

Financial Sector

Fair Lending and Access to Capital

The current economic crisis was initiated by subprime and non-traditional mortgage loans defaulting due to lax underwriting and an increase of the interest rates on these loans. The lax underwriting arose due to the ease with which these loans could be securitized and sold to investors, so that lenders bore little of the risk of their underwriting. The lack of transparency of these and other securities caused the freezing up of the general credit markets and the recession with high unemployment rates. This high unemployment is now causing originally creditworthy borrowers to become delinquent and in foreclosure.

“Since January 1, 2008, the lack of impacts transparency in banking has proven unaffordably quaint by every measure: the failure of 230 banks (8/08 through 5/21/10); more than \$700 billion to stabilize the biggest banks, car companies and their credit companies and financial re-insurer AIG (\$180 billion in 2/10); \$440 billion to rescue Fannie Mae and Freddie Mac; a 60% drop in share prices for major banks; a 23% drop in home prices; the irony that 60% of original Troubled Assets Relief Program (TARP) aid went to banks with “Outstanding” CRA (Community Reinvestment Act) ratings; and the expectation that banks will lose or write down another \$470 billion in 2009-10.” Source: “Using High-Transparency Banks to Reconnect Money and Meaning” *Community Development Investment Review*.

When examining Chicago foreclosure auction results and subsequent real estate transactions, Woodstock Institute found that 60% of vacant lender-owned properties from 2007 and the first half of 2008 were located in African-American communities. These properties also sat unsold much longer, taking 25% longer to be absorbed into the market than vacant, lender-owned properties located in predominantly white communities.

Institutional investors with social concerns examine in particular the lending to low- to moderate-income borrowers, especially minority borrowers. CANICCOR, a research consultant, computes a social performance relative to all Home Mortgage Disclosures Act reporters in the assessment and non-assessment portions of each metropolitan statistical area (MSA) and aggregates these performances to the corporate level. The meetings with banks and regulatory agencies, as well as written comments submitted to Congressional committees and regulatory agencies by CANICCOR, and the investors provide significant input into the process of making useable loan modifications to keep as many people in their homes as possible. Out of our own interest, investors must demand that servicers consider principal reductions and term extensions, should they be necessary in providing a net present value greater than a foreclosure.

As investors, we have a direct interest in working for the eradication of predatory and other poor or unjust lending practices, as they detract from long-term shareholder value. Moreover, the existing system to protect consumers is bureaucratic, unaccountable and ineffective,

spanning 17 different statutes and seven distinct agencies. A consolidated regulator of consumer financial products would promote greater efficiency and reduce unnecessary paperwork. Investors are urging the Securities and Exchange Commission to regulate effectively so as to protect consumers from predatory lending and to ensure that all people in the U.S. have adequate access to capital to start small businesses and buy homes. Congress, too, must ensure that all communities have access to capital. Therefore, any new consumer protection entity and any consumer financial protection legislation must help ensure equal access to capital by strengthening existing laws such as the Community Reinvestment Act.

In light of the lack of federal legislation and failure of regulatory agencies to govern the financial services sector, investors must take all opportunities to submit comments to Congress, the Securities and Exchange Commission, Federal Reserve and other federal agencies on housing goals for Fannie Mae and Freddie Mac to ensure affordable housing, including 5- to 50-unit buildings; loan modification requirements; tightened standards on mortgage lenders and insurers and transparent, accountable reporting measures.

Addressing the impact of companies on this issue is aligned with the Critical Concerns of the Sisters of Mercy to work for justice for the economically poor.

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Financial sector reform, domestic and international

In recent years, banks have sharply raised interest rates and penalty fees on credit cards. Despite the Credit Cardholders' Bill of Rights, intended to level the playing field between card companies and cardholders, issuers are implementing a wide range of new and excessive fees and penalties that fall outside of the law's restrictions. Securitization is a key driver behind this trend. From 2003 to 2007, seven of the largest issuers of credit cards packaged an increasing amount of card debt into securities and sold them to investors, just as banks did with mortgages. Selling off credit card debt gives banks a powerful incentive to raise card fees and penalties, since they pass along to investors some of the risk that the debt will go bad.

Credit-rating firms are paid by Wall Street firms to rate their products, and they provide other consulting services to those same corporations they rate.

Fannie and Freddie are effectively nationalized but neither the Obama administration nor Congressional leaders see a solution to how to fix the mortgage giants without choking the flow of credit to homeowners and dealing a blow to a still-fragile housing market.

In most developing countries, poor people are the majority of the population, yet they are the least likely to be served by banks. Microfinance means building financial systems that serve the poor. Microfinance is often seen as a marginal sector—a “development” activity that donors, governments, or social investors might care about, but not as part of the country's mainstream financial system.

The Center for International Policy reported the first comprehensive analysis and measurement of the pattern and quantity of money exiting developing countries by way of illicit activity. Primary findings of the January 2009 release:

- ❖ Total capital flight exiting the developing world may be as much as \$1 trillion per year.
- ❖ Measured against average yearly Official Development Assistance, poor countries are losing \$10 for every \$1 that they receive in aid funds.
- ❖ The volume of capital flight is increasing at an average of 18.2% a year.
- ❖ During the five-year period of this study, illicit financial flows grew at the fastest pace in the Middle East and North Africa region (49.4%) followed by Europe (25.4%), Asia (15.7%) and the Western Hemisphere (2.8%). Flows from Africa declined (-2.9%), but this is more the result of incomplete data than supportive economic or political factors.

“Vulture” funds is how critics label the investment houses that buy up the defaulted debt of poor countries for pennies on the dollar and then proceed to sue them for immediate repayment on their full face value, plus interest. When litigated, more than half of the resulting court cases were won by the vulture funds, ensuring in many instances profits in excess of 400%.

The Commodity Markets Oversight Coalition and Americans for Financial Reform agreed that inadequate federal oversight and excessive speculation contributed significantly to the financial crises and commodity bubbles of the previous decade and urged federal lawmakers and regulators to consider 10 principles for reforms in the futures/derivatives markets including:

- ❖ Federal regulators should be given authority to ensure transparency and accountability and to prevent fraud, manipulation and excessive speculation on foreign boards of trade that allow U.S. access or that trade derivatives on commodities destined for U.S. delivery.
- ❖ Any exemptions from exchange trading or clearing should be restricted to *bona fide* commercial hedging of physical commodities by end-users and customized or specialized contracts that cannot be traded or cleared. Hedge funds, private equity funds, exchange traded or index funds and other speculators should not fall under any end-user exemption.
- ❖ The Commodity Futures Trading Commission should be granted the same statutory enforcement authority as the FTC, SEC and Federal Energy Regulatory Commission (FERC). (Joint Statement of Shared Principles for Needed Reforms in the Futures/Derivatives Markets, 1-7-10)

"The Catholic tradition is clear about the responsibility of governments to order and regulate economic activities and financial markets so that they serve the common good," said Fr. Seamus Finn, Director for Justice, Peace and Integrity of Creation for the Missionary Oblates of Mary Immaculate and a board member of the Interfaith Center on Corporate Responsibility. "The near collapse of the financial system in 2008 should serve as a wake-up call to Congress, investors, Wall Street and the American people. A well regulated and supervised financial system is in everyone's interest."

As members of the Interfaith Center on Corporate Responsibility, Mercy Investment Services values a reliable regulated financial system that:

- ❖ Enhances access to credit, promotes responsible lending with fair and transparent criteria and contains a commitment to local community investments;
- ❖ Includes reporting and accounting standards that have the capacity to give an accurate picture of risk and includes a measurement of all the costs that are involved in any business transaction; and
- ❖ Protects the rights of shareholders, values the role of stakeholders and is reliable, transparent and monitored. Our concerns flow from the principles that guide our investment decisions and the active exercise of our shareholder positions with corporations: safeguarding human dignity, care for the earth and promoting sustainable communities.

Addressing financial sector reform demonstrates the Sisters of Mercy's care and concern for the economically poor and their efforts to create systemic change.

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Predatory Credit Card Practices

According to Consumer Affairs, U.S. household debt has increased from a joint \$59 billion in 1980 to nearly \$830 billion in 2005; the number of consumers filing for bankruptcy has increased by 609%.

Federal Reserve estimates say that U.S. consumers carry nearly a trillion dollars in credit card debt. The typical family has seen income decrease more than \$1,000 between 2000 and 2007 after inflation, while food, gas, housing and health care costs increased more than \$4,000. Analysts seem to agree that cutting back on spending is not possible because most of those who carry credit card balances cannot pay expenses on their declining real salaries. Credit card practices contributed to the subprime mortgage collapse; \$1.2 trillion in home equity was extracted between 2001-2006 to pay credit card debt and basic living expenses. In recent years, use of high-interest credit cards to pay big medical bills has become a leading cause of consumer bankruptcy. Aggressive and questionable marketing to teenagers and college students has contributed to a rise in undergraduate credit card debt from an average of \$2,169 in 2004 to \$8,612 in 2006.

Lack of financial literacy amidst a saturated “buy now, pay later” consumer culture has further exacerbated the problems many borrowers face.

A credit card agreement was supposed to be a contract but in recent years cardholders have lost the ability to say no to unfair interest rate hikes and fees. The recently passed Credit Cardholders’ Bill of Rights levels the playing field between card companies and cardholders while fostering fair competition and free market values. It sets no rate caps, fees, or price controls nor does it dictate any business models to card companies...There is no doubt that credit card companies provide a valuable service and deserve to earn a fair profit, but consumers deserve the right to be able to understand their accounts and be empowered to control them. (Rep. Carol Maloney, D-NY)

The Credit Cardholders’ Bill of Rights, which takes full effect in August 2010, contains 10 rights that credit card companies must grant to consumers:

1. Protect cardholders against arbitrary interest rate increases
2. Prevent cardholders who pay on time from being unfairly penalized
3. Protect cardholders from due date gimmicks
4. Shield cardholders from misleading terms
5. Empower cardholders to set limits on their credit
6. Require card companies to fairly credit and allocate payments
7. Prohibit card companies from imposing excessive fees on cardholders
8. Prevent card companies from issuing subprime credit cards to people who cannot afford them

9. Require Congress to provide better oversight of the credit card industry
10. Contain no rate caps, fee setting, or price controls

In February, even as the reforms of the Credit Card Accountability, Responsibility, and Disclosure (CARD) Act took effect, reports showed that credit card issuers are implementing a wide range of new and excessive fees and penalties that fall outside of the law's restrictions. New credit card outrages include 79% interest rates and huge establishment fees on so-called "subprime" credit cards; hidden costs on pre-paid cards; and the marketing of specialty cards to cover medical costs. Demos, a public policy and advocacy organization, has published a briefing paper underscoring the urgent need for an independent Consumer Financial Protection Agency (CFPA) to establish rules against potentially abusive financial products. In *Why We Need an Independent Consumer Financial Protection Agency Now*, the authors show that financial industry regulation historically has been critical for protecting families from abusive practices and preventing financial crises. Currently, the U.S. Chamber of Commerce, the Association of Credit and Collection Professionals and other groups are spending hundreds of millions to lobby against CFPA and other crucial reforms.

The coalition of investors, too, has a continuing role to play in promoting sound, clear issuer policies and best practices for the credit card market.

Addressing predatory credit card practices supports the care and concern of the Sisters of Mercy for the economically poor of the world.

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