherewithal to hire a lawyer and allege the originator of the loan defrauded them, or engaged in usury or other violations of the law, the buyer of the loan on the secondary market can hide behind a holder in due course defense.[11] The result is that the loans must generally be repaid regardless of fraud or other legal problem in the inception of the loan.

**The securitization of home equity loans:** The 1990s saw the phenomemonal growth in the use of asset-based securities to fund an ever-increasing supply of mortgage credit. Asset-backed securities are debt or investment securities which are backed by receivables such as credit card, automobiles, or home equity loans. They are similar to mortgage-back securities which are the

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8 In this case, where default was absolutely predictable and inevitable as of the first payment on a 12-month balloon note, the contract provided for extremely high late charges plus a 42% default interest rate. Thus, at the end of the 12 month term, the lender could claim a lien on the property that was approximately $50,000 greater than the original principal plus 22% interest provided for in the note.

9 In fact, state laws on foreclosure almost universally allow foreclosing creditors to buy the property at a significant discount from fair market value and then to resell it at full value, pocketing the difference.

10 *See* Exhibit 3.

11 The holder in due course doctrine generally gives assignees or other subsequent holders of negotiable instruments (such as promissory notes) immunity against legal claims and defenses that the borrower may have had against the original creditor. *See* discussion, *infra*. Some also bought the loans with a recourse arrangement, whereby they would return non-performing loans to the originator, giving them yet further protection against risk -- at least until the originator went bankrupt.

foundation for the secondary mortgage market. Investors are repaid the principal amount of their investment plus interest. Sales of asset-backed securities generally increased from $65 billion in 1993 to $167 billion in 1996, an incredible leap of $102 billion in three years.[12] Securitization helps to fund equity lenders by creating new capital through the securitization process.

**Prime and "sub-prime" mortgage market:** The credit industry refers to "A" and "A-" borrowers (those with good credit histories) as "prime," and "B' and "C" borrowers (those with no credit history or poor credit history) as "subprime." "Subprime" homeowners are the hot new market of the 1990s.[13] The earnings of small-volume subprime mortgage lenders are matching or surpassing the earnings of conventional mortgage lenders with significantly greater loan volume.[14] The securitization of home equity loans is a driving force behind the subprime market popularity. A segment of the subprime market includes the predatory lenders which are the subject of this hearing.

One myth upon which some lenders thrive is that higher interest rates, points, and fees must be collected from riskier borrowers in order to cover the increased risk. Thus, some subprime lenders believe they can charge exorbitant rates, fees, and costs and excuse such behavior under the rubric of "high risk." While this has some validity in the non-mortgage market, mortgage lending can be essentially risk-free when the loan is secured by the home and the loan-to-value ratio is 80% or less. If a loan made on this basis goes to foreclosure, the lender will generally cover 100% of its losses because there is enough equity in the home to pay off the principal balance as well as any foreclosure costs. It is with this in mind that many predatory lenders require at least a 65-75% loan-to-value ratio to provide themselves with a *greater* cushion than the prime market. Since many predatory lenders also load the loan principal with credit insurance costs, the risk to the lender if something unexpected happens to the borrower is even further reduced. Predatory lenders create a "win/win" situation. They will make an enormous profit from the revenue stream created by the repayment of these loans and suffer no loss if default occurs.[15]

Further, the additional cost of a high rate mortgage can make a "high risk" loan a self-fulfilling prophecy because the higher costs become the fuel for failure. As has been recognized by the industry, higher ratios between monthly payments and income are one predictor of a higher risk of default. Many of the high cost loans provided to low income borrowers appear to have debt to income ratios designed to create default, or forced refinancing of the loan.

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12 "The Asset-Backed Securities Market: The Effects of Weakened Consumer Loan Quality," FDIC Regional Outlook. Second Quarter 1997.

13 "Subprime Lender is the Place to Be." National Mortgage News, Sept. 22, 1997. Even the "D" market is being explored by some lenders. *See* "Countrywide Credit to Offer Mortgages to High-Risk Groups," The Wall Street Journal, Jan. 7, 1998.

14 *Id.*

15 *See generally* Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 Tulane L. Rev. 373 (1994).

**"Tax Reform:"** The amendment of the tax laws which retained the deductibility of interest only for home-secured loans added to the massive increase in home-equity debt. Many consumers and taxpayers are not well-equipped to calculate how the tax savings would weigh against the extra interest to be paid. Yet that is a sales pitch given by many creditors, and many homeowners listen to that siren-call.

**Cultural & Business Mores:** Finally, these economic and legal changes happened in a context of shifting cultural attitudes. The business ethic was that "anything goes," and greed was no longer the subject of opprobrium, but rather viewed as an engine for growth. Unfortunately, home equity lending became one of the targets for the speculators.

*THE VICTIMS*

The problem of mortgage scams and home improvement scams is not limited to certain regions. We have seen them from almost every state in the nation. But there are certain factors which make it worse in some areas:

- areas which had the greatest increase in real estate values tend to have more home equity lending problems;

- the more permissive the legal environment (i.e. the less regulation), the greater the problem.

Most poignantly, the more vulnerable the population, the greater the problem. Thus the less educated and less sophisticated are particularly victimized by these lenders; as are the elderly (who often have a lot of equity in their homes); and those whose other borrowing options are blocked, or who perceive themselves as having no options.[16]

*THE PERPETRATORS*

When one looks at both the "sins of commission" and the "sins of omission," there is a great deal of culpability across the spectrum.

**"Tin Men:"** Fraudulent home-improvement contractors, particularly the door-to-door operators, have long been a major source of complaint about abusive home-secured loans. They have been with us always, and probably always will. But as to whether they are isolated actors, or are commonplace, depends upon whether the ultimate sources of the financing -- and the regulatory environment -- encourage or discourage oppressive business practices.

In addition to needing a source of financing to run their business at the outset, these

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16 This factor helps explain the disparate impact of predatory lending felt by minority borrowers and people living in minority neighborhoods. *See, e.g.* Kathleen Keest, "Second Mortgage Lending: Abuses and Regulation," (NCLC for the Rockefeller Family Fund 1991); "Nature Abhors a Vacuum: High-rate Lending in Redlined, Minority Neighborhoods," 9 NCLC Reports *Consumer Credit & Usury Ed.* (May/June 1991).

contractors must have an outlet for their credit sales, as generally they cannot afford to carry the credit accounts themselves. Thus, they will either arrange for lenders to make direct loans, with the proceeds to pay off the sales; or will write financing contracts themselves, to be immediately assigned by prearrangement to a lender. In some instances, it may be the ultimate financier who drives the operation, in essence using the contractor as a "bird-dog" to drum up mortgage business for it.[17]

These ultimate lenders can be mortgage companies (which may or may not be regulated by the state); often they are finance companies (which are regulated by the state); or banks (which are regulated by either the state or a federal agency, depending upon their charter.) It is the cooperation of the ultimate financing sources which keep a contractor in business. Thus the lender is in a position to help assure that legitimate value be given for the money, or to help compound the problem by trying to disassociate themselves from any complaints the borrower may have about the contractor or his work.[18] Unfortunately, many ultimate lenders, despite their heavy involvement in facilitating the transaction, choose the latter course.[19]

**Mortgage companies**: As was noted above, the 1980s witnessed the growth of second mortgage lending companies -- many of which received notoriety: Landbank Equity; First American Mortgage Company; Freedlander. In many states, these companies were not (and still are not) regulated. The earlier discussion about the secondary mortgage market explains how these companies generally operated.

The 1990s, however, saw a decrease in the frequency of second mortgage loans as many lenders began to see the benefits of being the first lienholder. Those benefits include:

1) To assure repayment in the event of a foreclosure, mortgage lenders want to be in first position relative to other lienholders;
2) First lien mortgages are not subject to usury and points restriction under most states' laws due to the federal preemption created by the Depository Institutions Deregulation and Monetary Control Act of 1980. Many states, however, still regulate second mortgage loans to varying degrees.
3) To assure first lien status, predatory mortgage lenders convince homeowners to refinance their current mortgages (whether or not the current mortgage is a less

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17 This was the heart of the claim in *Baker v. Harper*, in which a mortgage company was ordered to pay $45 million to 5 families. See "Alabama Jury Orders Lender to Pay $45 Million in Fraudulent Lending Case," 57 BNA Banking Rept. 270 (Aug. 12, 1991).

18 *See, e.g.* "Spiking and Loan-Splitting in Home Improvement Contracts: Artful Dodges," 26 Clearinghouse Review 415 (Aug. 1992). Where the sale of home improvement goods and services is involved, the Federal Trade Commission's "holder rule" (16 C.F.R. § 433) provides that a related financier has vicarious liability for any claims or defenses the consumer has against the seller.

19 More and more frequently, the same principals direct both sides of the business. But they try to disguise the connection, so as to try to claim the borrower's obligation to pay is distinct from the contractor's obligation to perform its part of the contract.

expensive loan with better terms) and consolidate unsecured debt into a home-secured loan.[20] This mightily increases the principal amount of the loan. By doing so, the lenders earn more from charging points. For example, 5 points on a $15,000 home improvement loan yields only $750; whereas, the same number of points will yield $2,500 on a $50,000 refinancing and home improvement loan.

The rush to be the first lienholder leads to an increase in some of the age old abuses: loan padding; frequent refinancings; and the refinancing of more favorable loans into less favorable ones.

As with the "tin men," it is frequently regulated lenders -- banks and thrifts -- which provide the wherewithal for these companies to survive. Again, there are degrees of culpability among these "enablers." Some may actually know what kind of operation the mortgage lenders are running. Others simply choose to ignore the red flags in these transactions, and buy up the paper anyway.[21] The more "the legitimate" lenders opt to purchase these kinds of loans with an "ostrich" approach to their investment, the easier it is for the predatory lenders to flourish.

**Finance companies:**[22] Finance companies moved into home equity lending in a big way in the past 15 years. Some of the finance companies have been particularly bad at "loan-padding:" -- inserting costly add-ons onto loans, making them much more expensive for borrowers.[23] Finance companies are regulated (with varying degrees of success) by the states, but some are subsidiaries of banks, which, in turn, are regulated by either the states or a federal agency, depending upon their charter.

**The supporting cast:** Mortgage brokers have played a major role in steering borrowers into bad loans. As their fees are a percentage of the loans, there is a "reverse competition" effect which

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20 The median amount of outstanding mortgage loans rose about 30% over the six-year period from 1989 to 1995. Over the same period, the median value of a primary residence rose only 4.8%. The much larger rise in the size of mortgage debt suggests that debt consolidation through refinancing is now the primary reason for home equity borrowing. *See* "Family Finances in the U.S.: Recent Evidence from the Survey of Consumer Finances," Federal Reserve Bulletin, January 1997; "Trends in the Home-Equity Asset-Backed Market are Important to Banks," FDIC Regional Outlook, Third Quarter 1997.

21 Unlike the home improvement sales financing contracts, the FTC "holder" rule does not apply to straight loans, so these assignees can try to assert a holder-in-due course defense to claims the borrower may raise based on the originator's wrong-doing.

22 Finance companies, such as Beneficial, ITT Financial, and others, are what used to be thought of as "small loan" companies, though in many states today they can make relatively large, mortgage secured consumer loans. It has been our experience that finance companies tend to keep the home equity loans they make (refinancing them frequently), rather than using the secondary market.

23 "Insurance-packing" is one of the more common means of loan padding favored by finance companies. For a description of the practice, see National Consumer Law Center, Cost of Credit Chap. 8 (1995 and Supp.). For a good example of how it can distort the price of credit to a borrower, see *Besta v. Beneficial Loan Co. of Iowa*, 855 F.2d 532 (8th Cir. 1988). In that loan, insurance packing enabled the lender to skim an extra $3000 from what was really a $1400 loan. In one loan seen at the Center, the very same scheme was used to skim an extra $23,000 from a loan.

encourages them to hook borrowers up with expensive, loan-padding lenders. Brokers are paid in either (or both) of two ways: directly by the borrower in the form of cash or by financing the broker fee as part of the loan; and/or by the lender in the form of a yield spread premium which is repaid by the borrower over the term of the loan in the form of a higher interest rate. The lender payments to brokers not only drive up the cost of mortgage loans, but also create reverse competition. The result is that brokers are provided incentives to steer borrowers to the lenders that pay brokers the *most* rather than to the lenders which give borrowers the most favorable terms.

Many of these brokers advertise as if they are market-rate lenders and do not disclose their true role -- or their commissions -- until loan closing. By that time many borrowers have lost their leverage to object or walk away. Loan brokers are not regulated in many states, and some regulation which does exist is token only.

**Banks and thrifts**: As the above discussion indicates, even if banks and thrifts are not directly engaging in predatory business practices, it often is their ultimate financial support which enables the predatory lenders to operate on the scale we have seen in recent years.

*PREDATORY MORTGAGE LENDING ABUSES*

These abuses are carefully chronicled in the written testimony of William J. Brennan, Jr. and will be only briefly described here:

- **Home improvement scams,** which are home loans stemming from unsolicited sellers of home improvements in which the work is generally overpriced, and rarely performed adequately;
- **Mortgage broker kickbacks** which result in higher priced loans than the borrowers qualify for with their lenders;
- **Steering to high rate lenders;**
- **Lending to people who cannot afford to repay;**
- **Falsified loan applications** such that the loan originator pads the borrower's income to make the loan qualify, yet which leads to unaffordable payments for the borrower;
- **Incapacitated homeowners;**
- **High interest rates** which are far more than are justified by the alleged additional risks and costs of providing credit to homeowners with lower credit scores;
- **Balloon payments terms** for which the borrower has no way to meet without refinancing the loan at excessive costs or losing the home;
- **Negative or non-amortizing loans,** such that even after making loan payments for years the borrowers end up owing *more than* was originally borrowed;
- **Padded closing costs,** which can often be fees for settlement services two or three times as high as are charged middle income homeowners;
- **Credit insurance packing** with high priced pre-paid term credit insurance which add thousand of dollars in unnecessary costs to loans for borrowers who could obtain more reasonably priced credit insurance if paid on monthly basis;
- **High and unfair prepayment penalties;**
- **Mandatory arbitration clauses,** which frequently require only the borrower to

submit to it and not the lender and which can force a homeowner to pay large sums for their concerns to be addressed by arbitrators who have no incentive to follow consumer protection laws, and whose decisions are not reviewable by any court;

- **Repeated refinancings** which have the effect of bleeding the homeowners equity from the home by *increasing* the amount borrowed exponentially in each refinancing without providing any benefit to the borrower;
- **Spurious open end loans** whereby the lender is allowed to avoid making the more comprehensive disclosures required by closed end credit, and thereby avoid any chance of the homeowner asserting the right of rescission, as well as completely avoiding the restrictions under the Home Ownership and Equity Protection Act, regardless of the cost of the loan;
- **Paying off low interest mortgages** such as purchase money loans with FHA with much higher interest rate loans;
- **Refinancing unsecured debt** for which the borrower could not lose the home, with high interest rate debt which must be paid to avoid foreclosure;
- **125% loan to value loans** which effectively prohibit borrowers from selling their homes or filing bankruptcy to escape unaffordable debt, without losing their home;

***CONSEQUENCES OF HIGH COST MORTGAGES -- LOSS OF THOUSANDS OF HOMES***

It is significant that **foreclosures have increased by approximately 300% since 1980.** (Exhibit 3.) *These numbers do not include the thousands of homes which are turned over to lenders voluntarily (called deeds in lieu) or are sold for less then their value to avoid foreclosure.* The bottom line is that millions of Americans are losing their homes because of unaffordable home mortgages.

There are a number of reasons for this. Data shows that most foreclosures are caused not by homeowner mismanagement, but rather by unexpected life events which are beyond the homeowner's control such as loss of job, illness, death or divorce.

Census data establishes that more than 1/3 of households in the lowest 40% of income range will experience a loss of income of at least 33% for one month in a given year. Income disruptions obviously increase the likelihood of mortgage defaults especially since the same lower income households also have low savings rates and high debt to income ratios. As family debt increases as a percentage of income,[24] families are increasingly vulnerable to the exigencies of unforeseen income decreases or increases in expenses. Problems which would be manageable for a family whose housing costs constitute 20% of the monthly budget are unmanageable when those costs are 40% of the total household expenses.

Additionally, there has been a major expansion of home equity lending, thus creating an

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24 The Federal Reserve Board concludes that one in nine families face debt payments that are higher than 40% of annual income. The rate rises to one in six families among those earning less than $25,000 per year. "Family Finances in the U.S.: Recent Evidence from the Survey of Consumer Finances" at 21, Table 14, *Federal Reserve Bulletin*, January 1997. *See* Pearlstein, "Trendlines: The Fed's Knowledge of Wealth", *Washington Post*, p. E1 (1/23/97).

additional pressure on the homeowner's budget. The median amount outstanding on mortgage debt for a typical family rose 30% between 1989 and 1995. Yet the number of foreclosures executed on American homes increased by 300% in the same time period.

For these reasons, the federal government cannot rely on the marketplace -- or self-regulation by the mortgage finance industry -- to police lending secured by the home. While Americans enjoy a strong home lending industry, the appropriate degree of regulation should not hamper legitimate lenders, while it will serve to protect the most vulnerable homeowners from losing their homes.

## *RECOMMENDATIONS*

The problem of predatory home equity lending has a multitude of sources, and the solutions will have to come on many fronts. We have developed a catalogue of recommendations to address both the overall problem and individual pieces of the overall pattern.

### 1. Interest rate ceiling and limitations on other charges:

As a result of an anomalous mismatch between statutory usury ceilings and market rates in the late 1970s, the entire concept of rate caps became anathema to lenders and regulators. Consequently, we threw the baby out with the bath water.

In 1827, the Virginia Supreme court observed that "It has been a good deal the fashion of late, to decry the policy and justice of our laws regulating the rate of interest....It may be permitted to observe, however, that if the experience of the ages, and the general opinion of mankind, deserve weight in legislation, their voice is in favor of usury laws. They have prevailed in all civilized countries, and in all time."[25]

The experience of the "deregulation decade" simply proves the point. The heartbreak caused by the spiraling increase in abusive home loans and foreclosures proves that rate caps are needed to protect the trusting, the unsophisticated, the unwary, and the necessitous consumer from "the oppression of usurers and monied men, who are eager to take advantage of the distress of others"[26] now no less than 150 years ago. The 1970s problem of a mismatch between statutory cap and market rate is easily resolved by the imposition of a statutory ceiling which can float with a specified market-related index.

Furthermore, the usury ceiling should be combined with limitations on additional non-interest charges (points, brokers fees, closing costs, credit insurance, bogus escrows, etc), which will curb loan-padding. In the absence of a federal cap, the Depository Institutions Deregulation and

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25 *Whitworth & Yancy v. Adams*. 5 Rand 333, 335, 26 Va. 333 (Va. 1827).

26 *Id.*

Monetary Control Act of 1980 (DIDA) should be amended to permit states to reintroduce rate caps on home equity loans should they choose.[27]

**2. Regulate Loan Terms Based on Cost of Loan.**

In 1994, Congress passed the Home Ownership and Equity Protection Act (HOEPA) to prevent some predatory lending practices after reviewing compelling testimony and evidence presented during a number of hearings that occurred in 1993 and 1994.[28] The new law created a special class of regulated closed-end loans made at high rates or with excessive costs and fees. Rather than cap interest rates, points, or other costs for those loans, the protections essentially prohibit or limit certain abusive loan terms and require additional disclosures. HOEPA's provisions are triggered if a loan has an APR of 10 points over the Treasury bill for the same term as the loan, or points equal to more 8% of the amount borrowed.

It was hoped that HOEPA would reverse the trend of the past decade which had made predatory home equity lending a growth industry and contributed to the loss of equity and homes for so many Americans. However, experience over the last two and a half years has shown that while HOEPA has made a start at addressing the problems, there are still yawning chasms of unprotected borrowers subject to the abuses of high cost home equity lenders.

*The 2 most significant problems with HOEPA:*

1) HOEPA does not in any way *limit* what the lender can charge as up-front costs to the borrower. It is the excessive, combined fees -- in closing costs, credit insurance premiums, and points -- which deplete the equity in abusive loans. These excessive, combined fees are charged over and over, each time the loan is refinanced. And with each refinancing, the homeowner's equity is depleted by these charges because they are all financed in the loan. The effect of this situation is to *encourage* lenders to refinance high cost loans because they reap so much immediate reward at each closing. If the law limited the amount of points and closing costs that a lender could finance in high cost loans, this incentive to steal equity would be stopped cold.

2) The interest rate trigger for HOEPA is too high, causing many abusive lenders who want to avoid HOEPA strictures to make high cost loans just under the trigger. The effect is that

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27 It will be also necessary to assure that a state's law is not further subject to preemption by a sister state with less inclination toward consumer protection through the "exportation" doctrine as a result of recent interpretations of § 521 of DIDA. 12 U.S.C. § 1831d. *Cf. Greenwood Trust v. Commonwealth of Massachusetts*, 971 F.2d 818 (1st Cir. 1992).

28 *Problems in Community Development Banking, Mortgage Lending Discrimination, Reverse Redlining, and Home Equity Lending, Hearings Before the Senate Committee on Banking, Housing and Urban Affairs*, 103d Cong., 1st Sess. (Feb. 3, 17, 24, 1993); *Hearing on S. 924 Home Ownership and Equity Protection Act, before the Senate Banking Committee*, 103d Cong., 1st Sess. (May 19, 1993); *The Home Equity Protection Act of 1993, Hearings on H.R. 3153 Before the House Committee on Banking, Finance and Urban Affairs*, 103d Cong., 2d Sess. (March 22, 1994).

there are no protections whatsoever against these very high cost loans which are just under the HOEPA triggers.

But, otherwise, HOEPA has some good ideas. It is based on the economic rationale that the higher the charges for the loan, the more regulation is necessary and appropriate. By passing HOEPA, Congress has already recognized two essential truths: that there are some loans for which the marketplace does not effectively apply restrictions; and government must step in to provide balance to the bargaining position between borrowers who either lack the sophistication to avoid bad loans or do not believe they have a choice if they want the credit.

The HOEPA structure is essentially good: apply prohibitions and restrictions to higher cost loans, and leave lower, more reasonably priced loans free from regulation. We propose to leave this basic structure in place while filling in the gaps.

First, rather than have only one set of triggers which determine whether a loan is either regulated or not, home loans should be regulated on a more graduated basis. Very high cost loans should have prohibitions similar to (or more stringent than) those applied to current HOEPA loans. Loans which are high cost, but not as expensive as those covered by HOEPA should also be regulated, but to a lesser extent. Lower cost loans -- such as those which are commonly offered to prime borrowers as well as to subprime borrowers by non-abusive lenders -- would not be regulated whatsoever.

The federal law would thus recognize three categories of home lending: Category 1 loans would have unregulated terms because the price of these loans was less than the trigger for Category 2 loans. Category 2 loans would be those overpriced loans which are priced at rates higher than provided by non-abusive lenders; these loans would be regulated to a limited extent. Category 3 loans would be those loans which fall into a very high price range and which, like current HOEPA loans, would be closely regulated. The effect of this two-tiered approach to determine the level of regulation would be to ensure that even those expensive loans which fell just under the trigger for HOEPA loans would still have some degree of regulation.

The exact numerical triggers which would determine whether a loan fell into the high cost or into the lower priced but still expensive category should be carefully determined. The interest rate triggers would be floating -- a certain amount over the Treasury bill for an equivalent term as the loan -- just as HOEPA is now. There should also be triggers based on the percentage of the loan charged in up-front costs, based on points, and all closing costs.

Additionally, a key, and essential new regulation which would apply to both categories 2 and 3 loans would be a limitation on the financing of points and closing costs. Lenders providing category 3 loans -- the most expensive -- would be prohibited from financing any points or closing costs. Lenders providing the less expensive, but still overpriced loans -- category 2 -- would be limited in the amount of points and closing costs that could be financed.

**Points and Fees Trigger.** Finally, the points and fees trigger should include all points, fees, and insurance charges. Under current HOEPA law, there are confusing rules to determine which fees and insurance charges are included in the trigger for up-front costs. [29]

For example, this trigger does not include "reasonable" charges if they are not retained by the creditor and are not paid to a third party affiliated with the creditor. Fees for appraisals performed by unaffiliated third parties are not be counted if only the direct cost is passed on to the borrower. On the other hand, such a fee is counted if the cost is padded. Determining what is a "reasonable" for purposes of triggering coverage, however, is a difficult burden for consumers to meet. The closing costs trigger should include all points and all fees for closing costs.

**Credit Insurance.** Credit insurance is a big ticket item in each individual loan.[30] Nationally, consumers spend as much as $2.5 billion per year on credit insurance, often with little understanding of what they have bought.[31] This volume of business conceals overcharges of $900 million[32] to $1.2 billion,[33] where 40 to 50% of the premiums are paid to lenders as commissions. The marketplace has created reverse competition because credit insurance premiums are paid up front for term insurance policies which cover the whole or a significant portion of the loan term and lenders receive a commission based on the size of the credit insurance premium. Thus, lenders are rewarded for selling the *most expensive* forms of credit insurance, rather than the least costly to the consumer. Hence, unsophisticated consumers spend thousands of extra dollars for credit insurance which provides negligible value to them.

The remedy for the reverse competition established by the marketplace: only allow credit insurance to be sold when the premiums can be paid monthly, along with the loan payments, and the credit insurance can be canceled at any time.[34]

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29 15 U.S.C. § 1602(aa)(1)(B).

30 For individual borrowers, the costs of a credit insurance policy are huge in relation to the loan amount. For example, a Georgia homeowner paid $2,200 for a credit life insurance policy sold to her in connection with a home-secured loan with a principal of $40,606.26. The cost of this insurance added over 5% to cost of the loan. Nevertheless, this loan is not covered by HOEPA because the credit insurance premiums are allowed to be excluded from the closing cost trigger in HOEPA under current law.

31 *Credit Life Insurance Hearing Before the Subcommittee on Antitrust, Monopoly and Business Rights of the Senate Committee on the Judiciary*, 96th Cong., 1st Sess. 48 (1979) (statement of Robert Sable).

32 *Id.* at 3.

33 *Id.* at 7 (testimony of James Hunt). *Credit Life Insurance: The Nation's Worst Insurance Rip Off*, Statement of Consumer Federation of America and National Insurance Consumer Organization (June 4, 1990), updated (May 20, 1992 and July 25, 1995).

34 Allegations of coercion in the sale of what is suppose to be a "voluntary" product have been the subject of federal enforcement cases and private litigation. *In re USLIFE Credit Corp. & USLIFE Corp.*, 91 FTC 984 (1978), *modified on other grounds* 92 FTC 353 (1978), rev'd 599 F.2d 1387 (5th Cir. 1979); *Lemelledo v. Beneficial Management*, 674 A.2d 582 (N.J. Super. Ct. App. Div. 1996).

**3. Eliminate holder-in-due course status for assignees and purchasers of home equity loans.**

Purchasers of negotiable instruments, such as promissory notes, have enjoyed the benefits of the holder in due course rule since the 1800s.[35] The holder in due course doctrine protects assignees of a negotiable instruments from liability for the wrongdoing performed by the original lender or an assignee upstream, even though the borrower might be harmed.

Thus, regardless of any such wrongdoing, the consumer's obligation to pay the assignee downstream continues as long as the assignee purchased the loan without notice of the fraud or other misconduct. In the mortgage context, the homeowner is left to pay the mortgage despite having perfectly valid claims and defenses arising out of the transaction. Particular problems arise because some fly-by-night contractors or mortgage originators are insolvent, or they disappear (and reincorporate under a new name or file bankruptcy) at the first hint of litigation.

Since 1976, the Federal Trade Commission has limited the rule for the purchase of consumer goods or services.[36] The purpose of the Rule is to give consumers the right to assert claims and defenses against creditors in situations where a seller provides or arranges financing and then fails to perform its obligations. The Rule rightly shifts the risk of seller misconduct to creditors who could either absorb the costs of misconduct or return the costs to sellers.[37]

While the Rule created some protection for consumers in this context, it is limited in several ways. First, the consumer rights provided by the Rule depend upon seller compliance in placing a required notice in the loan document. Second, recovery by the consumer for seller wrongdoing is limited to the amount paid under the consumer credit contract. Third, there is no private right of action to enforce the Rule.

Recognizing the problems created for homeowners in the mortgage context, in 1994, Congress provided some protection for mortgage borrowers against the misconduct of the original lender by creating assignee liability if the loan is a high rate loan as defined in HOEPA.[38] However, the damages that a mortgage borrower can obtain against the assignee are limited to the sum of the total remaining indebtedness due on the loan plus the total paid by the consumer.

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35 Morton J. Horwitz, The Transformation of American Law, 1780-1860. at 213-215. A promissory note is an unconditional promise to pay a fixed amount of money, with or without interest, that is payable to order or to bearer, is payable upon demand or at a definite time, and does not state any other undertaking. U.C.C. § 3-104(a), (e) (1990). The actual note or loan document signed by a borrower secured by a mortgage is ordinarily considered a negotiable instrument and bought and sold on the secondary mortgage market. For a more in depth discussion of this doctrine, *see* Julia Patterson Forrester, *Constructing a New Theoretical Framework for Home Improvement Financing*, 75 Or. L. Rev. 1095, 1103-09 (1996).

36 16 C.F.R. § 433.

37 Forrester, *supra* note 35, at 1108.

38 15 U.S.C. § 1641(d).

If the holder in due course doctrine were eliminated for assignees and purchasers of home equity loans (and they were potentially liable for *all* of the claims and defenses which the borrower had against the originator), the industry will be forced to do engage in self-policing. If holders will clearly be liable for the claims the borrowers have against the originators, they will more carefully screen those with whom they do business. That, in turn, should help dry up the financial lifeline that has enabled the predatory mortgage companies to operate.

Some would argue that applying the limitation on the holder rule would reduce the amount of credit available to everyone, because creditors would be afraid to buy loans when they could be held liable for mistakes that were made by their predecessor in the credit chain. This is very unlikely. The protection provided by limiting the holder rule has applied to the automobile financing system for two decades. And, as one can see by perusing the classified section on "Cars for sale," the auto financing market is thriving. Applying the limitation of the holder rule to all assignees of a home loan would certainly not dry up the legitimate home equity lending market.

**4. Federal Law Should Prohibit Unfair and Deceptive or Unconscionable Acts and Practices in the Making of a Home Loan.**

Congress should flatly and unequivocally state that unfair, deceptive and unconscionable practices in the making of a home loan should be illegal. Although many states have laws prohibiting unfair acts and practices, too often these laws do not apply to loans secured by real estate, loans made by some types of lenders, or loans over a certain size.[39] Creating a laundry list of specific activities which are illegal or restricted would simply invite resolute lenders to transform their practices in ways to avoid falling into the definitions of specific prohibited acts. Instead there should be a broad prohibition.

The following are just a few examples of unfair and deceptive practices for which we have documentation:

- Some high rate lenders require homeowners to sign two loans, one which refinances debt, and the other, a smaller second mortgage, to finance the lender costs from the first loan. The APR on the first lien loan may be under the HOEPA APR trigger. But the APR on the second lien loan is a whopping 24%.

- Some lenders solicit borrowers with the promise that the borrowers can consolidate all of their debt into one payment which will cost less and save money over the term of the new mortgage. At settlement, when the borrower realizes that this claim is false, the lender or settlement agent for the lender promises that the loan will be refinanced on better terms in 6 months to a year. Further, borrowers are told, this is standard practice. Borrowers are induced to enter into the loan by these verbal statements. Many borrowers are not in a position at that point to refuse the bad deal

39 For a compilation and description of the state UDAP statutes, *see* The National Consumer Law Center, Unfair and Deceptive Acts and Practices App. A (4th ed. 1997).

because they have paid appraisal, application or other fees or are in danger of losing their homes. Of course, the bad loan is never refinanced or, if it is, the same lender re-charges points and fees, thus gouging the borrower yet again.

- Some lenders will get homeowners to sign loan applications which inflate their incomes or add other information to the application unbeknownst to the homeowners in order to satisfy underwriting requirements. Frequently, the homeowners do not see these applications in their final form until settlement when they are asked to sign numerous documents in a rush. Or homeowners are asked to sign loan applications that are not completely filled in. The lender later adds additional information. This causes borrowers problems for two reasons: first, credit is extended when the borrower does not have the true ability to repay which leads to foreclosure; and second, the holder throws the "fraud" on the application back at the borrower later to defeat any complains that the borrower has against the loan.

**5. Protections from Foreclosure.**

Given the alarming increase in foreclosures over the past two decades, federal law must provide some additional protections to borrowers losing their homes to foreclosure. There are however, several things that the federal law can do to help save homes, which would not unduly interfere with the private mortgage market:

- **Increased support for housing counselors and mandatory notice regarding their availability**. Good housing counselors can facilitate loan workouts that preserve home ownership, prevent foreclosure, and reduce costs for lenders. Fannie Mae, Freddie Mac, and the FHA have implemented loss mitigation tools to avoid foreclosure and housing counselors are an essential part of that process. All mortgage lenders should be required to provide some support for housing counselors and notice of the availability of housing counselors should be required before any foreclosure can proceed.

- **Lenders should provide homeowners with the opportunity to pay off the arrearage and avoid foreclosure.** Although this seems obvious and in the best interest of both parties, this is not always done. Lenders should be required to give notice to defaulting homeowners of the amount past due and the amount needed to avoid foreclosure prior to the addition of fees. The notice should list the various workout options available. These options have been accepted by Fannie Mae, Freddie Mac, and the FHA as appropriate loss management tools in the industry. Lenders should also be required to attempt to avoid foreclosure through various loan workout mechanisms. Further, a lender should not be permitted to unreasonably reject a workout proposal.

In sum, at the least, three substantive requirements would apply to all foreclosures of all mortgages:

a. Increased support for non-profit, independent housing counselors who can help homeowners navigate the loss mitigation rules that are now required of FHA, Fannie Mae and Freddie Mac lenders.

b. A federal notice must be provided to the homeowner *before any foreclosure can proceed*, notifying the homeowner of the following:

    (1) That housing counselors are available, how to reach them, and that the counselor may be able to help avoid a foreclosure by facilitating a workout;

    (2) The actual amount in default, along with the sum of all interest and fees due, which must be paid to avoid a foreclosure;

    (3) A list of possible workout options which might be considered.

c. Lenders should be prohibited from proceeding with a foreclosure if a reasonable workout option has been rejected.

**Conclusion.**

As is evident from the testimony presented at the hearing and these comments, the ills that plague older Americans due to predatory mortgage lending have not abated since Congress last addressed them in 1994. Given the stream of financing available due to the strength of the secondary mortgage market, the rise of securitization, and the profits to be made, the industry has no incentive (or desire) to police itself. For these reasons, Congress must once again step in to help those vulnerable homeowners who have few or no choices in the lending marketplace.

**TABLE 4**

**Homeowners and Homeownership Rates in the US by Selected Characteristics: National Consumer Law Center, 1997**

**A Snapshot of Homeownership in the U.S.: Low-Income Homeowners by Age**

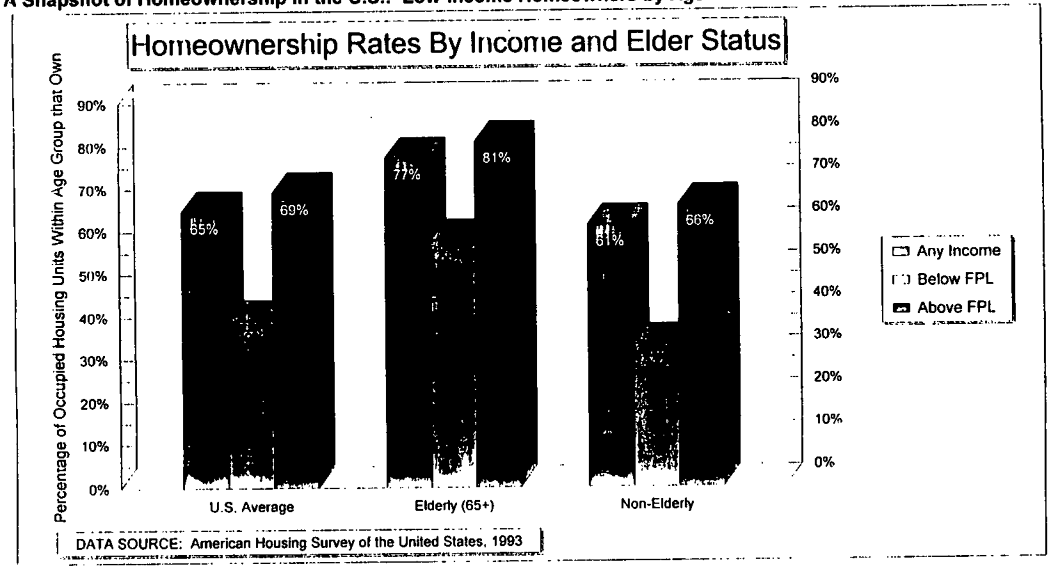




EXHIBIT 1

**TABLE 1**

**Homeownership Rates in the US and for Selected Metropolitan Areas: National Consumer Law Center, 1997**

**Low-Income Homeownership Rates Today**

On average in the U.S. , 39% of households with incomes below the poverty level own their own home. In the chart below, notice that homeownership rates for very low-income households are higher in cities with high homeownership rates in general.

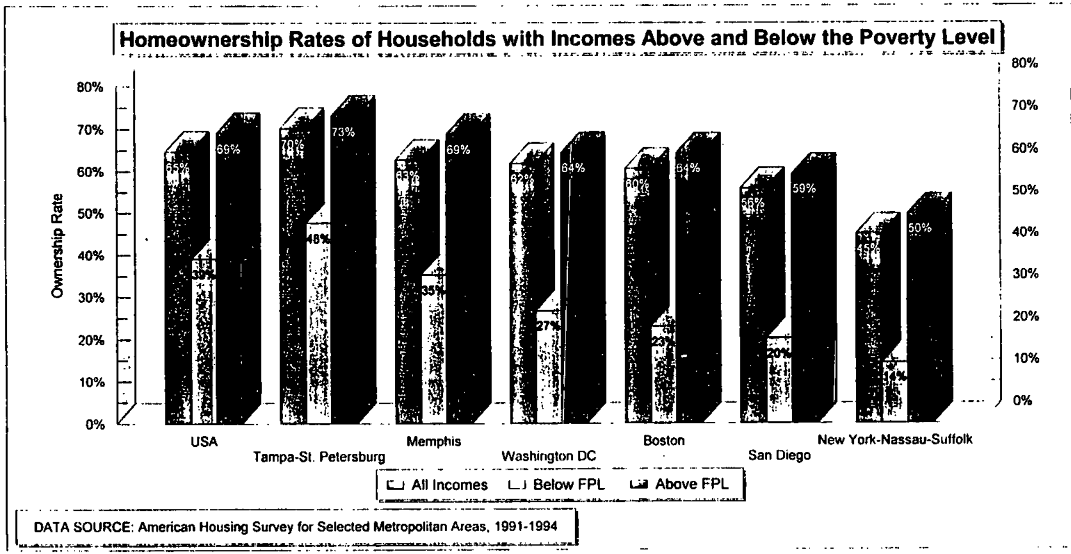


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EXHIBIT2

**TABLE 9**

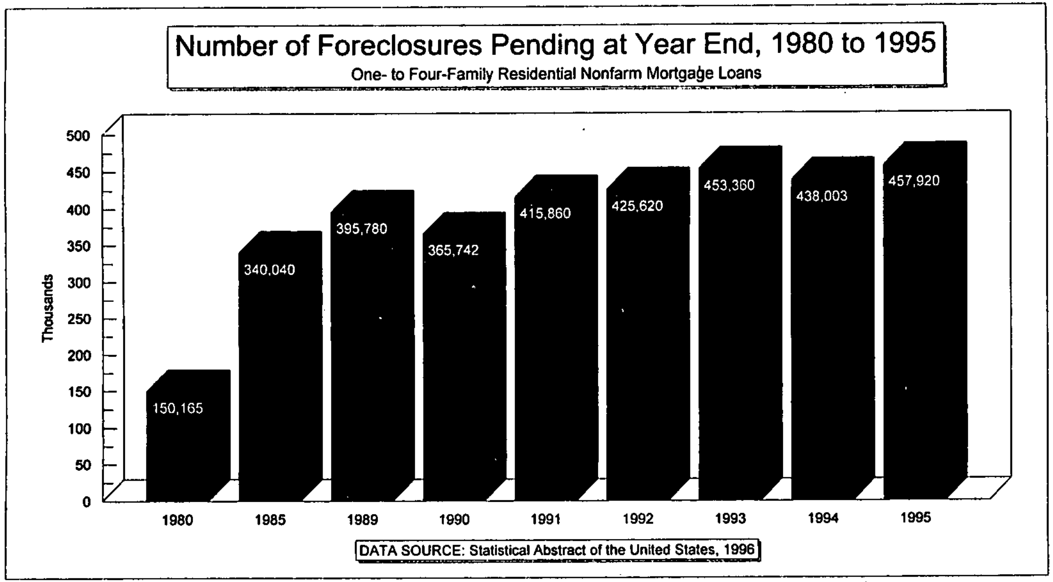




EXHIBIT 3

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NHEMA

March 16, 1998

Hon. Charles E. Grassley
Chairman
Senate Special Committee on Aging
Room SD-G31
U.S. Senate
Washington, DC 20510

Dear Chairman Grassley:

I am writing to you with regard to your hearing today concerning the predatory mortgage lending practices that some unscrupulous lenders and brokers are using to abuse senior citizens and other vulnerable consumers. I ask that this letter be made a part of the hearing record.

First, let me say that the National Home Equity Mortgage Association ("NHEMA"), which is the leading trade association for home equity lenders, finds the abusive practices----such as charging exorbitant loan fees, excessive loan flipping and stripping home equity from unwitting consumers----to be abhorrent. Many of these practices are patently illegal under existing federal and state consumer protection laws. We support your efforts to alert seniors to the dangers of dealing with such rogue lenders and to ensure that these laws are enforced more effectively. And, as explained further below, NHEMA has already called for new laws, regulations and penalties to further address such abusive practices and to help fill certain gaps that may exist under current law.

Although we condemn abusive and predatory lending practices, and are working actively to help curtail such abuses, we also must note our firm belief that these problems are being caused by only a small minority of lenders and mortgage originators. Just as there are a few bad priests and politicians, there are a few bad people in our industry[1]. But, as in other professions, the vast majority of home equity lenders and mortgage originators are honest and following ethical practices.

[1] NHEMA is aware that some critics have charged that hundreds of thousands of homeowners have been victimized at a cost of billions of dollars by unethical lenders and mortgage brokers, and that such parties contend that abusive practices are widespread and pervasive. We are not, however, aware of any independent objective, unbiased studies that confirm the alleged scope of the abuses referenced in such allegations and anecdotes. Based on their own experience and knowledge, industry experts are convinced that such claims of abuse are far overstated. Nonetheless, we do know that there is a small minority of unethical lenders and mortgage brokers, and we are working to stop their abusive practices as explained further herein.

This industry----which is often referred to "subprime lending" and "B and C" lending----evolved to fill the needs of borrowers who were turned down or left behind by more traditional lenders. Often, these unserved or under-served consumers were not able to obtain a conventional mortgage because their credit rating was somewhat lower than so-called "A" borrowers who qualify easily for lenders to sell off their mortgage loans into the secondary markets through Fannie Mae and Freddie Mac. Home equity lenders are often meeting the credit needs of families who are seeking to recover from unexpected life events like a divorce, a company layoff or high medical expenses. Or, the loan may be to provide needed credit for a child's education, or to add a room on the house of a growing family, or to pay off higher cost credit card debt. Although these consumers may pose higher credit risks, they are still good customers, and they clearly have credit needs that NHEMA's members and other home equity lenders help meet.

Also, I want to point out that home equity lending is not itself predatory. The vast majority of lenders in this business provide good mortgage products at fair prices. And, as the industry has become increasingly competitive, even many "traditional" bankers now are entering this market to serve these higher risk borrowers. Increased competition is lowering rates and costs and giving consumers far more product choice.

Today, the home equity industry is very diverse and is comprised of an estimated 35,500 lenders, with the largest having no more than about 3% of the market. The industry is served by around 5,000 banks, 2,000 thrifts, 23,000 mortgage brokers, 500 finance companies and 5,000 credit unions. Home equity loan originators have jumped from $179 billion in 1992 to $268 billion in 1997, when over 4 million such loans were made. Most equity loan rates range in the 8.5% to 14% range, depending on the risk and other underwriting factors involved in a particular case.

Given the size and breadth of our industry, it is not surprising that there are some unethical lenders. Many believe that most of the abuses come from the sales practices of mortgage brokers, or in some cases by company loan officers, who engage in predatory practices for their personal economic gain.

NHEMA member companies have been actively participating in the ongoing process to reform the current home mortgage lending laws. We have been working for much of the past year with other members of the so-called "Mortgage Reform Working Group" that is attempting to develop as much consensus on mortgage reform as possible among many diverse industry trade organizations and consumer groups. We are also seeking to work cooperatively with government regulators from the Federal Reserve Board, HUD and the FTC on these issues.

NHEMA has also proposed a detailed legislative proposal, based on extensive work from its RESPA/TILA Reform Task Force. NHEMA has recommended replacing many of the existing laws with new requirements that we believe would give consumers more meaningful disclosures and would also significantly control abusive lending practices that are being perpetrated on seniors and other borrowers by some unscrupulous lenders and mortgage brokers. (An article from NHEMA's <u>Equity</u> magazine describing our proposed reforms is attached for your information.) NHEMA has also been working on a new industry Code of Home Equity Lending Ethics, which we hope to promulgate soon.

Among other things, NHEMA has called for the following types of reforms to help protect against abusive lending practices:

- ✔ Increased consumer counseling and educational campaigns to help seniors and other borrowers better understand home equity lending issues and to warn them that some unethical lenders and brokers may be targeting them with predatory practices.
- ✔ Controlling loan flipping by limiting fees to brokers and loan officers when loans are refinanced within a 12 month period and/or by limiting the amount of costs that can be financed when a loan is refinanced within such a period.
- ✔ Requiring mandatory disclosure of whether or not mortgage brokers are representing borrowers and how brokers are compensated.
- ✔ Establishing federal minimum standards for licensing all mortgage originators.
- ✔ Creating a national clearinghouse to help ensure that regulators in all states can be aware of mortgage originators who have been found guilty of engaging in improper practices in another state.
- ✔ Bundling settlement services into a guaranteed cost package to help increase price competition and lower settlement service costs.
- ✔ Enactment of the "Homeowners Equity Recovery Act" ("HERA"), to delay transferring title in foreclosure actions to allow homeowners who are in default to have several months to try to sell their home, pay their outstanding indebtedness and retain any remaining equity.
- ✔ Tougher penalties for violations and enhanced enforcement.

**Senator Grassley, in closing, I would summarize my comments by saying that while we agree that there are some unethical mortgage originators, and we join with you in condemning their predatory practices, we also believe that it is critical to note that most home equity mortgage lenders are reputable and do not intentionally engage in improper practices against seniors or other borrowers. Instead, the vast majority of home equity lenders are providing much needed credit at a reasonable, fair price to the consumers they serve, and they should not be unfairly branded as being guilty of practices in which they do not engage, and which they, like you and NHEMA, abhor.**

Sincerely,

Jeffrey Zeltzer
Executive Director, NHEMA

cc: Senate Aging Committee Members

# WRIGHT ANGLES
## A WASHINGTON PERSPECTIVE

# NHEMA's Efforts on RESPA/TILA Reform

*By Wright H. Andrews, Jr., Esq*
*Partner, Butera & Andrews*
*NHEMA's Washington Counsel*

*NHEMA has emerged as the leading voice for the home equity lending industry's interests in the ongoing Washington efforts to dramatically change the provisions of the federal Real Estate Settlement Procedures Act (RESPA) and the Trust-In-Lending Act (TILA). This article provides an overview of these Washington developments and highlights the recommendations developed by NHEMA's Task Force on RESPA/TILA Reform.*

**Mortgage Reform Working Group** — After countless lawsuits and years of complaints by virtually all parties concerned with the home buying/home mortgage process that RESPA/TILA provisions are fundamentally flawed, earlier this year Congressional leaders urged industry and consumer groups to work together to try to achieve consensus on how these laws should be changed. This led to representatives from NHEMA and from over twenty other industry and consumer organizations meeting regularly during the past eight months in an informal body called the Mortgage Reform Working Group (MRWG). MRWG participants have educated one another on the different aspects of the consumer home buying and lending process and their various organizations' views and concerns with current RESPA/TILA provisions. NHEMA and several of the other participants have come forward with specific reform proposals for the full MRWG to consider as it seeks to develop consensus recommendations.

**MRWG Participants** — Other industry participants in the MRWG effort, for example, include the: Mortgage Bankers Association, Consumer Bankers Association, American Bankers Association, National Association of Realtors, National Association of Mortgage Brokers, Consumer Mortgage Coalition, HELLO, RESPRO, Credit Union National Association, National Association of Federal Credit Unions, American Financial Services Association, American Land Title Association, Appraisal Institute, America's Community Bankers, National Association of Bar-Related Title Insurers and American Bar Association. Participating consumer organizations include: Consumers Union, Consumer Federation of America, AARP and the National Consumer Law Center.

**Scope of Reform** — Preliminary consensus has been reached on several important points. In particular, the group appears to agree that the RESPA/TILA statutes are so defective that limited piecemeal legislative fixes would be inadequate. Therefore, MRWG is seeking to craft proposals that would entirely replace current provisions with a new comprehensive federal home mortgage law.

**Reform Principles** — MRWG members have tentatively agreed that the following general principles should apply to any reform proposals:

**Timely and Adequate Information for Informed Decision Making** — Consumers should have timely and adequate information as needed to make informed decisions about the home buying and financing process.

**Simple, Clear and Effective** — Consumer protection laws should be as simple, clear and effective as possible so that all parties can understand their rights and obligations.

**Substantive Legal Protections Where Needed** — Consumers should have effective substantive protections, where needed, against fraud, deception and unfair practices.

**Tailored Laws and Remedies** — Consumer protection laws and remedies should be tailored to the goals they are intended to achieve.

**Equal Application** — Consumer protection laws should apply equally to all parties performing a similar role in the transaction.

**Promote Competition** — Consumer protection laws should seek to promote, rather than restrict, competition among market participants.

**Perceived Problems** — General agreement also seems to exist on the nature of the major perceived problems associated with the existing laws and industry practices. However, various parties naturally differ on the magnitude of some of these problems, as well as how they should be addressed. In essence, the perceived problems include:

**Disclosures** — Current disclosures are often untimely, incomplete, unclear, confusing, misleading, too complex, burdensome, etc. Consumers generally do not or can not easily shop loan rates and closing costs. This lack of shopping frequently is caused by the lack of simple, meaningful disclosures and of a good comparative shopping tool (e.g., an early disclosure of the guaranteed loan rate and closing costs). Consumers also are often surprised and angered by unexpected costs at closings.

**Loan Origination & Pricing** — Some lenders and brokers engage in frequent loan flipping or churning whereby consumers' loans are refinanced repeatedly and the borrowers are charged repeated fees. Also, closing costs may involve excessive charges for certain settlement services (e.g., appraisal charges) and include "junk" fees. In addition, senior citizens and other vulnerable groups sometimes are targeted by certain predatory loan originators and given inappropriate loans that may lead to them losing their homes in foreclosure proceedings.

**Broker's Role & Compensation** — Consumers are frequently confused or misled regarding the role played by mortgage brokers. They mistakenly believe that the broker is representing their interest, and

(continued on page 14)

## RESPA/TILA Reform

(continued from page 13)

they do not know the amount and sources of all broker compensation.

**Referral Fees** — RESPA's restrictions on referral fees cause businesses serious legal uncertainties and may unduly limit the payment for referrals between certain parties.

**Section 32 High-Cost Mortgages** — The current provisions of Section 32 of RESPA need refinement.

**Consumer's Rights & Remedies** — The present rescission right is often used to unfairly penalize lenders who make minor, unintended technical mistakes. However, consumers have few other mechanisms for correcting errors and resolving disputes with lenders. Also, consumers may not be given adequate counseling, workout or forbearance options to avoid foreclosures. On the other hand, lenders feel that consumers file numerous costly lawsuits based on technical, unintended lender errors.

**Conflicting Laws** — Conflicts exist between certain RESPA and TILA requirements, and more significantly, due to many different state laws.

**NHEMA's Reform Proposals** — In order to ensure that NHEMA could fairly and effectively reflect its membership's view on these reform issues and be a constructive participant in this process, Laura Borrelli, NHEMA's President, formed a NHEMA Task Force on RESPA/TILA Reform. Member companies were invited to participate, and the Task Force held lengthy meetings in Philadelphia, New York and Washington to review perceived problems and possible legislative changes. After these initial meetings, the Task Force and its drafting subcommittee held three full days of meetings in Dallas on November 7 to 9. The Dallas meetings led to a specific set of proposals that have been further refined and endorsed by NHEMA's Executive Committee.

Key concepts in these proposals, which now are being considered by MRWG participants, along with the recommendations that have been made by other trade and consumer groups, can be summarized as follows.

### NHEMA's Proposals for Comprehensive RESPA/TILA Reform[1]

**I. SCOPE OF REFORM**

A. Broad, comprehensive RESPA/TILA reform should be pursued instead of seeking only limited, piecemeal legislative "fixes"

B. RESPA/TILA should be <u>replaced</u> by a new federal mortgage lending law

**II. DISCLOSURES** *(same disclosures for closed-end and open-end credit)*

**A. Pre-Qualification "Shopping" Disclosure**

1. Given <u>after credit bureau report</u> (obtained after borrower's authorization) but <u>before formal application</u>

2. Given <u>by the originator</u> who would be the party who was contacted by the borrower and asked for the shopping disclosure quotes (i.e., by the lender if the consumer made direct contact <u>or</u> by the broker if the consumer went through a broker)

3. The originator would pay the cost of the initial credit report

4. **Disclosure of Guaranteed Settlement Costs & Good Faith Estimate of Rate and Discount Points**

a. <u>Guaranteed Settlement Costs</u>

(1) Lender-approved, bundled settlement costs

(a) Items not included (escrow; per diem interest; hazard insurance; taxes; credit life insurance)

(2) Disclosed as guaranteed maximum cost based on particular loan type and amount

(3) Individual services not itemized

(4) Guarantee <u>in writing</u> and valid for <u>minimum of 5 business days</u>

(a) after date of in-person or electronic delivery to borrower, or

(b) from date of telephone pre-qualification request, in which case lender must have mailed disclosure guarantee within two business days of request

(5) This guarantee could include a "no-cost" loan with a guarantee of zero closing costs and an explanatory notice adding that because the rate includes settlement expenses it naturally may be higher than that quoted on loans where expenses are paid separately.

b. <u>Good Faith Estimate (GFE) of Note Rate and Discount Points</u>

(1) GFE given <u>in writing</u> concurrently with settlement cost guarantee and based expressly on particular loan type and amount and requirement of subsequent confirmation of home's value by acceptable certified appraisal and of title report, consumer's credit and income, etc. ***(Non-conforming lenders generally cannot give a firm rate guarantee until they have property appraisal, credit/income verification, title report, etc. — this information proves in 50%-70%+ of cases to be materially different than what borrower initially told lender and this means lender cannot know what is proper rate to quote until after getting this key underwriting information; it would be very misleading to consumers to offer a so-called "guaranteed rate" which was conditioned on all the initial information checking out because industry knows that the majority of the time the data proves to be so materially different that the rate/discount points will change; thus, it is far better to use the GFE approach and also give guaranteed settlement costs.)***

(2) <u>Explanatory Notice</u> to disclose to borrower that many consumers do not qualify for loan first sought because subsequent appraisal value and additional data turns out to be significantly different than consumer thought, but that if this occurs, often other loan options with different note rates and discount points may be available; also, as noted above, the notice would include an explanation that if a "no cost" loan was involved the rate may be higher because it includes settlement expenses.

(3) Consumer incurs no cost at this stage.

5. Pre-Qualification Shopping Disclosure includes:

a. Note rate

b. Total monthly payment (principal + interest)

c. Term (number of payments)

d. Type of loan

(1) Balloon payment feature, if any

(2) HELOCs

(3) Whether rate or payment can change

e. Loan amount

f. Discloses whether closing costs are financed or paid outside of closing

g. Closing costs, if applicable, as bundled amount, not separately itemized

h. Lender discount points, if any

i. Broker compensation, if any

j. Prepayment penalty, if any

k. Assumability

l. Notice that third-party credit counseling referrals are available

6. **APR, Amount Financed, Finance Charge** disclosures are <u>eliminated</u>

7. Legislative clarification required that the data gathered to provide a Pre-Qualification Shopping Disclosure is not deemed to be an application and therefore does not trigger HMDA reporting requirements

8. See footnote below regarding possible alternative shopping approach[2]

**B. Pre-Closing Disclosure Guarantees**

1. Discloses all items in pre-qualification shopping disclosure, plus servicing transfer notice and appraisal availability

2. Borrower has completed application for loan either in person, by phone or electronically

3. Lender has received and confirmed all required qualification data (credit/income, appraisal, income verification, title report, etc.)

4. Lender (not broker) then acts on application and if approved gives written pre-closing guarantee of rate, costs, etc.

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1. Please direct any comments or questions to Jeffrey Zeltzer, NHEMA's Executive Director, at 202-347-1210, or Wright Andrews, NHEMA's Washington Counsel, at 202-347-6875.

2. Borrowers who nevertheless want a guaranteed rate for shopping purposes can obtain one, <u>provided they adopt a different shopping approach whereby the borrower first provides the essential information lenders need to offer a guarantee of the rate and discount points</u>.

A. The borrower would first obtain an appraisal from a certified appraiser, a title commitment, verification of income and debt, etc. and submit this information to the lender directly or indirectly through a broker.

5. Disclosure guarantees must be mailed a minimum of 5 days before closing
6. Lender may turn down borrower if not qualified for original loan applied for, but may make counteroffer(s) with same type guarantees, etc., depending on type/amount of loan offered, but guarantees/counteroffer(s) are firm and no longer conditioned on qualification and are valid for a minimum of 3 business days so borrower can shop
7. Borrower may cancel before closing and have copy of appraisal, etc., but lender may retain application fee and/or appraisal fee paid by borrower
8. Discloses all items in pre-qualification shopping disclosure, plus servicing transfer notice

C. Closing
1. Borrower receives Closing Statement (same as pre-closing guaranteed disclosure) reflecting how funds are disbursed on borrower's behalf at closing
2. Notice of Right to Cancel for 3 business days (does not apply to purchase money mortgage)
   a. Borrower must notify lender of cancellation by telephone in timely manner utilizing an 800 number provided by the lender, but no refund required of application fee or appraisal fee
   b. Borrower can have copy of appraisal and title
3. If no cancellation, funds disbursed on fourth business day after closing
4. If a material change has occurred in borrower's status that adversely affects qualification (e.g., consumer becomes unemployed or incurs significant new debts) the lender has the right to terminate the transaction and may retain appraisal and/or application fee or can restructure offer and make new disclosures
5. Borrower-requested changes may be made at closing (e.g., borrower asks for additional funds) with written acknowledgment of borrower with no duty on lender to redisclose unless borrower requests it
6. Lender-initiated changes require disclosure

## III. CONSUMER REMEDIES/RIGHTS

A. Borrower's Right to Cancel
1. Borrower's right to cancel would be valid for three business days after closing and would replace current right of rescission
   a. No waiver allowed
2. If borrower cancels, borrower can have copy of appraisal and title report, and lender may only retain fees for appraisal and/or application
3. Exclude purchase money transactions and refinances with no cash out

B. Borrower's Right of Error Correction *(e.g. for mathematical errors affecting payment amount, per diem interest calculation, computer programming errors)*
1. If error found in consumer's favor, no recovery by lender as to past, but lender has option to correct as to future
2. If error discovered and confirmed during right-to-cancel period, lender must correct within two business days
3. If error discovered after right-to-cancel period expires:
   a. Borrower gives lender written notice of error in sufficient detail to permit lender to investigate
      (1) Notice must be given within 90-day period after closing
      (2) Correction not mandatory on amounts less than $100
   b. Lender has 60 days to act
      (1) Lender may correct error, including if appropriate, refunding overages with interest, or
      (2) Deny the error with written explanation
   c. Prevailing party entitled to costs and reasonable attorney's fees if litigation occurs

C. Credit Counseling
1. Lender to offer borrower free referral to third-party consumer credit counseling

D. Mandatory Arbitration
1. Court supervised mandatory arbitration of disputes
2. Arbitration would be conducted in county where property is located pursuant to existing rules and procedures of American Arbitration Association
3. Arbitration would not apply to foreclosure except foreclosure could be stayed if consumer's only recourse was arbitration

E. Repeated Abusive Practices
1. Enforcement of existing laws on repeated abuses needs to be increased
2. Strict state licensing requirements should apply to all originators
3. States should toughen laws to regulate private lenders
4. National Clearinghouse should be established to list anyone whose lending/brokerage license has been permanently revoked in one state, and other states would have option to prohibit such parties from operating in such other states after hearing

F. Foreclosure/Loss Mitigation
1. Workouts, forbearance and other loss mitigation tools continue to be employed and emphasized in good faith efforts to try to prevent foreclosure.
2. Notice of Third-Party Consumer Credit Counseling Availability must be given no later than 30 days prior to any formal commencement of foreclosure except where there is a default in a senior lien
   a. Notice must include a list of general options for workout and other loss mitigation procedures that may be available to the consumer
   b. Notice should specify that not all options may be available to all borrowers due to various state and federal laws
   c. Notice should state that consumer must take immediate action
   d. Notice would include a list of sources or agencies for third-party credit counseling
3. Protect borrower's equity and dignity by enacting a new "Homeowner's Equity Recovery Act" (HERA), which would apply at commencement of foreclosure procedures and give the borrower a tool to require:
   a. Lender must obtain a new full appraisal from certified appraiser prior to the time a foreclosure sale is completed.
   b. Borrower would receive a copy of appraisal and have 20 days to accept or reject and provide their own appraisal from a certified appraiser from an approved list.
   c. If Lender does not accept Borrower's proposed appraisal, then the two appraisers select a third appraiser from the approved list to determine the value
   d. If Borrower's outstanding indebtedness (current balance and interest, junior liens, etc.) is not more than 80% of the current appraised value, borrower has right to have a non-affiliated, licensed real estate broker list the property for an amount not to exceed the appraisal and to get a postponement of the foreclosure for 60 days to complete a sale
   e. Borrower would receive any profits from the sale after paying off indebtedness and costs
   f. If property is not sold within the 60-day period, lender may proceed with foreclosure while the property remains on the market, or the lender may extend the postponement period for such time as the lender deems appropriate
   g. Borrower must cooperate or lose rights under HERA
   h. Borrower may voluntarily waive HERA rights
   i. HERA does not apply if consumer is in bankruptcy or if property is not borrower's primary residence and owner-occupied at time of proceeding
4. Additional Points:
   a. NHEMA opposes expanding mandatory judicial foreclosure because:

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*Footnote 2, continued from previous page*
1. The appraiser and the appraisal format would have to be acceptable to the lender, and the appraisal would have to have been done within a specified time period
2. The borrower (and/or their mortgage brokers if applicable) would submit this information to a lender(s)
   a. The lender(s) would review this information and the lender *(or the broker if the broker had binding authority from the lender)* would issue a guaranteed pre-closing disclosure
   b. Lender's guarantee would be subject to verification of all information to lender's satisfaction
   c. This alternative shopping approach would:
      (1) in most cases require the borrower to pay for an appraisal and title commitment and possibly other items at the outset of the process, but
      (2) most of these costs would be required at the later application stage anyway and this gives the consumer who wants to shop rates a viable, cost-effective way to do so, and
      (3) significantly cut down on the percentage of cases where the lender would have to tell the borrower that the appraisal and other data turned out so different than what the borrower had initially said that a different loan rate, etc. would be required (i.e., you would not have 50%-70% consumers who applied later being told the initial guarantee was meaningless because the information given initially was materially wrong).consumer who wants to shop rates a viable, cost-effective way to do so, and
      (3) significantly cut down on the percentage of cases where the lender would have to tell the borrower that the appraisal and other data turned out so different than what the borrower had initially said that a different loan rate, etc. would be required (i.e., you would not have 50%-70% consumers who applied later being told the initial guarantee was meaningless because the information given initially was materially wrong).

## RESPA/TILA Reform

(continued from page 15)

(1) Costly to consumer and lender
(2) Places collateral at risk
(3) Too time consuming
(4) New foreclosure rules suggested herein will be adequate

b. Federal tax code (REMIC provisions) places limitations on types of compromise that a lender can offer

c. Need to address the strict requirements of Fannie and Freddie for the secondary market that require expedited foreclosures

### IV. ABUSIVE PRACTICES

**A. Loan Flipping/Churning**

1. <u>In any loan rewritten within 12 months by an originator/lender, only bona fide third-party fees (e.g., appraisal, title, recording) may be charged</u>
   a. No broker's fees
   b. No lender discount points

**B. Junk/Excessive Fees**

1. Bundled closing costs approach will cause competitive market pressures to control fees

**C. Target Marketing to Seniors and Other Protected Groups**

1. Proposed limitations on refinancing fees and foreclosures and the bundled-fee approach will limit abuses
2. Special Alert Notice in HUD pamphlets and elsewhere to advise <u>all</u> consumers some borrowers are being targeted and subjected to abusive practices by certain unscrupulous loan originators and that they should seek counseling and legal advice if they believe they are being targeted and subjected to abusive practices

### V. MORTGAGE BROKER COMPENSATION

A. Current HUD proposal defective, but endorse concept of broker contract

B. Contract should require:

1. Disclosure of broker's role/relationship with borrower (represent vs. do no represent)
2. Disclose all sources of broker compensation in the transaction
3. Disclose the amount of such compensation
4. Provide no limitation on amount of such compensation
5. Include a summary listing of borrower's rights

### VI. SECTION 8 — REFERRAL FEES

A. Lender-paid compensation to broker will be disclosed in broker contract and in pre-closing and closing disclosures and will not be considered a referral fee

B. Use FHA rule that settlement service provider(s) can be paid only once for the same service in a transaction, no duplication allowed

C. Volume discounting would be allowed

### VII. SECTION 32 — HIGH-COST MORTGAGES

A. Home equity lines of credit (HELOC) would be included

B. Current Section 32 disclosure would be incorporated and given to all borrowers

1. "If you default, you may lose your home"

C. Apply simplified test to determine if high-cost mortgage

1. Note rate 10% over prime rate (e.g., WSJ rate), or bundled costs exceeding 8% of note amount
2. ARM loans — interest rate calculation would be based on fully indexed rate

D. Apply to owner-occupied, 1-4 family, primary residence

E. If high-cost loan, the following would be disallowed:

1. Balloon payments due in less than five years, negative amortization loans and/or interest-only loans
2. Prepayment penalties
3. ARM loans with first adjustment in less than 36 months
4. Eliminate additional three-day cooling-off period in light of new disclosure scheme

F. Cure Provisions

1. Federal Reserve given discretion to define tolerances and cure provisions for errors

### VIII. STATE LAW PRE-EMPTION

A. Adopt the MBA proposals that the following types of state laws should be pre-empted:

1. Laws requiring disclosures of interest rate, fees and costs
2. Laws governing rate lock-ins and loan commitments
3. Laws restricting when fees can be collected prior to closing and the conditions that require a refund
4. Laws governing the process for declining a loan application
5. Laws governing the practices of mortgage brokers
6. Laws restricting business between affiliates
7. Laws prohibiting or restricting the charging of certain fees (e.g., prepayment)
8. Laws requiring that the lender give the consumer a choice of service providers
9. Laws requiring the lender to provide certain documents to the consumer, such as the appraisal
10. Laws relating to the servicing of mortgages, including restrictions on private mortgage insurance, interest on escrow, and fee limitations

B. Conclusion — The application of a standard set of laws and regulations for all closed-end mortgage loan transactions should allow all consumers to have the same mortgage process no matter what state they are in, to what institution they apply, and whether or not they use a mortgage broker or deal directly with the lender. Uniformity should also increase compliance for mortgage lenders since a myriad of state policies and procedures would be eliminated. Uniformity should reduce the cost to the lender and consumer since there will be significantly fewer documents to maintain and no further need to track and implement changes for each state.

**Outlook** — At this point, considerable uncertainty exists over the extent to which the MRWG will be able to take the various proposals being put forth by NHEMA and other

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## RESPA/TILA Reform

(continued from page 54)

groups, which naturally contain significant differences, and craft them into a single, comprehensive reform proposal to submit to Congress. While it seems likely that a high level of consensus can be achieved on some issues, serious differences will probably remain in some areas. Where such differences exist, parties can be expected to advocate their differing positions, and Congress will have to set the ultimate policies. For example, consumer groups have recommended that loan "suitability" standards be adopted to prevent loans from being made to consumers in certain circumstances. NHEMA and other industry groups have strongly opposed enactment of such new suitability tests, and this issue is likely to be fought out in Congress. In any case, it is certain that the Congressional Banking Committees will begin seriously considering RESPA/TILA reform in 1998, probably as early as March. And, many of the concepts embodied in the NHEMA proposals — and in the proposals that have been made by consumer organizations and other groups — are likely to emerge during the ensuing legislative debate as provisions in specific bills and/or amendments.

NHEMA and the home equity lending industry have a vital interest in the outcome of this upcoming legislative battle. NHEMA believes that while mortgage lenders' interests must be protected, it also is critically important that any new statutes that emerge from this process provide more meaningful disclosures for consumers and adequately protect consumers from abusive practices by unethical loan originators. The association will be working hard through its government affairs and public relations programs to see that NHEMA's views and recommendations are given careful consideration by Congress and to ensure that our industry's interests are understood and protected. Every NHEMA member company will be impacted by the new home mortgage law that comes out of this legislative process, and every company's active support and participation in the association's legislative efforts is needed and welcomed. ■

*This brief summary of NHEMA's RESPA/TILA reform proposal is necessarily somewhat oversimplified and does not go into all aspects of these recommendations (e.g., changes in RESPA Section 8's referral fee provisions and Section 32's high-cost mortgage limitations). However, it should be adequate to give the reader a general idea of the types of concepts that are being suggested. Anyone wishing to obtain a copy of the entire NHEMA proposal should contact Jeffrey Zeltzer, NHEMA's Executive Director, at 202-347-1210, or Wright Andrews, NHEMA's Washington Counsel, at 202-347-6875.*



## What Price Forgery?

(continued from page 28)

encompasses the opinion of search and states the quality of the title being insured as well as the name of the insured.

**Conclusion.** Title insurance is a valid and important device for providing a universal system of title opinions upon which a stranger can rely. The existence of national insurers permits the standardization not only of policies but also of the application process. It can be fairly said that the growth of a universal title insuring community has been one of the ingredients in the dynamics of multi-state lending. We might gripe about premiums, we might question individual underwriting decisions, but from the investor's perspective, the title insurance policy is the glue cementing the collateral to the insured. ■

## Commission's Findings

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could file up to 11 times in the space of 6 years. Furthermore, the exemption levels would be increased to permit a debtor to walk out of a bankruptcy with a net worth of $140,000. The Department of Justice points out that this is greater than the net worth of 75% of the American public. As a yardstick, bear in mind that the average American household has a net worth of $36,600.

If we put the NBRC's proposals in place and looked over the horizon, we could see many, many more bankruptcies. (Imagine 2 million bankruptcy filings per year by the year 2001!) The filing of bankruptcy would be easier and the debtor unquestionably comes out with more net worth than is possible with just earning money and saving it (the "old fashioned way"). In the end, the debtors get more relief than ever before because creditors have more barriers, more risks and fewer rights in bankruptcy than ever before. This translates to higher bankruptcy losses for all creditors, which in turn means higher price tags and higher interest rates for America.

**What Can You Do?**

Writing to your Congressperson and lobbying is definitely in order for all creditors at this point. The NBCR's plan will have a large negative impact on nearly every creditor's bottom line.

Asserting creditor rights is another form of action. It is time to participate in the bankruptcy process before all forms of creditor access to any rights in bankruptcy are forfeited.

To assist interested parties, the author has assembled a free **"Guide for Writing to Your Congressperson." It is available by calling Robert Mitsch at (612) 292-9900.** ■

## HUD Trek VIII

(continued from page 22)

Corporation, that mortgage brokers must perform "certain" core services to receive a fee for taking an application. This advice has been adopted by all of the federal banking regulatory agencies. There is no excuse for HUD's failure to recognize its prior advice as an official proposal.

8. HUD Is Reviving Its Strategy of Computerized Loan Origination Services.

HUD wants to restart its Computerized Loan Origination (CLO) concept by providing software for brokers to display loan products from many different lenders on a computer screen. HUD believes that this service will allow consumers to shop for the best rates. This concept failed to catch on in most areas of the country when HUD proposed it in 1992, and the exception for payments to a CLO was withdrawn last year. Despite HUD's good intentions,

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SBA Senior Benefit Association
Services and Savings for Senior Members

**EQUITY PREDATORS**

Senior Benefit Association is dedicated to fighting fraud against the elderly. When our Association began in 1993, it was our goal to prevent telemarketing fraud by providing specific answers via a telemarketing fraud hotline as members received the calls. In response to the growing needs of our members, we have evolved to fight additional kinds of fraud including, but not limited to, equity fraud.

The following scenario is a compilation of situations to demonstrate how thousands of the elderly, already victimized by telemarketing fraud, become vulnerable to equity predators.

It all begins with a single telephone call. Martha (not her real name) is a winner in a sweepstakes but has to buy a product for $798 to collect the prize. When she tells the nice man she doesn't have the extra cash, he suggests she get a cash advance on her credit card and send a personal check. She is so excited that she has won something, she does exactly what the nice man told her to do. She calls a bonded courier to pick up a check for $798 and she waits . . .

The prize comes, and now she is a "player". Martha gets another phone call. She is a winner again. This time, she has to pay the processing, shipping and handling fees on the prize before they can release it. Since she was disappointed from the first prize, she asks a question, "What did I win?" "Martha, $2,500 is a drop in the bucket compared to what you will be receiving" the nice man says. She hesitates but borrows against her credit card, and sends him a cashiers check for $2,500. And, she waits . . .

The prize comes, and now she is a "reload." Martha gets another phone call. This nice man knows that she has entered sweepstakes and has been promised large winnings, but has never gotten anything really big. His company wants to correct that situation and he informs Martha that she has been selected out of millions of entrants to receive a cash award in the amount of $75,000 that will make up for all the other times she lost out. However, Martha has to send a cashiers check in the amount of $7,500 to pay the taxes to IRS. She tells the nice man she doesn't have that kind of money but he suggests that she liquidate some stock or cash in some CD's because after all, she was getting so much more in return. Martha asks a question, "How do I know I can trust you?" The nice man tells her, "Martha, I am a Christian!" Martha follows his directions, cashes in her CD early and suffers a penalty. She sends a cashiers check made out to the IRS <u>agent</u> and waits . . .

The cash award never comes, and now she is "hooked". Martha gets another phone call. The nice man is a bonding agent and the government has closed down many of these bad telemarketers and put them in jail. The court has recovered $50,000 from them for Martha. All she has to do is pay a 10% bonding fee and the money will be released to her. He tells her that this is official government business and is confidential. She is not to discuss this with anyone. She is so relieved that she is getting her money back, she arranges to borrow the money against some stock which she uses as collateral and rushes out to wire the $5,000 bonding fee to the CPA and she waits . . .

While Martha waits, she gets another phone call from the bonding agent. He made a mistake. The court has awarded punitive damages to Martha and she is going to get $100,000. The 10% fee of $10,000 is due up front. The nice man reminds her that this is still confidential and tells Martha to do whatever she has to in order to get the money and wire it to the CPA before the deadline. Faced with the problem of no ready cash, Martha is forced to borrow from her annuity. Martha is thrilled with this news and again, she wires the $10,000 to the CPA and she waits . . .

The recovery money never comes. Now Martha is "broke". She has maxed out her credit cards, cashed in her CD, borrowed against her stocks and her annuity all of which has raised her monthly expenses and at the same time substantially reduced her income. In fact, Martha is forced to live on her social security. She can't pay her credit card bills and she can't afford to buy her medications, pay her insurance and, of course, there is precious little left to buy her groceries.

- Martha sees an advertisement on television about an equity loan against her home. She calls the 800 number and they send a nice man/woman who takes her application for a 15 year equity mortgage to consolidate her bills and reduce her monthly payments. One slight problem, Martha's income has been reduced to the point that her debt to income ratio won't qualify for the loan. Desperate, Martha remembers that sometime back, she loaned $13,000 to her son, who was supposed to pay it back at the rate of $300 a month. The problem appears to be solved. With her social security and the income from the "Promissory Note", Martha could qualify. Although her monthly bills are reduced, Martha has nothing left for any emergency requiring a substantial outlay of cash.
- 
- Suppose the air conditioning unit breaks down in the middle of summer and the repair man says she needs a new unit at a cost of $3,500. The money from her equity loan is gone and she doesn't have access to any more. She can't borrow the money from her children because she will have to tell them why she doesn't have any money left. *She will keep entering sweepstakes because they can't all be bad and she can't afford to take a chance that she will miss out on the real one.*
- 
- Down the road, Martha finds out that she can't make the payments on her equity loan and falls seriously behind. The lender refinances the 15 year equity mortgage, increasing the term to thirty years and raising the monthly payment from $489 to $532, paying off new debts from sweepstakes and other mounting bills she could not pay.
- 
- Martha falls behind again. Her son stopped paying the $300 note because she would just lose it anyway in a sweepstakes. (He knows she has gotten involved in a few sweepstakes but he doesn't know to what degree, nor does he know about the equity loan.) The lender sends her notices telling her that if she doesn't catch up her payments, they will foreclose on her home. While Martha struggles to borrow from a sibling (not her son) she is able to make a payment or two. Finally Martha's house of cards comes tumbling down. She can't make any more payments.

- 
- The equity lender posts a sign on her front gate for all the neighbors to see that her house will go up for public auction. Martha scrambles for a place to live and a way to tell her son she has lost everything --- especially her dignity.

The equity lender claims they were justified in granting the loan because of the equity she had available from the property. They were assured of getting repayment on the loan. They also claim that they could use the income from the "Promissory Note" to 'gross up' her income to qualify even though the note would run out in less than five years and was an unenforceable verbal contract between a mother and her son. It has since been documented that the "Promissory Note" was not a contract between the mother and son and that the signature appearing on the document is not that of the son.

Martha had another option. She could have qualified for a reverse mortgage, which would also have cleared her debts, and she would have had **no monthly mortgage payments**. In addition, she **could not** have lost her home, as a reverse mortgage would allow her to borrow from herself.

However, the equity lender did not tell Martha about the reverse mortgage option.

Did the equity lender have an ethical or moral obligation to make this option known to Martha? Does an equity lender, in the position of giving financial advice to its clients, bear any fiduciary responsibility? In this case, the equity lender got all the payments Martha made and the house long before the five years was up because her son quit making his payments to his mother.

Consider that Martha, a widow, 78 years of age, her social security income under $800 per month and the $300 income from repayment of a loan from her son, an unenforceable note at best, would run out in less than five years. In five years Martha would be 83 years of age less the income from the note and not much more than $800 a month from her social security. How was she to continue paying the mortgage payment?

**Is this equity fraud? Senior Benefit Association believes it is! Is this an isolated case? Senior Benefit Association doesn't believe so.**

Martha represents thousands upon thousands of seniors in similar situations. Equity lenders advertise heavily on television. It would appear that the marketing direction is to an audience that includes the senior citizen. They use well known personalities (the type who represent the image of an era gone by --- clean cut sports figures of a pre-drug society and who appeal to the senior population) to attract consumers to their services.

What fiduciary responsibilities do equity lenders have? What responsibilities should they have? Does a lender become a financial counselor when advertising debt consolidation through an equity loan?

Senior Benefit Association would propose that new legislation be considered that requires anyone over the age of 62 receive specific counseling regarding real estate loans of any type before the loan is closed. This counseling process by a not-for-profit organization would be an appropriate vehicle for seniors to have all options, for example reverse mortgage where available, presented to them in a fair and unbiased manner. An offer of proof of this counseling should become a permanent part of the loan record. Lenders who fail to refer qualified borrowers for counseling should suffer appropriate penalties.

Senior Benefit Association recognizes that this kind of legislation does not resolve the problem(s) that make equity loans necessary, nor is it intended to do so. It is our firm belief that this is only a symptom of an underlying problem of telemarketing fraud.

P.S. Martha was formally evicted from her home as of mid December 1997 and given three days before the sheriff would have no choice but to enforce the eviction and lock her out of her home. All this, less than two weeks before Christmas. On December 30th, Opal Henson (her real name) was admitted to the Hospital. I can personally attest that, through her panic stricken phone calls to me, her failing health was aggravated by the stress and anxiety of the process that caused the loss of her home. On January 27, 1998 at 4:25 PM Opal Henson died.

SENIOR BENEFIT ASSOCIATION MARCH 1998

Leslie Richards
President

# PREPARED STATEMENT OF THE CONSUMER CREDIT INSURANCE ASSOCIATION

**SUBMITTED TO**

**THE U.S. SENATE SPECIAL COMMITTEE ON AGING**

**REGARDING**

**EQUITY PREDATORS: STRIPPING, FLIPPING AND PACKING THEIR WAY TO PROFITS**

**MARCH 16, 1998**

**BY**

**WILLIAM F. BURFEIND**

**EXECUTIVE VICE PRESIDENT**

CONSUMER CREDIT INSURANCE ASSOCIATION

The Consumer Credit Insurance Association (CCIA) submits this statement for the hearing record at the invitation of committee staff.

CCIA is a national trade association of insurance companies engaged in the business of insuring consumer credit transactions. Our members account for in excess of 80% of the national premium volume for consumer credit insurance. Since 1951, the year of its' incorporation, CCIA has been dedicated to preserving and enhancing the availability, utility, and integrity of insurance and insurance-related products delivered through financial institutions or in connection with financial transactions..

Having reviewed the filed statements of hearing witnesses, we would concur that the exploitation of the elderly by lending practices known as stripping, flipping and packing is truly reprehensible. Our interest is limited to the allegations of insurance packing. According to the ***Wall Street Journal*** (March 17, 1998) report on the committee hearing, Senator Grassley emphasized that the hearing was aimed at "a few bad apples". The CCIA concurs.

The sale of credit insurance is highly regulated by both federal and state law. Regrettably, law and regulation operate much like door locks, i.e., they serve as deterrents for honest citizens but are only obstacles to the unscrupulous.

On May 29, 1968, then President Lyndon Johnson signed into law The Truth-in-Lending-Act (TILA), also known as Title I of the Consumer Credit Protection Act. TILA has been amended ten (10) times since then.

On July 1, 1969, the Federal Reserve Board adopted Regulation Z to implement TILA. The purpose of Regulation Z is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. The regulation includes model forms and disclosures. The Model Credit Insurance Disclosure Notice states that "credit life insurance and credit disability insurance are not required to obtain credit, and will not be provided unless you signed and agreed to pay the additional cost." Its clear that the purchase of credit insurance is optional; there is an additional charge for the coverage which is separately stated for each coverage option; and, that the consumer must indicate that the election of coverage, if any, by written signature. While this is a model disclosure, examination of actual credit or loan documents will reveal credit insurance disclosures substantially identical in form and content. These disclosures are uniformly provided on the first page of the loan document and highlighted by bold border or distinctive type size or face for prominence.

The victims of the fraudulent practices investigated by the committee must be viewed as exceptions to the experience of the general population. Numerous consumer studies conclude that consumers do understand that the purchase of credit insurance is optional.

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Studies by the Federal Reserve Board[1] asked consumers whether taking credit insurance made a difference in obtaining a loan. Consumers with credit insurance on their loan concluded the purchase was irrelevant to the loan decision in overwhelming numbers; 80.3% in 1977 and 94.2% in 1995.

The Federal Reserve Board studies confirmed findings of earlier consumers studies. For example, the study by the College of Business Administration of Ohio University (1973) - the most exhaustive study of credit insurance - revealed that 90.10% of consumers with credit insurance knew they "were obtaining credit life insurance protection" and 91.97% "understood that there was a charge for credit life insurance in addition to the interest charge."

The most recent study (1994) by the Credit Research Center, Krannert Graduate School of Management at Purdue University[2] (since relocated to Georgetown University) concluded that the most common reason for buying credit life insurance, cited by 81% of survey respondents, was to ensure that debts would not be a financial burden to others. Further, borrower awareness of the credit insurance purchase appears to rise with the size of the loan to be insured (a corresponding rise in the premium). Of particular relevance to the committee focus on the elderly, this study found that individuals over the age of 45 are more likely to purchase credit li'fe insurance, other things being equal. For those in need of additional financial security, this is a rational economic decision. Group rated credit life insurance becomes increasingly the least expensive insurance option as borrowers age.

Available evidence clearly support the conclusion that consumers recognize the purchase of credit insurance to be an option unrelated to creditor approval of the loan and that borrowers have rational economic motives for the decision, as opposed to being pressured or coerced at the point of sale.

CCIA has adopted a Consumer Bill of Rights to embrace the consumer protections provided in federal and state law. Our member companies subscribe to this statement and, as a matter policy, strive for its implementation. These consumer rights are as follows:

- **A credit insurance consumer has the right to expect truth in advertising as the guiding principle in any credit insurance promotional or sales materials.**

- **A credit insurance consumer has the right to receive a certificate or policy of insurance which includes a description of the policy provisions and disclosure of the premium charge.**

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[1] Cynak, Anthony W., and Glenn B. Canner. *Consumer Experiences with Credit Insurance: Some New Evidence.* Federal Reserve Board

Eisenbeis, Robert A., and Paul R. Scheitzer. *"Tie-ins Between the Granting of Credit and Sales of Insurance by Bank Holding Companies and Other Lenders."* Staff study 101. Board of Governors of the Federal Reserve System. October, 1978.

2Barron, John M., Ph.D., and Michael E. Statten, Ph.D. *Monograph No. 30 Credit Insurance: Rhetoric and Reality.* Krannert Graduate School of Management: Prudue University. 1994

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- **A credit insurance consumer has the right to no less than a 10-day "free look" during which the insurance may be canceled at no cost.**

- **A credit insurance consumer has the right to know when the purchase of credit insurance is optional and is not required as a condition to obtain the loan.**

- **A credit consumer, when he or she is required to purchase insurance in connection with a loan, has the right to purchase the insurance from the insurance company of his or her choice.**

- **A credit insurance consumer has the right to expect that the insurer, as a general business practice, will attempt in good faith to offer prompt and fair settlement of claims submitted in which liability has become reasonable clear.**

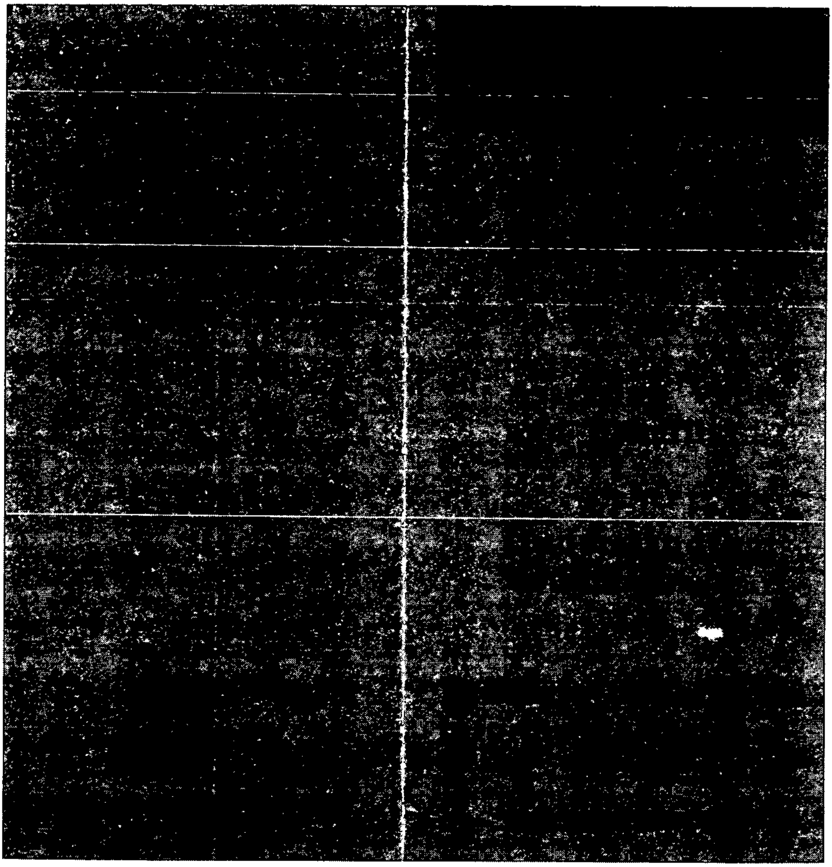
Credit insurance is purchased in connection with a loan transaction and assures the consumer of loan repayment in the event of death or disability. For many, credit insurance is an efficient and economical way to provide additional financial security.

The credit insurance option is usually presented after the loan has been approved. A federally required disclosure statement is prominently displayed on the face of the loan document and clearly states that purchase of credit insurance is optional, not a condition of credit. The premium is fully disclosed and separately stated for each coverage option. The consumer indicates in writing the option of choice, including the option of declining.

Numerous consumer studies have repeatedly and overwhelmingly demonstrated that credit insurance buyers are aware of the coverage, knew there was a separate premium charge, did not feel coerced to purchase it and would buy it again.

The members of CCIA are committed to maintaining the integrity and availability of credit insurance products responsive to the needs of consumers. We would be pleased to work with The Senate Special Committee On Aging to assure that these objectives are met with regard to the elderly. We thank the committee for the opportunity to submit these comments for the record.

# # #



**Consumer Credit Insurance – What is it?**

**Where is consumer credit insurance sold?**

**How many kinds of consumer credit insurance are there?**

- *Credit life insurance,*
- *Credit accident and health insurance,*
- *Credit property insurance,*
- *Credit involuntary unemployment insurance,*

**How does credit insurance differ from other types of insurance?**

- *No medical exam requirement*
- *Age not a factor*
- *No minimum purchase requirement*
- *No pre-payment requirement*

credit insurance is financed, as part of the credit card or installment loan payment.

**How do I decide if I need consumer credit insurance?** There are several questions you can ask yourself in determining whether consumer credit insurance is right for [illegible]

***Would there be surviving dependents?*** [illegible]

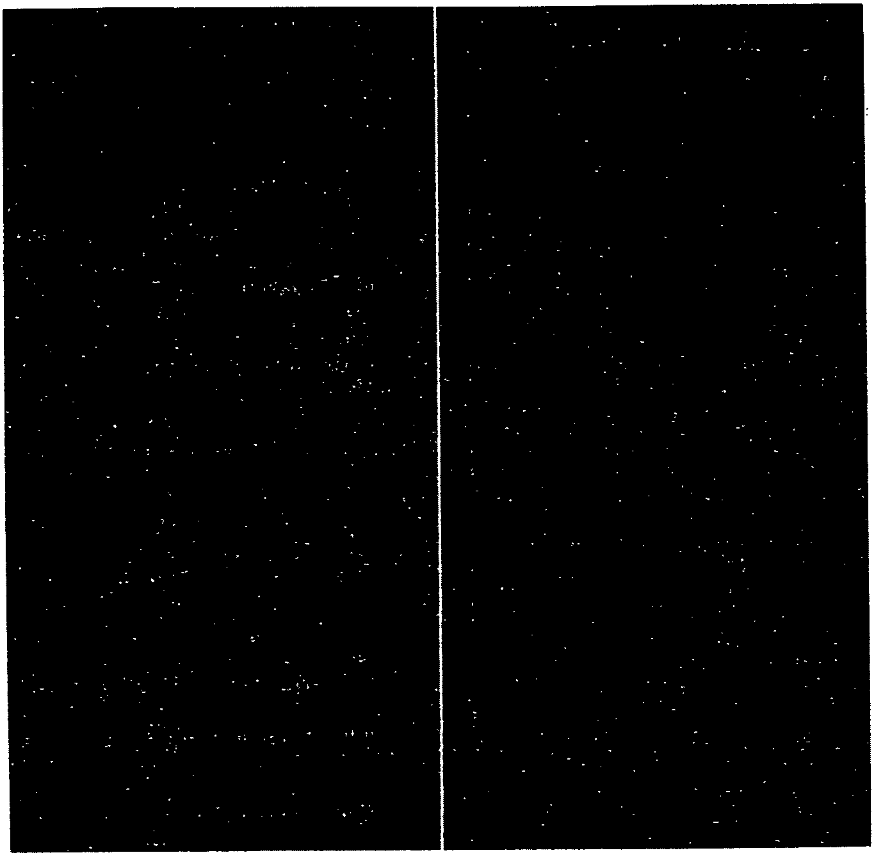
***Is the loan amount small enough that the monthly payments could be handled easily without insurance?*** [illegible]

***Do you currently have adequate savings and/or insurance to cover your needs?*** [illegible] ... You may need three times that [illegible] ... equal to seven times its annual earnings.

*(Source: 199x Life Insurance Fact Book, American Council of Life Insurance)*

## Credit Insurance is Highly Regulated

[illegible]



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