

## **AVOIDING UNDERWRITING AND SECURITIZATION OF PREDATORY LOANS**

WHEREAS an estimated 63% of the \$213 billion of subprime loan originations in 2002 were securitized, and our corporation has served as manager/underwriter in many securitizations, accounting for an estimated \_\_\_% of the total securitizations.

WHEREAS a recent judgment against Lehman Brothers has shown that secondary market purchasers and underwriters may have liability for allegedly fraudulent practices of an originator. Specifically, Lehman had provided a credit line to and bundled the mortgages for the secondary market of First Alliance Corporation, a now bankrupt subprime lender. The recent judgment against Lehman stated that Lehman "substantially assisted" First Alliance Corporation in perpetrating the alleged fraud. The court held Lehman responsible for 10% of a \$50.9 million judgment. Further litigation is likely.

In originating subprime loans, a number of subprime lenders have been investigated by federal and state authorities for alleged predatory lending practices. These predatory practices include:

- Credit life insurance being implied as necessary to obtain a loan (packing);
- Unnecessarily high fees;
- Loans refinanced with high additional fees rather than working out a loan that is in arrears (flipping);
- High pre-payment fees, with prepayment penalties applying for more than three years;
- Borrowers with inadequate income receiving loans, who will then default;
- Payment performances of borrowers not being reported to credit agencies.

Some of these practices have led to large settlements:

In 2002, the two largest subprime lenders entered into settlements, which provide restitution funds for consumers alleged to have been wronged by some of these practices.

- Household International settled with the Attorneys General of 20 states to provide a \$484 million restitution fund and,
- Citigroup made a similar settlement for \$215 million with Federal Trade Commission for the practices of Associates First Capital, prior to its purchase by Citigroup.

We believe that the securitization of subprime loans plays a very important and valid role to the provision of subprime lending, and we believe that subprime lending does serve a useful and legitimate purpose when done in a manner that discloses costs and risks to consumers and potential risks to shareholders.

We believe that our corporation must perform adequate re-underwriting of the loans and verification of the originator's methods to be assured that loans with so-called predatory practices are not included in any securitization that the company performs.

**BE IT RESOLVED** that the shareholders request the Board of Directors to develop policies that require management to develop operational procedures for more intensive screening of loans and for more intensive screening of their originators, so that the Corporation is not party to securitizations involving subprime loans that could lead to liability for the originator's practices.