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POSSIBLE RESPONSES TO RISING MORTGAGE FORECLOSURES

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

APRIL 17, 2007

Printed for the use of the Committee on Financial Services

Serial No. 110–21

U.S. GOVERNMENT PRINTING OFFICE

36–817 PDF WASHINGTON : 2007

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

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POSSIBLE RESPONSES TO RISING MORTGAGE FORECLOSURES

Tuesday, April 17, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Present: Representatives Frank, Waters, Maloney, Velazquez, Watt, Moore of Kansas, Clay, Baca, Miller of North Carolina, Scott, Green, Cleaver, Bean, Sires, Hodes, Ellison, Klein, Wilson, Perlmutter, Donnelly; Bachus, Pryce, Castle, Gillmor, Biggert, Miller of California, Capito, Feeney, Hensarling, Garrett, Brown-Waite, Pearce, Neugebauer, Price, McHenry, Campbell, and Bachmann.

The CHAIRMAN. The committee will come to order. Please, if people will take their seats. There should be enough seats for everybody. If there's an empty seat, sit in it. Press or staff isn't here. They probably are not coming, so people should just find seats and take them.

This is a hearing on the serious problem the country now faces on the consequences of people having been given loans, having taken loans, a mutual process, which many of them have been unable to comply with. And we have a serious problem in the country. The issue of subprime/predatory lending has several facets. It makes sense from the standpoint of the Congress to deal with it in two essential ways. One is the question of what legislation is appropriate going forward.

And I know there are people who sometimes accuse us of hindsight and say, well, now you're involved. I, along with the ranking minority member, sitting next to me, and the gentleman from North Carolina, who is here, and our other colleague from North Carolina, 2 years ago began to work on this issue. And I will say that it was not a case of hindsight with us. We tried very hard to come to some agreement. Other forces intervened. But I think if we had been able to work freely, we would have had a bill 2 years ago that frankly might have diminished some of this damage. And I think we are going to—we are determined to work together.

That's on legislation going forward. Legislation going forward will not help the current group of people who are entrapped in this. Now one of the arguments has been, well, people make their own judgments, and why are you getting involved? The fact is, these kinds of loans are not randomly, geographically distributed. There

is an element of concentration in them, which means that the victims when some of these loans go bad are not just the individuals but the neighborhoods and cities in which these individuals live. Plight can be increased, and it is therefore a legitimate public policy problem. It also of course has, as we are seeing, potential macroeconomic consequences.

So, today's hearing will be to look into what can be done with regard to people who are already in this situation. And I want to say members will note that our colleague, the gentlewoman from Ohio, is with us. She is somewhat a former alumna of this committee who moved on to be a housing advocate in the Appropriations Committee, and she represented the State of Ohio as both of our member witnesses do, and as our colleague, Mr. Wilson, does. Ohio has been a State that's been hit particularly hard by this, and it helps underline the point that these are not random geographically. But in the State of Ohio, what we have is an example of why these are a problem not just for individuals, but for neighborhoods and communities in a lot of ways. And the gentlewoman from Ohio was, let me say politely, insistent that we look into this.

And so, what we have today is the first half of this, and that is, looking at what we can do to alleviate the plight of the people who are already in this situation. Now let me put one thing to rest. We are certainly well aware of the restrictions against retroactivity. Where rights are vested, we are not interested in trying to jeopardize them. On the other hand, we do think that all manner of people in this situation have a vested interest in working together going forward.

We are going to be joined here today by Fannie Mae and Freddie Mac, and let me say, by the way, to the extent that loans that were made are held in the portfolios of Fannie Mae and Freddie Mac, it seems to me we have some options that we wouldn't have if they were securitized. So, for those who think that the always best thing to do is to reduce the portfolio of Fannie Mae and Freddie Mac and to require them to securitize everything, I think today is a counterindication of that. And to the extent that we were able to provide some help to some people, the fact that we have some portfolio situation here is important. And to the extent that we can get Fannie Mae and Freddie Mac to help in this situation, my guess is we're going to be looking at things that they will be holding in their portfolios, and the notion that the portfolios are this bad thing may be somewhat undercut by their usefulness in this situation.

We have the FHA with us, and one of the things that we think both currently and going forward is that the FHA has a great potential to be more useful in this, both in terms of helping out and going forward, and we appreciate the cooperation we've gotten from the Commissioner of the FHA. And I also want to express my appreciation for the bank regulators, who have shown a great deal of supportive interest here.

So this hearing is going to focus on what we can do to help the people who have already been in difficulty. We will then be moving on later to talk about legislation. With that, I will now recognize the ranking member, and I think we have both exercised our op-

tions under our rules so that there will be 20 minutes on each side for opening statements. I recognize the gentleman from Alabama.

Mr. BACHUS. I thank the chairman and I appreciate your holding this hearing. I'm excited about hearing from our various panels. First off, I want to say that this first panel couldn't have been better chosen. Congresswoman Kaptur has said many times that she was the first in her family, I think, to get a college education. And you come from Toledo, a town you've talked to me about the problems with subprime mortgages. In response to that, the chairman and I have, as he said, as late as 2 years ago tried to work a solution, but as you know, people on both sides say if you do this or you do that, we're going to blow up the whole agreement. In hindsight, I wish we had pressed through and taken on some of the folks on both sides and come to some solution.

We have not. Congressman Turner, being Mayor of Dayton, has spoken to me and stressed what the chairman stressed, in that this is not a problem just for homeowners, although what we're hearing now is that anywhere from 1 million to 3 million American families may face foreclosure. Now you say 3 million, and that's one of the figures we're just now hearing. The reason we're hearing that is that we have 2 million additional mortgages that are going to adjust upwards. And some people are starting to call that as opposed to just upwards, they're starting to say "blow up" is a word we're beginning to hear. Because basically, when those payments go up as much as they do, they really blow up in the homeowner's face.

And Congressman Turner stressed to me that this isn't just a problem for the homeowners; this is a problem for communities. And as Congresswoman Kaptur has said, a college education is a key to many things. A home is the key to many things. Homeownership is one of the things most Americans, you know, if you ask, at least when I grew up, I grew up in a community very similar to yours, Congresswoman Kaptur. The steel industry was very important. We had coal mines. But if you ask people what are the two things they wanted, they wanted a college education and they wanted to own a home.

That dream of homeownership for millions of Americans is disappearing before them. They thought they had it. Now, in some cases, the reason that they're facing foreclosure is traditional reasons that we've always had. You know, we've always had people who lost their jobs. We've always had people who faced serious illness or disease. We've always had marital breakups, things that cause people to have financial reverses, and people getting in trouble maybe just from a lack of financial planning, or being overly optimistic. That really represents the minority of people facing foreclosure today. The majority of the people who face foreclosure today have gotten into mortgages that they should not have gotten into.

And one problem, I think the big problem we face is that a lot of those people are facing prepayment penalties to try to get out or work out of that mortgage. So, I think we do owe it, if we're—we owe it to Dayton. We owe it to Toledo. We owe it to thousands of communities around the country, as well as families, to first of all become educated, and all members of this committee to be as educated as our first panel about the problems out there, the mag-

nitude of the problem. The fact that we're going to have more mortgages, you know, as I said, as many as 2 million this year or within the next 12 months maybe blow up on people.

We had fraud in some cases. We're further complicated by the fact that a lot of these mortgages have been assigned, and most of these people now because of the mortgage companies that have gone under that made these loans, I don't know whether we're—now the majority of these loans are by companies that no longer exist. But now they're being assigned. And their covenants and their trust, all sorts of agreements where assignees say we can't do this, we can't agree to a workout. There are all these problems in that the person who took out the mortgage doesn't know who to deal with, or there's some restriction, a signee restriction. So we have to try to get past that.

I think the big thing is we're all becoming appreciative of the problem, but what is the solution? My first reaction any time we have a problem like this is to go to the consumer groups, go to the industry, go to the regulators, and find out from them, is there any consensus? Are there some things we can do?

I know some in the Senate and some in the House have talked about a taxpayer-funded—and I'm going to call it bailout. I can't agree to that at this time. I can't agree to taking taxpayers' money and addressing this problem, at least I think that's a premature judgment to make. I do believe that the regulators, and I know they're in different places. We're going to hear from them. There are some immediate steps I think we can take. Maybe there's statutory language that needs to be authorized.

I want to commend the nonprofits as well as the for-profits. We have a lot of companies, big American financial companies, that have stepped forward with hundreds of millions of dollars worth of commitments to help people work their way out.

Foreclosure ought to be—foreclosure in all cases ought to be avoided if it can be. Foreclosure doesn't help anybody. It doesn't help the lender. It doesn't help the homeowner. It's terrible for communities. It's obviously something that if we can avoid, it is in a taxpayers' benefit. And I think a lot of my colleagues might not realize that. They may not realize. They may say, well, these people have—they've cut a deal, and the marketplace ought to operate, and, you know, foreclosure just ought to be what happens.

I think that what some do not realize is that this often even is not in the taxpayers' benefit. It's not in the country's benefit, it's not in the communities' benefit. We're not talking about people here who simply don't want to pay or are unwilling to pay, or made a deal that they knew what the deal was and they're now being hurt by it. We're talking about people who because of really the lack of laws, and most of these laws, there was—we had a Federal standard, but a lot of these, and sort of the mysterious thing to me is that a lot of this occurred in States where there is a tough State law.

So I'm wondering what happened. You know, Ohio is an example of a State that passed a tough law. Now maybe most of these mortgages were made before that law went into effect. North Carolina has a model legislation. We're finding that a lot of these loans were

in North Carolina. So, we obviously have some gaps in the regulation.

I'll just close by saying, as the chairman said, that there are two different issues here. One is what do we do to prevent this in the future. And we obviously do need a national standard. But beyond that, we do need to look and see if there's some reasonable, prudent things we can do. And I say short of a taxpayer bailout.

With that, I would like to—

The CHAIRMAN. The gentleman has used 8½ minutes. I'm now going to yield for 5 minutes to the gentlewoman from New York, who is the chairwoman of the Financial Institutions and Consumer Credit Subcommittee.

Mrs. MALONEY. Thank you, Mr. Chairman. I thank you for having this important hearing, and I welcome my colleagues, Congresswoman Kaptur and Congressman Turner. We look forward to your comments.

This is the second in a series of hearings on this critical issue in the full committee and the subcommittee. Last month we heard from the Federal regulators, industry, and consumer advocates about the proposed Federal regulatory guidance to reform underwriting of subprime loans so that borrowers get loans they can pay for over the whole life of the loan, not just the teaser rate.

The guidance focuses on future prevention. What we are looking at today is what can be done now for homeowners already trapped in mortgages they cannot afford, and how can we help them refinance into sound products and stay in their homes.

First the problem is big and getting bigger. It is no exaggeration to say that we're facing a tsunami of defaults and foreclosures. Last week the Joint Economic Committee released a report on subprime lending, and this report is on the committee's Web site. It fully documents the dimensions of the crisis in each State, and is a helpful tool for each of us to see what is going on in our localities.

The JEC report makes clear that subprime foreclosures will increase substantially in 2007 and 2008, as 1.8 million hybrid ARMs, many of which were sold to borrowers who cannot afford them, reset in a weakening housing market.

That finding is corroborated by a report released by New York University's Foreman Center for Real Estate and Urban Policy recently, showing that the percentage of home purchased loans in the subprime category in New York City more than tripled from 6.5 percent in 2002 to over 22 percent in 2005. A startling 50 percent of homeowners in five of the city's poorest neighborhoods are holding subprime loans. Those five neighborhoods with the highest subprime rates also have the highest foreclosure rates.

This hits local economies hard. Every new home foreclosure can cost stakeholders up to $80,000 when you add up the cost to the homeowners, lenders, neighborhoods, and local governments. This is a problem that is serious and one that should be addressed at every level of government and civil society by the city, State, and Federal Government and the public and private sectors together. We need creative thinking and multiparty engagement.

Personally, I'm opposed to a bailout of lenders, but we need to find a way to refinance many borrowers who will otherwise lose

their homes. For example, one idea is what if HUD waives the requirement that borrowers have to be current on their present mortgage to qualify for an FHA loan, but only for borrowers who were current on their payments until they met the reset rate? That would allow borrowers to refinance out of loans that they are defaulting on through no fault of their own.

Adding to this challenge is the fact that the subprime market is largely securitized, which makes it harder for borrowers and lenders to work out private sector market-based solutions. I understand the FDIC had a conference on this yesterday, and I look forward to any solutions they may have learned.

Finally, we have to remember that many States and localities face very different challenges in enforcement and in keeping people in their homes, and localities need to come up with solutions that are particular to their localities. For example, one solution that we are going forward with in New York State, Suny Mae, the mortgage financing agency of New York, is looking at reviving the 40-year fixed-rate mortgage as a refinancing vehicle to help people. I understand some of the GSEs are also looking at this idea.

I look forward to the testimony today and to hearing solutions that come forward to help us help our constituents and residents across our country stay in their homes.

Thank you very much for holding this hearing, Mr. Chairman.

The CHAIRMAN. The gentlewoman from Illinois is recognized for 3 minutes.

Mr. GILLMOR. Actually, I know when you get west of the Hudson, but it's Ohio.

The CHAIRMAN. I said the gentlewoman from Illinois.

Mr. GILLMOR. Oh, I beg your pardon.

The CHAIRMAN. If you think I got the State wrong—

Mr. GILLMOR. Well, I thought you were looking at me.

The CHAIRMAN. Well, that wouldn't have been the only thing I got wrong, if you were listening. I'll go back. I'm going by the order that the ranking member gave me, so the gentlewoman from Illinois is next on the list.

Mrs. BIGGERT. Thank you, Mr. Chairman. I believe I did hear "Congresswoman" and "Illinois", so I started to open my mouth.

The CHAIRMAN. The Chair does want to make clear that he can tell the difference.

Mrs. BIGGERT. Thank you. Thank you, Mr. Chairman, and thank you for holding this hearing today. And I, too, would like to welcome our witnesses, and I look forward to hearing their views on the ways to help Americans avoid foreclosure and stay in their homes.

Over the past several years, the housing market has driven the national economy as Americans bought and refinanced homes in record numbers. Many regions were spared the worst of the recent recession due to the strength of some of the local housing markets.

The benefits of homeownership are undeniable, and for this reason there has been a significant focus on improving homeownership opportunities for everyone, including the lower income borrower. The subprime market has flourished and provided credit to many families that may not have qualified under conventional standards, and today this country enjoys record high homeownership rates.

Today more than 68 million Americans own a home. Of these 68 million, 50 million homeowners have a mortgage, and 13 million homeowners with the mortgage have a subprime loan.

According to a recent Chicago Tribune article, subprime loans, often with adjustable rates, "made homeownership possible for millions of Americans whose credit ratings or income levels made them ineligible for cheaper prime loans."

However, what brings us here today is not the good news of homeownership, but the troubles of the predatory market and increases in foreclosure rates. In my home State and district, foreclosures have touched homeowners in affluent and nonaffluent communities alike. A study titled, "Paying More for the American Dream: A Multi-State Analysis of Higher Cost Home Purchase Lending", determined that in the 6-county region in the Chicago region, which included my entire district, foreclosures went up by 36 percent last year. Rates are on the rise. According to statistics issued by the Center for Responsible Lending, about 4 percent of U.S. homeowners, or a little over 2 million homeowners in the United States, may lose their homes.

On the flip side, this prediction estimates that 96 percent of homeowners will keep their homes. Nonetheless, the increase in mortgage foreclosures raises eyebrows and calls into question what actions can be taken to help homeowners keep their homes.

And I do want to issue a word of caution as we begin to discuss ways to assist those that have been harmed due to predatory and/or subprime lending practices. The housing market has been the engine for our economy over the last several years, and the availability of credit has been crucial to that engine.

While we may need to look at ways to resolve this current crisis, we must take care to not stifle the market going forward. There are clear indicators today that the market is taking steps to correct itself, and I'm most interested to hear from the witnesses on steps that the public and private sector are taking to address those that are facing foreclosure.

And I'm not sure how much time I had. Is that—

The CHAIRMAN. Four seconds.

Mrs. BIGGERT. Okay. With that, I will yield back.

The CHAIRMAN. I thank the gentlewoman. The gentlewoman from California, the chairwoman of the Housing and Community Opportunity Subcommittee, is recognized for 3 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. I'm very pleased that you and Ranking Member Bachus decided to hold today's hearing on a possible response to rising mortgage foreclosures. The newspapers are full of stories about this crisis in which we find ourselves.

Many families are now suffering, and the Center for Responsible Lending recently released a December 2006 report, "Losing Ground: Foreclosures in the Subprime Market and their Cost to Homeowners." The report documents the relationship between subprime lending and foreclosures, indicating that at the end of 2006, 2.2 million households in the subprime market either have lost their homes to foreclosure or hold subprime mortgages that will fail over the next several years.

These foreclosures will cost homeowners as much as $164 billion, primarily in lost home equity. One out of five, or 25 percent of the subprime mortgages originated during the past 2 years will end in foreclosure. At the end of 2006, the Federal regulators issued guidance related to subprime loans. While the Federal regulatory authorities regulate many of the Nation's financial institutions, subprime lending is really in the domain of the States, because they regulate mortgage brokers and lenders. The Federal regulators guidance addresses loans where the rates can change dramatically after the second or third year of the mortgage, for example, from 7 percent to 11.5 percent. Specifically, the guidance suggests that lenders be required to take into account the borrower's ability to make monthly payments at higher rates and also the property taxes and homeowners insurance, which are often not escrowed in the subprime loans.

However, the major issue for Congress is to balance the interest of assisting homebuyers who are low- and moderate-income first-time buyers, while ensuring that they avoid the pitfalls of subprime markets and unintended consequences such as foreclosure. Providing assistance to existing subprime borrowers who are in danger of losing their homes is an important aspect of this debate. FHA modernization may be another part of the answer. Reasonable workout plans represent another mechanism that can assist homeowners from falling into foreclosure. And in fact, the lenders are better off not losing these borrowers to foreclosure, since it creates a ripple effect in the communities where the properties are located, creating vacancies, blight, arson, etc. In addition, the cycle of predatory lending activity continues with investors purchasing foreclosed properties at depressed prices, only to turn around and sell the properties quickly at an inflated price.

These hearings are a first step to addressing the issue of foreclosures tied to subprime lending. Many believe that we have not seen the end of the collapse of the subprime lending market and resulting foreclosures. I hope the testimony that we hear today will shed some light on these important issues. And again, I thank you for this very timely hearing.

The CHAIRMAN. I thank the gentlewoman. And the Chair now recognizes the gentleman from Ohio, not Iowa or Illinois, Ohio.

Mr. GILLMOR. I thank the chairman.

The CHAIRMAN. For 5 minutes.

Mr. GILLMOR. I also want to commend the chairman for the series of hearings on this subject. The problem of foreclosure is one I'm very much aware of in my district in northwest Ohio. Even before the significant loosening of credit standards in recent years began affecting subprime market across the country, Ohio ranked high in foreclosures. As the rest of the country over those years experienced an expanding economy, not only Ohio's job market, but the job market of Michigan and other Midwestern States were slow to realize the gains, and too many people suffered financial difficulties, making it more difficult for them to pay their mortgages.

In the subprime market in Ohio and elsewhere, there's no doubt that in the past several years, there has been a general loosening of underwriting standards. America has one of the highest rates of homeownership in the world, and that's good, and we want to con-

tinue to encourage homeownership. But you're not doing anyone a favor by putting them in a home with a type of mortgage that when interest rates go up or they have an economic reverse, they're thrown out of the home.

When considering how best to move forward, Congress may want to separate out the causes of foreclosure. The vast majority of homeowners in the subprime market are able to handle the complex, hybrid mortgage options available. But even the most educated, well-intentioned homebuyer could have difficulties with making their payments should their job situation change around the same time as their rate changes.

I think it's also worth reminding everyone the difference between subprime lending and predatory lending. They're two different animals. And I think it's worth pointing out also that the defaults in the subprime area have by and large not been with loans made by federally regulated banks or savings and loans. Most of the problems have been loans by nonbanks, non-savings and loans regulated by the State. And I would hope that as Congress continues its investigation into the circumstances which have led to the current crisis, it will spend some time considering disclosure requirements.

Much of the problem with today's mortgage market, both prime and nonprime, is that the average prospective homebuyer is snowed in with paper, much of which is difficult to understand or redundant. Now that's not breaking news. But the Federal Government and the States have shared blame for the complexity of the homebuying process, and both I think must work to reform the system. Any legislation that comes before the committee should focus on reforming RESPA and improving disclosure.

And with that, I look forward to hearing our three distinguished panels, and I'm particularly pleased to see that we have a representative of the Ohio Housing Finance Agency on Panel 3. Through their partnership with over 150 lenders across the State, OHFA has shown a willingness to look for innovative solutions to foreclosure problems in my State.

And I yield back.

The CHAIRMAN. The Chair now recognizes one of those who was most engaged in our trying to deal with this 2 years ago, the gentleman from North Carolina, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman, and I thank the chairman for convening the hearing, and welcome our colleagues as witnesses. This is certainly a problem that defies geographic definition or district definition. It seems to be a generalized problem across the country.

And from all indications, foreclosures are up in both the prime and subprime markets, although it seems to be disproportionately a problem in the subprime markets. And from what I have read up to this point, there are multiple causes, which makes it more difficult to find a solution to the problem. Just from what I've read, some people have blamed it on teaser rates, exploding adjustable rate mortgages, lack of care of lenders resulting from easier securitization, easier credit, fraud and other predatory lending practices, our push for more homeownership, and a virtual demonizing of people who rent, lack of education and knowledge about

what people are getting into when they get a mortgage, turnaround of rates to go back up, and a generalized irrational exuberance in the housing market.

From what we've heard from testimony at previous hearings and read in the press, this does not seem to have created a national crisis in the financial markets or a threat to safety and soundness, probably because lenders do reserve for these kind of contingencies, and they can prepare for these kind of realities. But the fact is that each one of these foreclosures represents a different story from a borrower perspective, and many of these—while the lenders can recover, many of these property owners and borrowers have no capacity to recover. So, it is especially timely that we have a panel on how we may be able to assist borrowers in recovering and avoiding foreclosure.

So, with that, Mr. Chairman, I thank you and the ranking member for convening the hearing, I look forward to the witnesses and their testimony, and hopefully look forward to finding some solutions that will both reduce the number of foreclosures and insulate the borrowers who are being subjected to this increasing number of foreclosures. I yield back the balance of my time.

The CHAIRMAN. I thank the gentleman. The gentleman from New Jersey is now recognized for 2 minutes.

Mr. GARRETT. Thank you, Mr. Chairman, and thank you members of the panel. To start off with, the chairman started the hearing talking about the victims, and I really think the victims are two groups, both the borrowers and the lenders. And they're victims probably because they listen too much to the politicians.

There was an article in Bloomberg, I think today, talking about the last Clinton Administration putting pressure on the lenders to make these type of loans. So that's the wrong politicians to listen to. And the borrowers for listening to Congress too much when we encourage people to get into loans that, quite frankly, they cannot afford. When we encourage people to get involved with zero downpayment loans, no credit check loans, no equity loans, this is what brings us to the problem today.

And I've met with folks from some of the housing councils out there, and they tell us that, you know, not everyone is suited for to be in the private market—in the home market. Some are suited to be, based on their income and what have you, to be in the rental market. But Congress continues to push only in one direction. So, that may be part of the problem.

Immediately after that, of course, we heard what is the ledge fix? Well, you know, quite frankly, there's not always a ledge fix to every single problem that comes out there. I would suggest that maybe what we need more is financial literacy so people understand what's going on and can get into the right loans or find out that they shouldn't be in some loans. I commend groups such as the credit unions and the community bankers for doing a great job of trying to provide credit literacy.

And tied to this, there is also a suggestion that maybe we need some sort of a national standard to solve these problems. Where I come from, the great State of New Jersey, where I just met about a couple of weeks ago with our banking insurance commissioner, and I commend, even though he's from the other side of the aisle,

I commend the job that New Jersey is doing about regulating their own system, and I think New Jersey can do it just fine without Washington's help. But I'm all open for the idea for any other members of this committee if their State can't get the job done, then their State can look to Washington for solutions. But as for New Jersey, in our State, we can do it very well on our own, thank you.

And finally, going back to what the chairman said with regard to GSE and reform there, I think this proves the point that Chairman Bernanke was absolutely right, and the amendments that we suggested before that were his amendments, to say that the GSEs should—were not doing their jobs before for providing affordable housing, and that their portfolios should be limited to just what Chairman Bernanke said, and that they should be limited to affordable housing. And if the GSEs were doing a better job of providing the direction for providing affordable housing and limited their portfolios to just the affordable housing mix as opposed to what they do right now, we would not have the risk that Chairman Bernanke talked about, and maybe some of these problems would not be with us today.

So, again, I thank the members of the panels, and I would appreciate their comments on any of the things that I just talked about. And again, I yield back.

The CHAIRMAN. I thank the gentleman. And our other member who was one of the leadership people in our efforts to deal with this previously and will again, the gentleman from North Carolina, Mr. Miller, is recognized for 4 minutes.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman. I agree with my colleague, Mr. Bachus, and I disagree with my colleague, Mr. Garrett. I think it should be the policy of this government to try to help middle-class folks get into homes. About the only good news for the American middle class is the homeownership rate. Wages aren't keeping up with inflation. We have a slightly negative savings rate, but almost 70 percent of American families own their own homes.

And for most American families, the deed to a home is the membership card in the middle class. It is also the most important investment they will ever make. It becomes the bulk of their life savings. The equity they build in their home by faithfully paying a mortgage month after month becomes the bulk of their live savings.

Subprime lending is not really about helping folks get into homes. More than half of subprime loans are not loans to purchase homes with, they're refinances. They're helping people who have gotten behind, who have had life's rainy days. Only about 1 in 10 subprime loans are to help first-time buyers. It is not about helping people get into homeownership. It is people who have had life's rainy days. Someone in the family got sick. Someone lost their job. They went through a divorce. They had to repair their home. They got in over the heads in credit card debt. They needed to borrow money against their home. That is the bulk of what we're talking about. And the mortgages they're entering are frequently mortgages they can't possibly pay back. Not—the might be able to pay a teaser rate. They can't possibly pay the mortgage back.

The bankruptcy laws have long been intended to help give people a fresh start. And we see that in business. It seems almost cynical—strike "almost." It is cynical the way many businesses take a quick dip into bankruptcy and high net worth individuals, what we call in North Carolina rich folks. They can go into bankruptcy. They can shirk their obligations, obligations that they entered with their eyes wide open, with plenty of advice from lawyers and accountants and financial planners and actuaries, and any other kind of advice they get.

And they can rewrite all of those obligations. They can rewrite their pension obligations. They can rewrite their health care obligations for employees. They can rewrite their debt. They can rewrite their union contracts. They can get a fresh start. And usually after they come out of bankruptcy, the top executives all pat themselves on the back for their good work by giving themselves a nice bonus.

But for the American homeowner, they can't get a mortgage obligation rewritten in bankruptcy. They used to be able to. But just in the last 2 or 3 years, when Congress changed the bankruptcy laws, they said bankruptcy judges could not rewrite loans, could not rewrite mortgages.

American homeowners, the American middle class, needs someone on their side. American business has someone on their side. The American homeowners need someone on their side. They need Congress on their side, and I hope we will be.

The CHAIRMAN. I thank the gentleman. The first panel consists of two of our colleagues who have each, a former mayor and a former housing advocate respectively, Mr. Turner and Ms. Kaptur, a longstanding interest in housing. I believe our colleague from Ohio, Mr. Turner, has been the chair and is the ranking member of the relevant subcommittee on the Government Reform Committee. Ms. Kaptur has been on the Appropriations Subcommittee. So we have had a shared interest in jurisdiction here and we look forward to their testimony. I will begin, in order of seniority, with the gentlewoman, Ms. Kaptur.

STATEMENT OF THE HONORABLE MARCY KAPTUR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Ms. KAPTUR. Mr. Chairman, I cannot thank you enough, and Ranking Member Bachus—

The CHAIRMAN. Most people cannot either, I noticed.

Ms. KAPTUR. And all of the dear colleagues of ours on this very significant committee of the House for helping us tell our story and to provide some moments of enlightenment so we as a people can work forward together.

There is a cartoon character some of you may have been familiar with named Joe Bifflestick and he was a character who walked around with a dark cloud over his head all the time. And I can tell you that dark cloud is hanging over Ohio today and it is hanging over my region of Ohio, the northern third more than the southern two-thirds of Ohio. But it is dark and it is foreboding and it is having an enormous impact on our economy.

Ohio thanks you for allowing us to testify today. If our Governor, Ted Strickland, were here, he would thank you. I can tell you that the Mayor of Cleveland, Frank Jackson, who could not be here

today, his City is the most affected in Ohio, would thank you. Our Mayor in Toledo, Carlton Finkbeiner, thanks you. The Mayor of Port Clinton, Tom Brown, an associate of Congressman Gillmor, thanks you for this opportunity to tell Ohio's story and to give some guidance to the Nation.

We know that in the fourth quarter of 2006, Ohio experienced a higher rate of foreclosure than any other State in the Union. So by allowing us this opportunity to appear before you, you have brought ground zero on mortgage foreclosures to the Congress of the United States.

In fact, our rate is 3 times the national rate of foreclosure. In our 9th District, one of the most impacted regions, I can tell you every weekend when I go home I am met by a flurry of "For Sale" signs. You cannot go anywhere—auction signs, for sale signs. This is not productive to have the real estate market collapse in any part of the country, particularly a major State like our own.

This impacts families. It is impacting communities. I can tell you it is impacting the real estate industry. It is estimated that Ohio's near term credit crunch gap, if we were to try to refinance everything and make it whole in some way, is $14- to $21 billion looking forward.

We have not hit the crest of this. We are just starting up the bell curve. We have not hit the crest because we will have over 200,000 mortgages reset this year and next.

We know that there are numbers that were mentioned this morning by Congresswoman Waters, for example, over 2 million foreclosures that are predicted nationally just in the subprime mortgage market. But I can tell you it is not just the subprime market. It is largely the subprime market, but the "regular" market is also being impacted.

The cumulative impact of irresponsible lending, irresponsible borrowing and the mortgage securitizing process has threatened the safety and soundness of our financial system. And I think as this thing rolls out over the next year we are going to see that more and more. My message this morning is simply that America can do much better.

Mr. Chairman, my testimony is extensive. I will ask unanimous consent that it be submitted for the record.

The CHAIRMAN. Without objection, yours and your colleagues will be submitted for the record.

Ms. KAPTUR. Along with extraneous materials.

I want to focus my remarks this morning on three things. Ohio's foreclosure crisis in order to enlighten and instruct, to urge your committee which it sounds like you're already doing to develop immediate actions to help stem further foreclosures and then undertake long-term solutions to restore the three Cs of lending: character; collateral; and collectibility; and put due diligence back into the safety and soundness of the financial system of this country as it relates to real estate.

We believe, I believe, that system has been violated by a mortgage-backed security system that fails to provide accountability in underwriting, proper management of loan assets, and checks and balances for both the mortgager and the mortgagee.

Thirdly, I would like to suggest that action by your committee may not be sufficient to address what is required and I would urge you—and Congressman Miller made a reference to this—to review changes to bankruptcy laws that impact what is happening as well as securities market regulation as essential elements of a comprehensive solution.

For the record, I am submitting lots about Ohio. We know that our foreclosure rate has been exacerbating dramatically over the last 10 years. Data from 12 of the 13 largest Ohio counties indicated that 2006 foreclosure filings increased by roughly 25 percent over 2005 with an estimated 80,000 additional foreclosure filings. In 2006, all but 10 of Ohio's 88 counties saw an increase in the number of foreclosure filings.

I can tell you two of the counties I represent, Lucas County and Lorain County, experienced a 210 percent and a 445 percent growth respectively, in foreclosure filings over the last 10 years. This is a situation that is not getting better for us.

I mentioned that the—

The CHAIRMAN. Would the gentlewoman sum up, please?

Ms. KAPTUR. Oh, my.

Mr. BACHUS. I would like to ask unanimous consent for 2 more minutes.

The CHAIRMAN. Without objection, the gentlewoman will get 2 additional minutes.

Ms. KAPTUR. I thank the gentleman very much for that.

Let me just describe what a real estate industry representative said to me. The problem when we try to work out a solution is, let us say we call Countrywide and we try to do the work-out. We cannot find the person to do the work-out with because Countrywide's person says, "We cannot take care of that. We have sold your loan into the secondary market."

"Well, which company on Wall Street sold it?"

They go to Wall Street. They go to try to find the loan and Wall Street has sold it into the international market. There is no person to work out the loan with.

In terms of recommendations, in terms of short-term recommendations, I would recommend, and I have summarized these in my testimony, rescue funds to assist groups like Neighborhood Housing Services, which is dealing with a small portion of those affected.

Financial work-outs, and this is really important, OHFA, the Ohio Housing Finance Agency, is going to issue a $500 million bond offering this year in Ohio. That is small. That will deal with thousands, not tens of thousands of people affected.

I would urge the committee to look at establishing some type of secondary market for specialized bond offerings like this that could link to States that have put in place programs to deal with this.

I would look at loan remediation programs to help community development finance institutions and groups like Fair Housing Centers that are working on these issues. But they are only accommodating about 8 percent of the need in Ohio. And, finally, additional funds for housing counseling at HUD.

In terms of national solutions, I would urge this committee to invite before it the Presidential Working Group on Financial Markets

chaired by the Treasury Department but involving the SEC, the Federal Reserve, and the Commodity Futures Trading Corporation, which is structured to deal with financial crises of this magnitude.

I would ask you to look at restructuring current mortgages and establishing mechanisms through HUD and perhaps the Federal Reserve to help families restructure their loans. Congresswoman Maloney talked about extending the mortgage term to 40 years. I support that type of solution, but it is not the only one. Increasing refinancing programs, I mentioned the additional housing counseling, the bankruptcy moratorium, and to engage the mortgage-backed securities firms to engage in the restructuring and finally and I know you are already thinking about this, regulation of the securitized mortgage in subprime mortgage industries. More stringent underwriting criteria—

Mrs. MALONEY. [presiding] I grant the gentlelady an additional minute.

Ms. KAPTUR. And finally on the predatory lending, it seems to me that what was lost in all of this—and we can put blame in many quarters—is the rigor that goes into and discipline that goes into making a loan and servicing that loan. This has been lost in this current system.

Ohio thanks you very much for the opportunity to be here and I welcome the testimony of my colleague, Mr. Turner, whose Dayton area shares in the pain that our region of Ohio is experiencing. And I thank the gentlelady for the additional time.

[The prepared statement of Ms. Kaptur can be found on page 65 of the appendix.]

Mrs. MALONEY. Thank you. The Chair now recognizes Congressman Turner. Thank you for joining us.

STATEMENT OF THE HONORABLE MICHAEL R. TURNER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. TURNER. Thank you. Thank you for having me today. I want to thank Chairman Frank, Ranking Member Bachus, and my fellow Ohioan, Congressman Gillmor, for inviting me to participate in recognizing Congressman Gillmor's ranking member status on the Financial Institutions and Consumer Credit Subcommittee. And I want to acknowledge and appreciate being able to participate with my fellow Ohioan, Marcy Kaptur.

Today is a story of lost homes, lost confidence in property values in neighborhoods, lost capital in markets, and, of course, loss tax revenue for local governments.

In the last Congress, I was fortunate to be able to chair the Government Reform Subcommittee on Federalism and the Census. We spent 2 years looking at issues of community development block grants with, of course, Congresswoman Maloney, the importance of historic preservation, public housing, revitalizing neighborhoods through brown fields and also working with former Chairman Oxley, another Ohioan, on the issue of predatory lending where he came to my district and held a forum on the impact of predatory lending in neighborhoods.

And I have also worked with another fellow Ohioan, Chairman Kucinich of the Government Reform and Domestic Policy Sub-

committee where last month he held a hearing on the topic of predatory lending and the impact on urban America.

Today we have before us the important issue of home foreclosures. The latest figures from the Mortgage Bankers Association tell us that home foreclosures are at a record high. I do not want to agree with Congressman Brad Miller on the bulk of the loans that we are seeing in my community are not first-time homebuyers. They are, in fact, individuals who have been successful homeowners who have refinanced and are now finding themselves in the unfortunate situation of being in foreclosure.

Last month, at the Oversight and Government Reform Subcommittee hearing on this issue, Jim McCarthy, CEO of the Miami Valley Fair Housing Center in my district testified about this problem in the Dayton region.

According to a study commissioned by the Fair Housing Center, foreclosure filings in Montgomery County, Ohio, doubled from 1994 to 2000 going from 1,022 foreclosures to 2,400 foreclosures and subprime lenders were responsible for a disproportionately high share of that increase.

Additionally, since the study was completed, mortgage foreclosures have continued to rise to 5,075 in Montgomery County in 2006. The lending problem has an equally troubling impact on the entire State of Ohio. According to the Mortgage Bankers Association, for more than 2 years now, Ohio has had the highest rate of foreclosures. The percentage of loans in Ohio that are in the process of foreclosure was at 3.3 percent, approximately 3 times the national average.

In 2001, the University of Dayton released a study measuring the regional numbers of mortgage foreclosures in Ohio. They found that in Cleveland, Lorain, Aleria, and the Mentor area, they had 1 foreclosure for every 40 households. Akron ranked 16th, with 1 foreclosure for every 43 households. Other cities in the top 100 were: Dayton, my community, which ranked 15th in the Nation, with 1 foreclosure for every 43 households; Columbus ranked 19th, with 1 foreclosure for every 45; and Cincinnati ranked 49th, with 1 foreclosure for every 87 households.

According to Mr. McCarthy's testimony, because of the foreclosure crisis in Ohio, a task force consisting of the Cuyahoga County Foreclosure Prevention Office, Fannie Mae, the Federal Reserve, Freddie Mac, Miami Valley Fair Housing Center, National City Bank, Neighbor Works Option 1, and led by from Congresswoman Kaptur's area, the Toledo Fair Housing Center, worked through 2006 gathering information on foreclosures in the State, and in November 2006, hosted the Ohio Foreclosure Summit in Toledo, Ohio.

Prior to the Foreclosure Summit, a series of workshops were held throughout the State in six locations. Home foreclosures resulting from predatory lending have taken a toll in American cities. Properties which are foreclosed often sit vacant for long periods of time and not only become eyesores but become a threat to public health and safety. Boarding up neighborhoods results in failing property values, increased crime, and an eroded tax base, as well as impairing a city's ability to provide important services to urban families.

Additionally, as I served as Mayor in the City of Dayton and faced this issue commencing about 10 years ago and looking at how it impacts homeowners, my community continued to wonder how the financial markets would be able to sustain the losses associated with these mortgage foreclosures.

Beyond the individual impact resulting from predatory lending, these practices were resulting in the loss of capital in the market that cumulatively one would expect that would have a cascading effect. And today we are seeing headlines showing the growing concerns of financial markets regarding predatory lending practices.

Owning and maintaining a home is a challenge even in the best of financial circumstances. I believe that homeownership is a privilege that everyone should enjoy, but we must not allow the dream of homeownership to be shattered because of questionable and less than honest mortgage practices that can steal an individual's future.

I want to thank Chairman Frank and Ranking Member Bachus and, of course, Congresswoman Maloney, for the opportunity to testify before you today.

Just recently I met with a representative from my realty community and I also learned there that there are tax consequences for individuals who are subject to predatory lending and seek a work-out. That individuals who do not go through foreclosure or do not go through bankruptcy can find that if they do a work-out situation with the mortgage lender that they can be sent a Form 1099 and have to pay taxes on the difference. That is another issue that's impacting the finances of families that we need to take a look at.

Here is a sample of some of the headlines from Ohio: "Ohio's Foreclosure Crisis Hits the Suburbs." "Report shows Ohio foreclosures rising." "State foreclosure crisis worsens substantially in 2006", and "Dayton Fifteenth Nationally in Foreclosures."

When I served as Mayor, we sought to assist individuals in providing them communication as to what to avoid. In our educational attempt, we tried to get people to look out for balloon payments, variable payments, unusually high interest rates, payment penalties, or looking to roll their other bills into their mortgage payments and, of course, to read the fine print. Ohio is taking some action in the area of consumer protection. We are certainly hoping that their effort will have an impact in protecting individuals who are seeking the dream of homeownership. Thank you.

Mrs. MALONEY. I want to thank both of my colleagues for bringing the perspective from your communities and helping us to further understand the challenge.

I would like to ask Marcy Kaptur and Michael Turner, could you elaborate on how Ohio's new predatory lending law has helped the subprime lending problem in your State?

A number of my colleagues in their opening statements mentioned that some States have good anti-predatory lending laws in place and still the foreclosure problem exists. So, could you bring the perspective of what your localities are doing to combat this. I understand you have passed a new predatory lending law. What has been the impact and what do you see the impact of it being in the future?

Ms. KAPTUR. Yes. I could say, Madam Chairwoman, before I answer that question, that there was one important point I forgot to mention in my remarks although it is in my testimony. And that is that I would urge the committee to consider some type of office at HUD that would be a full-service mortgage foreclosure hotline which is inclusive, well advertised, does advertising out in the country, and is well-staffed and aggressive.

One of the problems in this whole arena is that there are so many people taking little pieces of responsibility, there is no central place you can go. And, as I mentioned with some of the companies that are out there having made these loans and sold them off, they cannot answer the question either. So however that might be structured, I would urge you to think about that because people are losing their homes, they're losing everything before they have anybody even help them. And as hard as the counseling agencies are trying—and they are—the numbers they are able to help are small. For example, Neighborhood Housing Services has income limits. And, if you fall above that income limit, you cannot get their help.

Mrs. MALONEY. I think that is a very valid recommendation. It is one the committee will consider and we thank you for it.

Now could you comment on your predatory lending law and the impact?

Ms. KAPTUR. I can tell you that in Ohio, where legislation was passed, it is not retroactive. And, therefore, it does not deal with the carnage that we have experienced to date and it has just been passed and, therefore, I could say it has no impact yet in Ohio. I do not know what Mr. Turner's experience is, but it was a very hard-fought issue in our State legislature.

Mrs. MALONEY. Thank you.

Mr. TURNER. The bill was passed in July of 2006. So, Congresswoman Kaptur is describing to you really the situation that we have now as we look forward to what that law might have as an impact on consumers when they go to seek loan products.

Another aspect that should probably be reviewed and which I am not prepared to speak on is that in Ohio also there has been the initiation of criminal action against many of the predatory lenders that have taken advantage of consumers.

Now many of the instances where predatory lending has occurred have some element of fraud either in the valuation of the property or in the loan documents themselves. And under existing laws, there are actions that are beginning to be commenced to enforce those laws.

Mrs. MALONEY. I thank the gentlewoman and gentleman for your testimony. I have no further questions.

Mr. Gillmor? No questions, all right.

Are there any questions from the panel?

Thank you very much for your testimony and we will call the next panel. I would like to welcome the second panel: the Honorable Sheila Bair, Chairman of the Federal Deposit Insurance Corporation; the Honorable Brian Montgomery, Assistant Secretary for Housing-Federal Housing Commissioner, U.S. Department of Housing and Urban Development; Mr. Daniel Mudd, president and chief executive officer, Fannie Mae; and Mr. Richard Syron, chairman and chief executive officer, Freddie Mac.

Welcome, and we will begin with Chairman Bair.

STATEMENT OF THE HONORABLE SHEILA C. BAIR, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Ms. BAIR. Madam Chairwoman, Congressman Gillmor, and members of the committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation regarding our continuing efforts to address the problems faced by subprime mortgage borrowers.

Yesterday, the FDIC, along with the other Federal regulators, including the SEC and OFHEO, hosted a forum with principal participants in the subprime mortgage securitization market. The forum included lenders, servicers, trustees, investors, attorneys, tax experts, consumer groups, rating agencies, and accountants.

Our goal was to facilitate an exchange of ideas and an industry-led consensus on ways to help struggling subprime borrowers avoid foreclosure while maintaining the integrity of the secondary market.

At the outset, it should be emphasized that securitization has had a positive impact on credit availability to the overall benefit of the Nation's homeowners. It is an essential process in the U.S. mortgage market. By packaging loans into securities and diversifying the risk by selling these securities to a broader array of investors, securitization has increased credit availability to borrowers, reduced concentrations of mortgage risk, and improved the liquidity of the mortgage markets.

The result has been the development of a variety of lending products that have contributed to unprecedented levels of homeownership in this country. Unfortunately, the benefits of securitization have not been achieved without cost. The excess liquidity generated by securitization, especially in the subprime mortgage market, has encouraged a departure from traditional underwriting standards as lenders quickly sell off higher risk loans rather than retaining them in portfolio.

Far too many borrowers have been given mortgages they cannot afford and have little prospect of refinancing in light of today's real estate and loan market conditions. Almost three-quarters of securitized subprime mortgages originated in 2004 and 2005 were so-called "2/28 and 3/27" hybrid loan structures. These loans are characterized by lower payments during the first 2 to 3 years with payment shocks of 30 percent or higher after the loan resets.

According to one study, an estimated 1.1 million subprime loans will reset in 2007. An additional 882,000 subprime loans will reset in 2008. Most of these borrowers, probably all, will have great difficulty in making their higher payments.

Many subprime borrowers could avoid foreclosure if they were offered lower-cost more traditional products such as 30-year fixed rate mortgages. Restructuring would allow them to stay in their homes, repair their credit histories, and dampen the impact the foreclosures could have on the broader housing market.

The FDIC, along with the other Federal banking agencies, will issue a formal message today to banks encouraging them to find more affordable, sustainable products for borrowers who are currently struggling with hybrid adjustable rate mortgages.

It is important to note, however, that there is a limit to what insured banks can do to assist many of today's distressed borrowers because most subprime loans have been securitized or sold into the secondary market. Securitization has greatly complicated the loan restructuring process, reducing flexibility for addressing problems of distressed borrowers.

What was once a simple, often personal, relationship between a borrower and a lender is today a complex structure involving many parties, including servicers, investors, trustees, and rating agencies. Yesterday's forum provided useful insight into the ability of loan servicers and other securitization participants to work with troubled borrowers. Every participant agreed that foreclosure of owner-occupied homes was rarely, if ever, the best option for the investors or the borrowers. Every participant also agreed that early contact between borrowers and servicers increases the opportunities to help borrowers facing financial distress.

Recognizing this, many financial institutions servicing loans that have been securitized are proactively contacting borrowers facing rate resets and seeking to modify the problem loan terms, such as extending the initial interest rate for the life of the loan and thereby eliminating the threat of payment shock altogether.

I would encourage borrowers who anticipate having difficulty making payments to take the initiative and seek assistance even if they have not been contacted. They should contact their servicer, the entity that receives their monthly payment, as soon as possible. The contact information for the servicer can be found on the monthly billing statement.

During the forum, we identified three distinct categories of subprime borrowers. The categories are: one, borrowers who are able to refinance their loan prior to the reset in normal course; two, borrowers who are living in their homes and making regular payments at the teaser rate but will not be able to make the higher payments after reset; and, three, borrowers in early payment default—some of these loans could involve speculative investment or fraud. Each category will require different approaches.

For borrowers who are eligible to refinance their loans, a fixed rate mortgage may offer the same or even a lower rate than the starter rate on a hybrid ARM depending on the credit history of the borrower and the ability to document income. Given the realities of today's housing market, I would strongly encourage these borrowers to consider refinancing into fixed-rate products.

For borrowers in the second category who have been occupying their homes, making regular payments at the starter rate, but are unable to make the higher payments at reset, the consensus of forum participants was that loans held by these borrowers should be restructured at a rate they can afford to pay over the long term.

The forum participants agreed that there is considerable but not unlimited flexibility for servicers to restructure or modify troubled loans. In many cases, to achieve this result, there will be a role for housing finance agencies and consumer groups to assist in the transition. Roundtable participants agreed that servicers should actively work in partnership with consumer groups and housing agencies.

During the forum we did learn that there are impediments and restrictions on what loan servicers can do. Accounting rules, REMIC tax rules, and the securitization documents can limit flexibility in restructuring loans.

For example, some accounting rules, such as FAS 140, limit the ability of servicers to restructure loans on a proactive basis by requiring the loan to be delinquent before the servicer can modify or restructure the loan. These constraints underscore the necessity for policymakers and the industry to work together to provide servicers with the flexibility to modify and restructure troubled loans.

The final category of borrowers includes those who have defaulted early and where there may be fraud or speculative investment. Unfortunately, these loans are obviously going to be much more problematic and many may ultimately end up in foreclosure.

The forum was designed to facilitate industry solutions to the current problems in the market. During the day an action plan began to take shape. Industry participants specifically agreed to work together to create mechanisms for working with distressed borrowers that would benefit all parties involved.

To be honest, there is no silver bullet. This will be a difficult process. It will take time to work out, but I believe yesterday's forum was a good first step. That concludes my statement. Thank you.

[The prepared statement of Chairman Bair can be found on page 93 of the appendix.]

Mrs. MALONEY. Thank you.

Mr. Montgomery?

STATEMENT OF THE HONORABLE BRIAN D. MONTGOMERY, ASSISTANT SECRETARY FOR HOUSING–FEDERAL HOUSING COMMISSIONER, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. MONTGOMERY. I want to thank you, Madam Chairwoman, Ranking Member Bachus, and distinguished members of the committee, for the opportunity to speak today. As you know, FHA's purpose is to serve low- to moderate-income homebuyers who have less than perfect credit and little savings for a downpayment.

However, I would like to qualify for the record—clarify, rather, that while the FHA insures borrowers with profiles similar to those of subprime borrowers, FHA does not insure subprime loans. FHA requires borrowers to meet strict underwriting criteria, including that they must document their income, not just state it.

And unlike most subprime mortgages, FHA does not offer teaser rates or utilize prepayment penalties. And the borrowers do get in over their heads, for example, they lose their job or have other life events that prevent them from keeping current on their mortgage. We have one of the best loss mitigation programs out there. As a matter of fact, last year, we assisted more than 75,000 FHA insured families by preventing foreclosure through our loss mitigation program.

The rise in subprime foreclosures, however, is far from a surprise for most people in this room. In fact, at my confirmation hearing before the Senate Banking Committee in June of 2005, I told the

committee that I thought many subprime borrowers would have been and could be better served by a modernized FHA.

I do not mean to infer that all subprime lending is harmful. The subprime markets served many borrowers well and in many cases this option was the only way for them to achieve homeownership. In recent years, though, as the subprime industry grew exponentially, this committee was well ahead of the curve in understanding the role a modernized FHA could play in offering those same homebuyers a safer, more affordable financing option.

The leadership of many people here on this issue was well received in June of last year when the FHA Modernization Act passed the House of Representatives by a vote of 415 to 7. Under the modernization proposal, FHA would have been given the expanded authority to charge insurance premiums commensurate with the risk and increase maximum loan amounts. This would allow us to dive deeper into the pool of homeowners who could benefit from a refinancing of their subprime loan. FHA could also potentially assist thousands more borrowers who need an exit strategy from their subprime mortgages.

Modernizing FHA is a most practical and immediate way to address the needs of a large number of subprime borrowers. FHA modernization legislation has already been filed in both the House and the Senate again. We look forward to the hearings to discuss those bills, but back to the subprime borrowers who have been noted in many cases are paying interest rates of 10 percent or more. Refinancing into an FHA insured mortgage can, on an average $200,000 mortgage, save a qualifying borrower $3- to $4,000 in the very first year. Thus, FHA could save borrowers substantial money and do so in a financially sound manner.

I am pleased to report that there are actually an increasing number of conventional borrowers who are already refinancing into FHA. We estimate that at least 60 percent of those are subprime borrowers. In fact, for the first 5 months of 2007, conventional to FHA refinancings were up 94 percent from the same period in fiscal year 2006.

In efforts to assist more subprime FHA refinances, we have been working hard on outreach since October of last year in particular in the States of Pennsylvania, Ohio, and West Virginia. We have conducted hundreds of meetings nationwide with groups of housing counseling agencies, lenders, and Realtors to promote the refinancing through FHA of subprime and other high cost loans.

While FHA as it stands today is witnessing an upward trend of refinances by likely subprime borrowers, we are still considering some programmatic changes to assist more subprime borrowers in trouble.

We recognize that many subprime borrowers have mortgage debt that far exceeds the value of their homes. In addition, one factor that may prohibit many of these borrowers from refinancing out of their subprime mortgage is the cost of the prepayment penalty, a common feature of subprime loans. FHA staff has also been analyzing our ability to restructure our underwriting guidelines to serve more of the troubled subprime borrower pool.

Please keep in mind that while we would like to stabilize the mortgages of as many homeowners as possible, I have to protect

the solvency of the FHS insurance fund, so there will be a limit to what we can accomplish. We can help families that can document their ability to afford payments on a fixed market rate loan.

Mrs. MALONEY. I grant the gentleman an additional minute.

Mr. MONTGOMERY. Thank you.

With the FHA insurance premiums. These families must also have sufficient equity to qualify for FHA financing. I do want to restate in closing we would like to help as many subprime borrowers as possible while maintaining the soundness of the FHA insurance fund.

In closing I would like to thank you for your leadership and for understanding the need for FHA to be modernized to help low- and moderate-income families achieve the dream of homeownership for the long term. Thank you.

[The prepared statement of Secretary Montgomery can be found on page 170 of the appendix.]

STATEMENT OF DANIEL H. MUDD, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FANNIE MAE

Mr. MUDD. Thank you Mr. Chairman, Ranking Member Bachus, and members of the committee, for inviting me to this hearing on the solutions to the problems arising in the subprime market.

Fannie Mae is committed to being a part of a solution that keeps people in homes, minimizes market disruption, and improves practices and products for consumers. We have a history of working with lenders to serve families that don't have perfect financial profiles. Subprime is, after all, simply the description of a borrower who doesn't have perfect credit, and we see it as part of our mission, our charter, to make safe mortgages available to people who don't have perfect credit.

Today's problem is that people are caught in confusing, unsafe mortgages. In early 2005 we began sounding our concerns about this so-called layered risk lending, and we applied strict anti-predatory lending standards to our loan purchases with 11 separate categories of qualifications. Unfortunately, Fannie Mae's version of quality, safe loans did not become the standard and the subprime lending market moved away from us, and here we are.

We lost a lot of share, but as a result our exposure remains relatively minimal, less than 2.5 percent of our book. While our approach to the subprime market helped to protect our company, our lenders, and our borrowers, it has now also, I think, given us some room to support the market.

We want subprime borrowers to have a fair shot at homeownership. We think simple, straightforward, fixed-payment mortgages are generally the best products for these borrowers. We are just a secondary market company. We can't solve all of the problems but we can't wash our hands of them either. Economic history has a way of punishing the most vulnerable first and last and we should try to avoid that as the lasting effect of the subprime clean up.

So what are we going to do? Fannie Mae has committed to help through a new company initiative that we call HomeStay, which has three basic parts. First, we are working with our lender partners to help homeowners avoid immediate foreclosure. Last year we already performed 27,000 loan modifications. HomeStay provides

lenders with systems and products to help borrowers before it's too late. In fact, currently we work out most troubled loans, thereby avoiding foreclosure 58 percent of the time.

Second, we are working with our lender partners to help homeowners avoid payment shock and transition to safer products. HomeStay simplifies our underwriting requirements, extends loan terms, and expands the distribution of our affordable options so more lenders can refinance more people. We estimate that about 1.5 million homeowners who face resetting ARMs and potential payment shock this year and next could be eligible for these loan options.

Third, we are working with our housing partners to help counsel the most vulnerable. HomeStay will include those for whom a modification alone will not save the day. We are working with nonprofits. We are launching a Know Your Mortgage campaign in English and Spanish and expanding the distribution of our free home counselor online system beyond the 2,000 agencies that use it now.

Finally, Fannie Mae will continue to support better lending guidelines. When banking regulators finalize the proposed new guidelines, we will work with our industry partners to comply with them. We look forward to working with this committee and the Congress as we serve our mission and fulfill our charter, and I thank you for giving me the opportunity to testify today.

[The prepared statement of Mr. Mudd can be found on page 175 of the appendix.]

Mrs. MALONEY. Thank you

And finally Mr. Richard Syron, chairman and chief executive officer of Freddie Mac. And I must take this opportunity to congratulate you for voluntarily following the Federal guidance on subprime loans.

STATEMENT OF RICHARD F. SYRON, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FREDDIE MAC

Mr. SYRON. Thank you. Thank you very much, Madam Chairwoman, and I want to thank Chairman Frank, Ranking Member Bachus, and all the members of the committee for this chance to appear before you on what I think is really a very, very crucial issue.

Freddie Mac shares the committee's deep concern that low- and moderate-income and minority families may be disproportionately hurt by rising levels of subprime mortgage foreclosures in that some communities, as we've heard about here today, with high concentrations of these mortgages will be seriously affected. And what we're all about here today is to talk about how we can ameliorate that.

Let me very quickly summarize what Freddie Mac is doing about it. As the gentlelady acknowledged, this year Freddie Mac said we would restrict subprime investments in securities backed by mortgages to those that are underwritten on a fully indexed base that are underwritten on the basis of insurance being provided for and that avoid no income, no asset verification. But that's something you can look at as going forward in a way to do no harm, if you will.

These efforts follow a strong leadership position on our part. I don't need to go through them all, but we've taken a lead in single premium life insurance, prepayment penalties, and mortgages with mandatory arbitration clauses.

Now this was noted by my colleague, Mr. Mudd. As I described in my testimony, some of our initiatives were followed by other market participants, but in other cases, to be quite candid, people just went around us. The plain fact of the matter is that Freddie Mac and Fannie Mae together are not powerful enough at this point in time to dictate what the market can do. We can lead the market, but we cannot dictate the market, and to the degree, even in what we're going to suggest today, that some market participants do not follow us, a leadership position won't do any good.

In addition to appropriate underwriting standards, we are currently working on a major effort to develop more customer friendly subprime mortgages and to have them ready by this summer. These offerings will include 30-year and possibly 40-year fixed rate mortgages and ARMs with reduced reset mortgages and longer fixed rate periods. We are designing these products to have a significant ameliorative effect on subprime going forward.

And again, I think a very important principle we've set in trying to do this is to make these things simple because in so many cases people have gotten into trouble by walking in and finding out they had to sign 8 inches worth of documents.

Now to address immediate borrowing needs, we are going to modify our existing Home Possible mortgage lending. What Home Possible does, very simply, is allow very high loan-to-value ratios to borrowers with blemished credit and who may be financially extended relative to their income. I mean these are folks who just don't have good credit compared to some others.

These characteristics overlap with those in the subprime market. This is something we've had out there for a while, but because we've had these anti-predatory conditions on them, they really haven't been as popular as they might be. But maybe things, because of what this committee is doing, are going to change.

Now while these efforts will help cushion the expected rise in foreclosures, we need to make clear that there's no one panacea. The problems we're facing in subprime are complex and they're very long in the making. I wish there was a simple, single solution, but unfortunately there's not. It's going to take all of us, and you're reflecting that here today; the regulators, the Administration, the Congress, the mortgage industry, and the GSEs working together to find a solution.

First and foremost, regulation is needed to ensure that borrowers have all the information they need to make informed mortgage choices in plain language. And I know the Mortgage Bankers Association is working on something. To be most effective, consumer disclosures need to be uniform and consistently applied. Second, we have to face that good regulation would also set a kind of a common social contract or notion of what an acceptable level of default is.

The plain fact of the matter is that everyone in the United States, at least initially, can't end up being in an owner-occupied house. I mean there may be for some people as an initial place—

my parents came from Ireland. We lived in multifamily housing for the first 7 years I was alive while they saved up enough to have a first downpayment. I'm not saying that applies to everyone, but some people need multifamily housing, at least in the beginning.

Third, it seems to me that good regulation must ensure a level playing field. As long as some institutions or areas of the country operate under different or no regulatory structures, potential for these sorts of excesses and abuses will exist. There are a lot of investors in the market, and relying on any one set of participants will be ineffective.

As a case in point, relying on the GSEs to regulate the behavior of other entities will not work when people can go around the GSEs. Let me just—

Mrs. MALONEY. I grant the gentleman an additional minute.

Mr. SYRON. Okay. Let me just finish by sort of where we think the market is. We think the market is essentially the subprime market, about a $3 trillion market that's divided into thirds, one third of which can probably be dealt with on its own, one third of which is going to require some new products, and one third of which is going to require some sort of deep discount approach to get a solution on this.

The last thing I want to say is that we are deeply committed to developing approaches for all of these things even though we haven't been heavily involved in subprime all along. Secretary Montgomery said, and I think it's right, "We're all here to protect the American Dream," but what we want to do at Freddie Mac is, in protecting the American Dream, we want to be sure that predatory behavior doesn't end up making it the Nightmare on Elm Street for a lot of people.

Thank you.

[The prepared statement of Mr. Syron can be found on page 179 of the appendix.]

Mrs. MALONEY. I thank all of the participants for their testimony, and without objection, your written statements will be made part of the record.

I would like to ask Sheila Bair to comment further about the securitization conference she was at. And also, on a comment from the first panel where many of you have come forward with many ideas of what can happen and some of you have taken steps already to help refinance and to help people stay in their homes, but how do we get this information out to the public?

Congresswoman Kaptur suggested a central office in HUD where all of this information is compiled so homeowners that may be losing their homes know where to go to get this information. Could you comment on how we can reach out and make people aware of possibilities to help them?

Ms. BAIR. Well, I think a lot can and should be done through the servicers. The servicers will be on the front lines working with the borrowers to try to restructure loans that are unaffordable or will soon become unaffordable because of payment reset. It's crucial that the servicers work with the community groups too, in neighborhood outreach. There's a significant trust issue now given that some of these mortgages are creating so many problems, and I

think it's very important for servicers to work actively with community groups.

NeighborWorks is a national umbrella group of a number of nonprofit organizations that is providing proactive counseling services. HUD maintains a list of qualified housing counselors. So I think there are resources there already, but I think we really need to motivate the servicers. The major ones are doing it on their own now—proactively reaching out to borrowers whom they see will be confronting payment shock and helping them walk through their choices and potential restructurings.

Mrs. MALONEY. Okay. You testified earlier that for the investors to take lower fixed rates to assure an income stream on performing loans rather than proceeding to foreclosure is obviously what we should be doing. What can government do to encourage that?

Ms. BAIR. Well I think, based on the forum yesterday, I think the industry is there. I think everybody agrees, including the individuals who were representing investor groups agreed, that it's going to be in their interest as well as the borrowers' interest for owner-occupied homes to keep people in their homes.

I think just sending a strong message along those lines may be beneficial in terms of showing congressional leadership. There was some concern among the servicing community about potential shareholder liability of some investors suing if too much was done to accommodate borrowers in terms of reducing interest rates. So, I think government making clear that we think that's the wise choice, policies making clear that that's the wise choice, I think, will help the servicers secure the legal opinions they need to restructure these loans so that the loans are affordable and continue to be affordable. There may be other options.

The forum, we think, was just a first step. The industry agreed to come back to us with a "battle plan." We're still looking at whether potentially there may be statutory initiatives that could help with the immediate problem of modifying these loans. Right now I think it's just important for policymakers to exercise leadership and strongly convey what is obvious, I think to most, namely that it's in both the investors' and the borrowers' interest to keep people in their homes.

Mrs. MALONEY. And how much of the secondary market is bound by third party consent requirements? Are they able to make adjustments or do they need a third party? Have you looked at that?

Ms. BAIR. Yes, that's a good question. If it is reasonably foreseeable that there will be a default, then most of these securitization agreements give servicers significant flexibility.

There are a number of servicer PSAs—Pooling and Servicing Agreements—that have 5 percent caps. They allow servicers to restructure only 5 percent of the loans in the pool, and require that a super majority of investors have to agree to change that 5 percent cap. This could be a potential problem.

Again, the read we were getting from the investor representatives yesterday is that they are supportive of this and perhaps Fannie Mae and Freddie Mac as investors could speak to that as well. That is a potential obstacle that will have to be overcome for those servicing agreements that propose this 5 percent cap.

Mrs. MALONEY. I'd like to ask Mr. Montgomery. Fannie and Freddie have indicated that they will, where appropriate, waive prohibitions on delinquent borrowers in order to assist borrowers in refinancing out of high cost ARMs. Could FHA use its authority to offer a refinancing alternative? What would be the barriers?

Mr. MONTGOMERY. Thank you for your question. At the risk of perhaps sounding like a bureaucrat, the two gentleman at my left have private corporations with immense more flexibility than I do to change programs. For one, if we were to make a modification such as you propose, a credit reform act, it requires that we put that through a stress test, so to speak, that we see how that performs relative to other FHA loans. I know this sounds like bureaucrat-ese, but because of the FHA Mutual Mortgage Insurance Fund, which we have to protect, we need to make sure that we operate any new program in a financially and fiscally sound manner. But I can assure you that's certainly one of the things that we are looking at relative to borrowers who happen to be in default.

There are some other things that we are looking at relative to loan limits, premium structure, but I want to get back to the central point I made in my opening statement. It was almost a year ago to the day that I appeared before this committee making a case for FHA reform for many of the same reasons that we're talking about today. And I can't stress enough through a reformed FHA with its flexibility to match premiums to borrowers, with its flexibility to have loan limits better reflect home prices, especially in high-cost States such as California, and basically from here all the way up to Massachusetts, we could not just help more borrowers avoid some of the pitfalls of the subprime, but 20, 30 percent of our business today are refis. We could help even more higher risk borrowers by having a modernized FHA.

So I want to stress that enough, however I do in the short term want to also stress that there are other things we are looking at to do being very mindful and protecting the solvency of the FHA insurance fund.

Mrs. MALONEY. We are looking at those reforms. My time has expired.

Congresswoman Biggert of Illinois.

Ms. BIGGERT. Thank you, Madam Chairwoman.

Mr. Mudd, I don't think you mentioned how many of the subprime mortgages that Fannie Mae holds.

Mr. MUDD. Yes, we have about 2.5 percent of our book that could be represented as being in subprime, either by virtue of coming from a lender that's designated as a subprime lender or that has terms that would generally be considered subprime.

You're absolutely right. The term is not a precisely defined one in the industry.

Ms. BIGGERT. Okay. And most of those loans either would be—since you have them or you have put them into bonds or they've been sold or packaged and sold to market investors, how do borrowers have the opportunity then to restructure their loans if they fall behind in the payment or somebody is trying to help them with that? Is that possible to do when the initial lenders no longer have the mortgages?

Mr. MUDD. It's a terrific question, and the answer is, it depends. In the case where the loans are in the form of whole loans, they're basically individual loans that we hold, for example in our portfolio. We have a very broad ability to restructure those loans and to create payment plans and basically to do anything we can to avoid foreclosure.

In our case, foreclosure is the least desirable and the most uneconomic alternative for a troubled borrower. As Ms. Bair was discussing however, when loans are held in the form of securities, those securities are structured with a series of agreements that give for legal reasons and accounting reasons and ownership reasons very specified authority to the servicer to restructure, which turns out to be quite limited.

Ms. BIGGERT. Would it be then that most of those loans that you might consider more risky would not be put into the securities, would not be secured that way?

Mr. MUDD. I'm not aware that there's a broad distinction between loans that could be in whole loan form or those that could be in securities from a risk stand point.

Ms. BIGGERT. Is there any—well, I'll ask Mr. Syron, if you have the same question then. How many loans would you consider subprime that Freddie Mac—

Mr. SYRON. In our book itself essentially we have no individual subprime whole loans. That's what's in our portfolio. Now it makes a big difference, as Dan said and as you recognize because, for example, when we had the Katrina situation, right, we applied forbearance for quite a substantial period of time, but we were able to do this in one of two circumstances, loans that were held by ourselves in our portfolio or loans that we had securitized, right; they had come through us and we had created the security. Since we had created the security, we could take those loans out of the security, take them into a book and then say, all right, we're forbearing on them and no one is being burdened by them.

The problem you have, as several people have pointed out, is that the subprime market really exploded for a variety of reasons, excess liquidity, all kinds of things. And as it exploded a lot of it went to what I would call nontraditional avenues. These nontraditional avenues don't have the situation where the loans are either in our book or are "agency securities," so you can't get at them as easily as you could in the other situation.

Sorry for going on.

Ms. BIGGERT. Thank you. And then Mr. Montgomery, it's my understanding that the major goal of the Administration's proposal is to encourage FHA to reclaim its share of the market that's been captured by the subprime lenders in recent years.

You talked a little bit about policies that you have right now that will try to attract these homebuyers, but do you think that legislation is necessary? As you're well aware, I'm sure, that both Mrs. Waters and I have introduced legislation aimed at reforming the FHA program; is this something that is necessary? You'd better say yes, but—

Mr. MONTGOMERY. I will say absolutely yes. Let me also add, and I've referenced this in previous testimony before another committee, FHA is not about market share. We're not a private cor-

poration. We're not here to make a profit. But to the degree that we can reinvigorate FHA to make it meaningful in today's marketplace to help more lower income borrowers, if that increases our volume by one loan, I will be happy with that.

I happen to think if we make it more meaningful in today's mortgage marketplace it will be more than one loan, but we're not about market share. In many ways, the mortgage market passed FHA by. We had some of our processes, some of our procedures.

I'll give you two quick examples. In the conventional market, if we've all purchased homes, if in part of the buying process you notice a tear in the screen door or a wobbly door knob, you make note of it. The seller either pays to have it fixed or deducts it from the cost of the loan. Not FHA, we require you to go back and fix every little cosmetic problem there was. We were also one of the last organizations to send case binders, the thick loan documents via U.S. mail or FedEx. Almost everyone in the industry, including our sister home buying agency, the Veterans Administration—

Mrs. MALONEY. I grant the gentleman an additional minute and then his time has expired.

Mr. MONTGOMERY. Thank you. Our sister home buying agency, the Veterans Administration, whom we consulted with in this, had been doing this since 1999, so yes those process and procedural improvements were long past due, but the bottom line is that we needed to have some flexibility to reach lower income borrowers in the premium structure. We need to have flexibility for the higher cost States to reach the loan limits, and we need to have some flexibility in the downpayment assistance, recognizing for a lot of working poor families, the downpayment is the biggest hurdle.

We thought by doing all those, all the while making sure that we protect the solvency of FHA mortgage insurance fund, we would ultimately help more borrowers, more lower income borrowers.

Ms. BIGGERT. Thank you.

Mrs. MALONEY. The Chair now recognizes Congresswoman Waters from California.

Ms. WATERS. Thank you very much. You have referenced my bill on more than one occasion here, and it is the same bill that passed this committee and this House with a bipartisan vote and we fully expect that Ms. Biggert will become a coauthor of my bill and that it will pass again.

Let me ask Ms. Bair, I have quickly reviewed your testimony and it seems as if you describe the problem in great detail. As you know, there has been some criticism of all of our regulatory agencies about being a little slow in seeing what was happening and doing something about it, and it seems to me that the guidelines are rather mild. They're commonsense guidelines.

What are you going to do about securitization? It seems to me that's where our problem is. It is not the traditional lender-buyer. And we can't get to—we can't restructure these loans, so what are you specifically going to do about securitization?

Ms. BAIR. Well, I think there will be some ability for servicers to restructure, and I think we should hold the servicers' and the investors' feet to the fire on this. We did not have good market discipline with investors buying a lot of these mortgages. There may be some issues with disclosure, but also it was very clear that a

lot of these were stated-income loans, a lot of these had very high debt-to-income ratios, and first and second liens. It was clear to investors that these were high risk, so I think everybody needs to share the pain now.

By making everybody share the pain, I think market discipline going forward will help correct what have been the problems in the past. We absolutely, though, need national standards applying to all lenders. Banks and thrifts account for about 23 percent of this market. We have to have standards that apply to both bank and non-bank lenders. At the end of the day it's the lenders initially making the loans that were poorly underwritten that were then sold into the securitization market and the secondary market. Granted, the secondary market made it easier to move those high risk assets off the books very quickly, but I think the first step is we absolutely have to have national standards applying to both banks and non-banks.

Ms. WATERS. National standards, I agree with you. Let me ask, in watching the way the subprime market is collapsing, how is it that we did not see that practices such as no vetting of income, no verification of income—how is that a practice that any of us should be supporting; no verification of income or assets? Should we just eliminate these practices altogether even if securitization continues? I mean, aren't there just some practices that we should not allow?

Ms. BAIR. Well, I think an interesting observation was made yesterday by one of our participants with regard to the stated-income loans, these "no-doc" loans. The practice originated in the refinancing market with prime borrowers who had a longstanding relationship with a lender, and somehow they became much more pervasive with purchase loans as well as refinancing, and there certainly is a very high correlation between delinquencies and defaults, especially for stated-income purchase loans.

I can't really comment further because that is one of the issues that's out for comment as part of our proposed guidance, and it would be inappropriate for me to signal what kind of decision we might take on stated-income. That is an issue. We do tighten up on stated-income. We ask whether we should tighten up more. And certainly that's something I'm going to be focusing on very carefully as we move to finalize the guidance.

Ms. WATERS. Let me ask Mr. Syron over at Freddie Mac, we talked a little bit in my office about the fear that many of these foreclosures will now be packaged by speculators and that perhaps Fannie and Freddie could have some role in not participating in that kind of activity. Have you thought any more about this?

Mr. SYRON. Yes, ma'am. Well, we certainly do not want to participate in any activity that leads back to some of the old phrases like block busting, those kinds of things. And I think particularly, and Congressman Frank noted this before, one of the major concerns you have here is the neighborhood effects. You know, when you start to have a lot of these things happen and the neighborhood goes downhill and then a non-subprime loan gets into trouble.

This is going to be complicated, as I said, and it's going to take all of us working together to work out. One thing that—one approach one could think of is that for some people that have some

of these loans that perhaps are very onerous that are in a security now is, as we develop new products, and we'll have to work them through with our regulator OFHEO and work them through with the rest of the government, but as we develop new products it may be possible for some of these people—not necessarily all of them, but for some of them to go and prepay that loan that's in a security off. They have the right to do that.

In some cases there are prepayment penalties, we'd have to look at that—but then to get out of the bad loan and as they get out of it to get into, in my mind, a longer term, fixed rate type of obligation that begins to bring some stability not just to themselves but to the neighborhood.

Mrs. MALONEY. The gentlewoman's time has expired. Congressman Hensarling.

Mr. HENSARLING. Thank you, Madam Chairwoman. The first question I have is for you Mr. Montgomery. I think I saw in your testimony that there were estimates that subprime lending is roughly 15 percent of the market and of that, roughly 13 percent of that are experiencing delinquencies. Did I read that correctly? I'm trying to get a scope of the problem here.

Mr. MONTGOMERY. Yes, those estimates are about correct.

Mr. HENSARLING. Is there anybody here on the panel who believes that's not a good ballpark estimate of the phenomena that we're seeing today?

As I approach these hearings I'm often reminded of the old Hippocratic Oath, first do no harm, and I believe I've heard adequate testimony on the value of securitization and the value that subprime lending has in making available homeownership opportunities, typically to low-income Americans, people who have had credit problems in the past.

I believe, Mr. Syron, in your testimony, you talked about the possible unintended consequences that prescriptive remedies of a widespread bailout or foreclosure moratorium might have. Could you elaborate a little on what those unintended consequences might be for the housing finance system.

Mr. SYRON. Yes, sir. First of all, I think it's very important to remember that this is not a homogenous market. For example, 52 percent of the people who are in subprime loans are not low- and moderate-income people. There's about another 8 to 10 percent, and I'm sure these overlap, that are investors, all right. Now I don't think anybody who is in this body really wants to say, how do we develop a program to bail out either those people, necessarily, or to bail out the holders of the securities.

We have to be very, very careful about future incentives that we promote in this. And to be quite candid, some of how we've gotten into this problem is by having—not all of it, there's been a lot of predation. But some of it is by having an overly aggressive appetite for debt on the part of all Americans. And if we were to inappropriately end up "taking care of people" who should have been able to take care of themselves, it creates a terrible precedent. It just says to people, I don't have to be responsible, and there will be a put; I'll be able to put the debt back to the market.

So I think we have to take a very rifle-shot approach and say, who are the people who were really mistreated in this approach,

and that really is unfair what's happened to them, and then develop things for that subset rather than trying to cure the entire universe.

Mr. HENSARLING. Mr. Syron, you used the term incentive in your comments there. I saw a study that came out of your organization. I don't recall if it was during your tenure or not; I think it's from 2005. Freddie Mac issued a study that said the average lender loses about $60,000 on a single foreclosure. Are you familiar with your organization's—

Mr. SYRON. I'm not—that was right about the time I came, but I am not familiar with that precise study. But I'm very familiar with the literature and that kind of data, yes, sir.

Mr. HENSARLING. Well, if that's close to being accurate then, it would seem to me that there is a great incentive not to have the foreclosure happen in the first place to the lender. Does anybody doubt—what's going on in the marketplace here?

Mr. SYRON. Sir, can I just say with respect to that, the $60,000 number, of course, is going to vary with the value of the house. That seems high to me, but just to make it very clear—

Mr. HENSARLING. The lenders have an incentive not to have a foreclosure in the first place.

Mr. SYRON. They have a very strong—no one wins basically in foreclosures because you just chew up the money in appraiser fees and legal fees and everything else.

Mr. HENSARLING. I saw a lot of heads nodding vertically so nobody wishes to disagree with it.

Ms. Bair.

Ms. BAIR. With only one caveat. The way these private label securitizations work is that the risk is tranched, so that the lower tranches are the higher risk and take the first share of credit defaults. However, if instead of foreclosing, you're just reducing the interest rate, that will work its way all the way up and impact all of the tranches. So there may be some investors at these highest tranches that will not necessarily have their interests protected.

Mr. HENSARLING. I see that my time is about to run out, but how is the market reacting today? What has happened to the subprime market and what have lenders done, whomever wishes to answer that?

Mr. MUDD. Well, there's less liquidity, is one of the first things that's happened, so the amount of money that's going into the market has dried up. The pricing has gone up and the rates have gone up. I think that's causing some of the business to come back to the safer, more traditional type of product. And I guess the broadest answer, sir, to the question is that a lot of what's going on on the ground varies from community to community so that what's working in one community won't work in another one, which I think speaks to Mr. Syron's point that specific rifle-shot approaches are probably the way to go here.

Mr. HENSARLING. I see I'm out of time. Thank you.

Mrs. MALONEY. Mel Watt of North Carolina, who has been a leader on this issue.

Mr. WATT. Thank you, Madam Chairwoman, and Mr. Chairman, who is returning to the seat, I think. I forget which one of the wit-

nesses, maybe two of you, Ms. Bair and Mr. Syron, kind of divided these foreclosures or problem loans into three categories.

One, you said, the market is already taking care of; it looks like just our increased jawboning about it has forced the market to do some things. Two, you said that you all can kind of take care of within the industry with some additional adjustments. I'd really like to focus on the last category, which is the category of people who are going to get hurt out there with somewhat inevitable foreclosures, and try to figure out whether there's something that can be done to address those.

Ms. Bair, on page one of your testimony you said, "While the recent supervisory guidance is directed at preventing future abuses there remains the urgent issue of how to address the current circumstances of many borrowers who have mortgages that they cannot afford," and you talk about three-quarters of those subprime mortgages originating in 2004 and 2005. I'm wondering what legal authority the regulators have to really address that category of loans.

Could you, for example, go back and retroactively apply guidance to those loans that were not underwritten appropriately on the current guidance that's out there and put an increased incentive on those lenders to refinance those loans by retroactively saying to them, we are going to apply the new guidance to you?

Could you retroactively, and it seems to me if the cost of foreclosures is as high as Mr. Syron has indicated that it is and everybody on the panel seems to agree with the one exception that you just indicated, could you say, even if you have a prepayment penalty on that category of mortgages, it's in your interest to waive that prepayment penalty and we are going to—I mean what could the regulators do to really make that happen so that lenders—those people who are, lenders who are kind of in these bad situations, find it in their interest to solve some of those problems in that lower one-third?

Is there a series of things that you can recommend to either by regulation that you will do or can do or by legislation that we ought to be considering doing that would address that one-third?

That's the question I have, and if you can answer that I think I'd be happy that we'd come out of this with something today that might be useful other than an academic discussion.

Mr. ELLISON. Thank you, Mr. Chairman. I only have a few questions and so maybe we can move on before the 5 minutes is up. My first question is as I understand how many of the subprime mortgages are done in the very beginning, if it is with a loan officer, the deal is done and then the bank sells it to the secondary market. So in that circumstance aren't the incentives, particularly with a 2/28 or 3/27, to do the deal without much regard to what ends up happening to it later, is that right?

Ms. BAIR. Yes, I think that has been a big part of the problem, absolutely.

Mr. ELLISON. And then the other thing is that if a mortgage originator does the deal, they get paid when you do fees at the very beginning of the closing, right? So some conversation is going on about how foreclosures are bad for everybody but they are not bad for the people at the front-end of the deal, am I right or wrong?

Mr. SYRON. On the deals they have already done, they are indifferent, okay. To the extent it influences their ability to go forward, I suppose you could have some effect but to the deals that are already done, they are indifferent. You are right, they have been wrapped, zapped, and shipped.

Mr. ELLISON. Right, and so it seems to me if we want to sort of get a handle on this, we need to deal with how the deals are done in the front-end, particularly with people who are more vulnerable. So let me ask you this, I know a lot of States have turned their attention to this problem, what is your view on whether we should just let the States address these issues, whether they are 2/28s, 3/27s, all the whole panoply of things that make these deals good in the beginning but sometimes end up being bad, should we have a State-by-State solution, should we have a national solution, what are your views on that?

Ms. BAIR. Well, I think the last time I was before this committee or the subcommittee, I strongly endorsed national standards. I think we need national standards.

Mr. MONTGOMERY. I would also add to that, I think, homebuyer education. With the dizzying array of mortgage products that are available to families in the last 5 or 6 years, it is not surprising a lot of them did not know what they were getting into, it is so complex. So I cannot stress enough for homebuyers to do their homework and fully understand what they are signing and do not be afraid to ask questions.

Mr. ELLISON. Yes, that sort of campaign, "Don't borrow trouble" has been good and effective. I just want to express this view and get your reaction to it that sometimes people propose that we just focus on disclosure but my concern with that is people who are highly motivated to get a home or get the loan they need on the refinance, they are not in the best position to exercise—they might just sign pretty much anything and they sort of trust that they are not being taken. I am not saying disclosure is not a good idea but in your view how important is it at sort of a panacea approach?

Mr. SYRON. Sir, if I might, I think the disclosure is very important. I think the disclosure can be, not purposely, but inadvertently not as useful as it should be because it is just so complex. My wife and I spent an hour two Sundays ago trying to understand a statement a credit card company had sent us, and we still cannot figure out which card it applies to.

Mr. ELLISON. And you do this stuff for a living, right?

Mr. SYRON. Right.

Mr. ELLISON. Well, the point is that I agree disclosure is an important part, but I just want to try to get some folks on the record for the point that it does not solve the problem and it is not good enough.

Lastly, I just want to ask you, I think Representative Green made some excellent remarks about neighborhood but would you care to sort of delve into the effect on neighborhood of clustered foreclosure? Could you talk about that a little bit, what that means to a neighborhood, particularly struggling neighborhoods that may have been trying to come back for a number of years, can you talk about what clustered foreclosures mean to a neighborhood?

Mr. MUDD. I would be happy to start. It varies a lot from community to community. I was in Texas last week, and I made it a point to go to a number of communities that have had a high incidence of subprime foreclosures and there are stark contrasts pretty much even in the same zip code. So in some communities you see that every other house along the street is for sale but there are buyers, there are sellers, and there is a process really of prices coming down to buyers' expectations and the market is moving, so to speak.

Now on the other side of that zip code is a community where there are not even foreclosures because people are just leaving the homes so it is an uncontested foreclosure. And what happens is that the lights go out because the electric bills are not being paid, the utility bills are not being paid, and the houses go into disrepair. Once the lights are out in every third house, the security goes down, and the houses are looted. You go inside the houses and there is no sink, there is no piping, etc., etc., etc. And so the effects on those communities is absolutely devastating, the communities are really being wiped off the map as a result. But, as I say, a mile away it looks like any other neighborhood where there are a lot of houses for sale, which is why we go back to the point that the solutions have to be very specific mortgage by mortgage, community by community.

Mr. SYRON. Can I just add to what Dan said because actually my Ph.D. dissertation was on this topic of what happens to neighborhoods and the thing that happens after the plumbing gets ripped out and the lights go, right, is people start sort of camping out in them and then you develop fires. And once you start to develop fires in the neighborhood and you go along and you have four houses and then you have a block that is burnt down. That neighborhood is going to be very, very, very hard to ever bring back.

Mr. ELLISON. Yes, and just to ask—

Mrs. MALONEY. I grant the gentleman 1 more minute.

Mr. ELLISON. Thank you, Madam Chairwoman, I will be quick. Just to go back to the houses that are not, the uncontested foreclosure, who typically buys up those houses? Do you see a stampede of speculators go in that rent to people who do not have a lot of regard for the neighborhood?

Mr. MUDD. In the community that I saw, which is one case in point, investors are going to buy it and their intention, I suspect, is to buy it and to hold it until the community recovers or the community does not recover and they plow it under and put up a subdivision.

Mrs. MALONEY. The gentleman's time has expired. Congresswoman Bean?

Ms. BEAN. Thank you, Madam Chairwoman. I had a question for Secretary Montgomery regarding FHA-backed loans, which have provided alternatives to some of the subprime mortgages available for low-income/low-credit individuals. My question is what can be done to make it easier for mortgage brokers who do a lot of this lending to more easily become accredited and qualified to participate because I have heard that that is a real challenge?

Mr. MONTGOMERY. Thank you for your question. We have met with the mortgage brokers on multiple occasions and some of the

issues we addressed last year in the FHA modernization bill. I sort of came at it from the direction that here we are a government program, that we should not be so onerous that in the case of small businesses, let's say mortgage brokers, can do business with the Federal Government. So we have had some discussions with them whether we do some sort of expanded direct endorsement authority. I know some of them have pushed the surety bond. But from the Federal Government's perspective on the mutual mortgage insurance fund, referenced by earlier remarks, that does not give us a lot. So I am very mindful because I go to the conventions, the conferences, and have a father or son or mother or daughter, a two person mortgage broker shop in Lubbock, Texas, came up to me and say, "I cannot do FHA because of your net worth requirements." I have to listen to that, being mindful also of my authority and responsibilities as FHA Commissioner. So we are not there yet but we certainly continue to discuss that issue with them.

Ms. BEAN. So you are working to address that then?

Mr. MONTGOMERY. Yes, we are.

Ms. BEAN. Can I ask another question sort of to the group? In district over the last 2 weeks, we got a chance to meet with our various advisory groups, and I had a senior advisory group and the seniors, many are participating in reverse mortgages. They are looking for cash-out, refinancings, different things, to give them a little more access to their asset base and to some capital that they can use for other things. There has been some proposed guidance relative to the subprime market. Is there enough attention do you think in the guidance to targeting that might be more specific to senior communities? And do you have any comments relative to how, if you have two seniors who are both on social security, and then one spouse is 87, and we are qualifying a loan based on their two incomes and one does pass away, it leaves the other spouse clearly in a position where they are not going to be able to make that payment, do you have any comments about what can be done to better think about the impacts on the senior community?

Mr. MONTGOMERY. Well, we are very mindful of the role that the reverse mortgage program plays in the country. As a matter of fact, the bill we think would ultimately do, the FHA bill, would do away with the cap. It seems like we are always coming to the Hill to ask them to raise the cap because the reverse mortgages are just growing exponentially. But there is a requirement, however, which we all enjoy and that is that seniors desiring to take out a reverse mortgage must go through counseling. And only about two out of three that go through the counseling end up getting the mortgage. Some of them just say we are not ready to do it or perhaps we will consider it later on. So that is a key consumer protection that we feel very strongly about in the case of the reverse mortgage. Relative to the other case, we have a couple of instances of lawsuits, I will not comment other than we do want to clean up that part of the legislation, and we have worked with some Members of Congress so we do not have that problem again.

Ms. BEAN. If I can respond to that, would you suggest the counseling for seniors even on other types of loans?

Mr. MONTGOMERY. Well, it would be difficult to speak for exactly what types of loans you are referring to but in the case of seniors

and groups, consumer groups, such as AARP and others, that feel very strongly about it, we feel very strongly about it so we certainly are not going to move away from that. And ways within our current resources and budget we could expand that, we would certainly do so.

Ms. BEAN. Other comments?

Mr. SYRON. I think these are appropriate products like everything else for people in certain circumstances, but I think you have raised a good point and it is probably something worth our all looking into.

Ms. BEAN. All right. Thank you and I yield back.

The CHAIRMAN. The gentlewoman from Ohio?

Ms. PRYCE. Thank you, Mr. Chairman, and thank you for holding this hearing. I am another Ohioan. The significance of this problem in Ohio is not lost on anyone. We had two Members of Congress, one from both sides of the aisle, testify before this committee this morning. And so I am sorry I had to be in and out a little bit and if you have answered this question to any extent, you can just tell me to go back and read the record. But to the extent you have not, can I ask, Mr. Syron, you made reference to the fact that the subprime market exploded for many reasons. And can you and the rest of you help me understand why you believe it exploded?

Mr. SYRON. Yes, ma'am, let me try. I think this "perfect storm" analogy has become hackneyed, so I do not want to say that, but I think we had several things happen at the same time. We had an enormous infusion of liquidity, an enormous amount of liquidity developing in the United States and in world capital markets. In my mind, not to be too esoteric, a lot out of Asia because of the emergence with China and China's desire to be an exporter and a capital supplier. At the same time, we had a period of a pretty good economy for a long period of time and a relatively steep yield curve, relatively low interest rates at the short end of the curve. And this was associated with rapidly rising housing prices, which became ever more rapidly rising, to the extent that some people were almost in a panic to get a house. Now in this kind of environment, if you thought that housing prices were going to go up 6 or 7 percent a year, and a lot of people thought they were going to go up much faster than that, even if you were taking out onerous terms, you were being bailed out by the appreciation on the house. And I think what we have seen in a lot of this is that while interest rates started to increase in 2005, they were very low at the short end of the curve so that a reset would only be about 7 percent instead of the 11 percent we have now. But even given that, housing prices really did not start to dramatically adjust until very late last year and early this year and when that happened, people said, "Well, gee, the line that was going like this is now going like that. I cannot get bailed out by the house price anymore and I am going to have to deal with the reset," and it has become the problem that it is.

Ms. PRYCE. And with that said, we talked a little bit about earlier, and once again if this has been covered in more depth, that no one loses in a foreclosure. Well, Ms. Bair started to disagree with that a little bit. And can you continue your line of thought and tell me do you really believe that that is the case and do devel-

opers lose to the same extent, do brokers lose to the same extent? Do you understand my question?

Ms. BAIR. I believe it is in the long-term best interest of investors as well as borrowers to keep—again with regard to owner-occupied homes, to keep borrowers in their homes. The caveat I wanted to make, because I think it is important for the committee to understand, is that the investors of these mortgage-backed securities that are collateralized through subprime mortgages are tranched into various levels of risk. And that if you have the foreclosures, if you foreclosed, if that is the option, the lowest tranches will feel that pain, the higher tranches will not. If you reduce the interest rate, that pain will be felt up through the chain. So I am concerned that there may be some investors at the highest tranche who may see it in their interest, who may not see so clearly a trade-off between foreclosures and restructuring the loan so that the interest rate is reduced. Now, I think long term you are going to have to reduce these interest rates because I think with the overwhelming majority of hybrid ARMs, the borrowers are not going to be able to make the reset payment; they are just not. The loans are underwritten at a very high debt-to-income ratio, so that just making the starter rate payment, these borrowers already are very stretched. So I think if we do not have significant and widespread loan modification, you are going to be seeing a very ugly situation which is in nobody's best interest. But I do think it is important for the committee to understand that those higher rated tranches may not necessarily see it that way.

Ms. PRYCE. Would anybody else like to comment?

Mr. MUDD. Just that it is very important to put some emphasis on the programs that have been talked about today to help people refinance before the resets hit. Because all that that is going to do is put folks—post reset, the bulk of which are coming through next year—create this problem continuing further down the line. So I think anything we can do to sort of stem the tide on those resets now would be very helpful and indeed in everybody's economic interest.

Ms. PRYCE. Ms. Bair also made the comment that she believes strongly that we need some national standards. Does anybody disagree with that? I take that as a no?

Mr. SYRON. It is a no.

Ms. PRYCE. Okay, all right, thank you. Thank you, Mr. Chairman.

The CHAIRMAN. We will close with one of the leaders again in this issue, the gentleman from North Carolina, Mr. Miller. I express my appreciation to the other witnesses. We did not ask for this to be the second biggest committee in the Congress and the good news is that there is a lot of interest. I apologize but we cannot do anymore to speed it up. The gentleman from North Carolina?

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman. Mr. Syron, I want to begin by commending you for wanting to avoid a hackneyed phrase even though you ultimately did not avoid it.

In the time I have been here, I have known very few witnesses or members who have not seized the opportunity to use a hackneyed phrase when one was available.

I agree with all the members and the witness who have said that the law we adopt on predatory lending should address the ability to repay. And both Mr. Montgomery and Mr. Mudd had pointed to the reality that most mortgages are not arm's-length transactions with sophisticated consumers. People are simply presented something to sign. They had no idea that they were entering into a 2/28 or a 3/27 mortgage. They had no idea what their payment would ultimately be. They had no idea of what a prepayment penalty would do to their ability to get out of a bad mortgage. But the current bankruptcy law, I know that this is not within the jurisdiction of the committee, the bankruptcy law, but it pertains to what we are talking about today, the bankruptcy law gives wide discretion to a bankruptcy judge to adjust the debt of someone entering bankruptcy, a corporation or an individual. The current law allows a bankruptcy plan to modify the rights of holders of secured claims or of holders of unsecured claims or leave unaffected the rights of holders of any class of claims with an exception. The exception is a claim secured by a security interest in real property that is a debt or his principal residence, in other words, a home mortgage. Can you explain to me what logic there is in allowing bankruptcy judges to modify all of the kinds of debts but not home mortgages? Any of you, Ms. Bair?

Ms. BAIR. No, I cannot. As you note, the Judiciary Committee wrote the bill and I was not involved in that. The consumer groups did send us a copy of their proposal, which we are reviewing. We have not completed that review, and I am not a bankruptcy law expert. I share your question, I think it is very curious, but I really cannot go beyond that at this point.

Mr. MILLER OF NORTH CAROLINA. Mr. Montgomery?

Mr. MONTGOMERY. I just want to add a point to your first point about people not understanding the standards and I, too, am not a lawyer and not familiar enough with that issue, but we have never had anybody call up our call center and say I didn't understand the terms of an FHA loan. This kind of gets back to the previous question about getting back to basics. We are a 30-year bread and butter fixed rate product that they can understand.

Mr. MILLER OF NORTH CAROLINA. Mr. Syron, on the bankruptcy law point, can you see a logic in distinguishing home mortgages, which are much more likely to be contracts of adhesion, not arm's-length transactions versus other kinds of debt?

Mr. SYRON. Well, no, I cannot on the face of it. I can sort of come up with one but I will admit I am coming up with it. If I was put in the witness' chair I guess to defend it I would say that maybe people thought that since these were such heterogeneous kind of instruments, loan by loan sort of situation—

Mr. MILLER OF NORTH CAROLINA. Right.

Mr. SYRON.—that in order to develop a securitized market in them that you had to treat them differently than you would treat other types of assets. I do not know if that is the case at all. It is the only thing that crosses my mind.

Mr. MILLER OF NORTH CAROLINA. Well, assuming that there was some logic in treating some kinds of secured debt versus mortgages, can you see any logic in distinguishing owner occupied

homes, mortgages on owner occupied homes versus second or third homes?

Mr. SYRON. No.

Mr. MILLER OF NORTH CAROLINA. Or you mentioned investors, a lot of the subprime loans are for investors to buy property as an investment. What is the logic?

Mr. SYRON. No, I am basically agreeing with you, I was just trying to think of what could be an answer.

Mr. MILLER OF NORTH CAROLINA. Okay. Well, let me not interfere with your agreeing with me. Mr. Mudd?

Mr. MUDD. I do not know.

Mr. MILLER OF NORTH CAROLINA. Okay.

The CHAIRMAN. I think we should point out, Mr. Syron, that you are right. I have often been in a situation where people ask me to explain why other people have done things and after I tell them that I did not agree, and I give the explanation, they get angry at me for giving the explanation.

We should note, and we will stipulate, that my colleague has asked you to explain why we, as a collective body, did something, none of us did it. Mr. Miller and I did not do it.

Mr. SYRON. Mr. Chairman, you can be sure I will follow your advice in the future.

The CHAIRMAN. Mr. Miller, anything further?

Mr. MILLER OF NORTH CAROLINA. I have no further questions. I yield back my time.

The CHAIRMAN. I thank the panel very much. This has been very helpful. We will be working with you and I would just say again in the debate on Fannie Mae and Freddie Mac, the issue has been somewhat posed as securitization is good/portfolio holdings are bad. And I think today we have turned that on its head and it turns out in many ways in our capacity to deal with issues, having things held in the portfolio of an institution which can be held accountable has significant advantages over things that are out there in the ether. The panel is thanked.

The next panel will assemble. The minimum courtesies to each other in leaving and coming. Do not shake hands. The nicer you are, the longer we are going to have to be here. So everybody move quickly. You can chit chat outside, come on, sit down. Let's move quickly, please. Will the witnesses take their seats? Again, I thank the witnesses. And we are going to begin with an introduction by our colleague from Ohio, Ms. Pryce. Would people please close those doors?

Ms. PRYCE. Thank you, Mr. Chairman. It is my great pleasure and honor to welcome Doug Garver, who is the executive director of the Ohio Housing Finance Agency, a fellow Buckeye, and a constituent. There has been special focus once again placed on Ohio during today's hearing. We have the unenviable position of being the national leader in foreclosures. And the Ohio Housing Finance Agency has had to shift its focus in part from putting people into homes and to changing that focus to keeping them into their homes. And I applaud the work of Doug and his team, the Opportunity Loan Refinance Program, which provides 30-year fixed rate mortgages to individuals and families in danger of foreclosure. I regret to say, however, that the crisis has not seen its last gasp yet.

And I thank the chairman for allowing me this introduction and I thank Mr. Garver for being present in Washington. Thank you.

The CHAIRMAN. I thank the gentlewoman. Let me introduce now the rest of the panel. Mr. Kenneth Wade is the chief executive officer of NeighborWorks America; Ms. Janis Bowdler is a senior policy analyst for housing at the National Counsel of La Raza; David Berenbaum is executive vice president, National Community Reinvestment Coalition; John Dalton is president of the Housing Policy Council of The Financial Services Roundtable; George Miller is the executive director of the American Securitization Forum and he is representing SIFMA, the newly emerged Securities Industry and Financial Markets Association; and the aforementioned Mr. Garver.

Before proceeding to these witnesses, all of whom have unanimous consent to introduce into the record any statements and supporting material they wish, I submit for the record testimony of the American Homegrown Grassroots Alliance and Mr. Barrett Byrd on behalf of Vantage Score Solutions. If there is no objection to those submissions, they are submitted. And we will begin with Mr. Wade.

STATEMENT OF KENNETH D. WADE, CHIEF EXECUTIVE OFFICER, NEIGHBORWORKS AMERICA

Mr. WADE. Thank you, Chairman Frank, and thank you for this opportunity to say a few words to the committee about this challenging issue of foreclosures. NeighborWorks America was created by Congress in 1978 to work with a network of community-based organizations involved in neighborhood revitalization and affordable housing. Over the past 5 years, we have assisted nearly 100,000 families of modest means to become homeowners. Our network provides 63,000 families with affordable housing on a day-in-and-day-out-basis. We have provided homeownership education and counseling to over 300,000 families. We have trained and certified 50,000 community development practitioners, and we have facilitated the investment of nearly $9 billion in distressed communities.

Today, my testimony will focus on the response that we have made to this precipitous rise in foreclosures. We have a 30-year history of working with low- and moderate-income buyers, helping them to achieve the dream of homeownership. Typically, we serve the buyers who would today be classified as subprime borrowers, borrowers who have been of lower credit quality and lower incomes. And through that 30-year track record, we have been able to demonstrate that with great pre-purchase counseling and ongoing support, you can create buyers from this strata who will perform as well as other buyers. And when you look at the analysis of the loans that our groups have made over the past number of years, these loans have experienced less delinquency and foreclosures than subprime loans, FHA loans, and VA loans.

One of the things that we did about 3 years ago was we decided to develop a Center for Foreclosure Solutions. Groups in our network were concerned about the high foreclosures that they were seeing in their communities and essentially thought that we needed to take a look at this issue and develop some ways that we could address it. We decided to establish both a way to do some additional research on the problem, and I think in my testimony you

will see that we did some work in Chicago where we drilled down to try to get a better handle on what was exactly happening at street level around this issue. We also recognized that we had to train and build the capacity of local community-based organizations, and we had to establish a public education campaign and a way to intervene to help prevent foreclosures from occurring.

With the establishment of this center, we developed a partnership with a broad range of folks, lenders, secondary market players, HUD, regulators, and other nonprofits to establish a way to get at this foreclosure issue. In particular, we have established a relationship with the Homeownership Preservation Foundation, which has established a national toll-free hotline for delinquent borrowers. That number is 1–888–995–HOPE. It is available now 24 hours a day, 7 days a week, in English and in Spanish.

One of the reasons that we worked with the Homeownership Preservation Foundation to establish this hotline was a study validated by Freddie Mac that upwards of 50 percent of all consumers who go to foreclosure never have any contact with their servicer. They allow the event to occur. They do not reach out to anyone. They ignore the calls, the letters, and the appeals from the lender that might have their loan and essentially allow the process to take hold. So we felt that one of the things that we needed to do was to reach that population, and we think the public education campaign that we have going will help address that. Once a call is received by the hotline, service begins immediately. People are connected with trained counselors who can help work through their issues, help them develop budgeting if that is the issue, a written financial plan, assistance with contacting their lender in order to work out payment options, loan restructuring, and referral to locally-based HUD-approved housing counseling agencies when consumers need more assistance.

Counselors also respond to callers who have experienced fraud in the mortgage process, and we do appropriate referrals to local agencies and resources to address that issue. In this work with the Homeownership Preservation Foundation and the support of our lender and other partners, we will be launching a public education campaign with the National Ad Council, directing struggling borrowers to the HOPE hotline. The campaign will launch in mid- to late June and we will be able to provide an opportunity for homeowners who find themselves in trouble to reach out to a trusted advisor so that they can get the kinds of assistance that they need.

[The prepared statement of Mr. Wade can be found on page 186 of the appendix.]

The CHAIRMAN. Thank you very much. You are right on time there. Next, we will hear from Ms. Janis Bowdler, who is the policy analyst for housing for the National Council of of La Raza.

STATEMENT OF JANIS BOWDLER, SENIOR POLICY ANALYST, HOUSING, NATIONAL COUNCIL OF LA RAZA

Ms. BOWDLER. Thank you. My name is Janis Bowdler. In addition to being a senior policy analyst at National Council of La Raza, I am yet another fellow Buckeye, so I am happy to be in some good company today. In my time at NCLR, I have published on issues related to fair housing and Latino homeownership. And

I have also served as an expert witness for Senate banking and the Federal Reserve. I would just like to begin by thanking the chairman and ranking members and the other members of this committee for inviting us.

The rising rates of foreclosure are a concern to us all. Homeownership is supposed to be your ticket to the middle-class. Well, research now predicts that 1 in 12 Latinos will be in foreclosure soon. Gone unchecked, the wave of foreclosure will leave thousands without their financial safety net. However, there is still time to save the homes of thousands of families. To stem the tide of foreclosure, NCLR is proposing three complementary approaches: increasing access to homeownership counseling; creating a rescue loan program; and protecting vulnerable borrowers from fraudulent rescue scams.

Let me start with housing counseling. Independent, community-based counseling connects Latinos with safe and affordable home loans. Ten years ago, NCLR created a network of housing counseling providers. Since then, we have helped more than 25 families—I am sorry, 25,000 families purchase their first home. Research shows that these families will be less likely to enter default than those who did not receive counseling. The best way to prevent foreclosure is to make sure that families receive appropriate loans in the first place. It means access to counseling. It also means that we need predatory lending reform. Yet, many of our families have urgent needs. Not all of our families get the advice of housing counselors and families facing unexpected financial emergency need immediate foreclosure prevention services. Victims of steering and other abusive practices need loan modification.

Counseling agencies are often in a great position to assist these borrowers as well. Although the tools exist, only a handful of industry leaders are making them widely available. Plus, as Mr. Wade mentioned, 50 percent of borrowers in default never contact their servicer. Housing counselors are a viable alternative for an industry that needs better access to borrowers. This is especially true for Latinos where local organizations have the confidence of their community. Counselors help families navigate a complicated system. They find realistic solutions and saving the home is always the priority. Mrs. Lopez is one of our clients who came in to see Montebello CDC in Montebello, California. Having purchased her home just 6 months before, she was already 2 months behind. Her mortgage was a bad fit from the start, high fees, an adjustable rate, and a balloon payment even though she had decent credit. And when her fiance left her, she simply could not make the payments alone. The counselors at Montebello helped her identify a short-term solution but what she really needs is a new loan. Most lenders will not refinance her mortgage. Her original loan has left her with little equity and the late payments make her a higher credit risk. Mrs. Lopez would have lost her home if it were not for the help of the Montebello housing counselors but we are concerned that her loan may not be sustainable.

This brings me to our second proposal: creating a program to refinance families into sustainable loans. FHA and the GSEs have social missions to extend affordable credit to underserved communities. Both have strong loss mitigation services. I go into this in

more detail in my written statement, but we believe the principles of these programs could translate into equity-saving rescue loans.

Finally, I want to draw your attention to the latest scam targeting Latino families. Our counseling agencies have seen an alarming increase in companies posing as foreclosure consultants. They advertise through the "We pay cash for homes" flyers in a lot of poor neighborhoods. They charge high fees and promise to help the borrower cure their default. The tricks they use against the families vary but most have the same tragic ending. Families are swindled out of their last dollars and the deed to their home.

Mr. and Mrs. Garcia are two of our recent callers. By the time they found the Resurrection Project in Chicago, they were being evicted from a home they thought they owned. Just months before, they sought to refinance their unaffordable mortgage. Now they are trapped in a shared investor scam. They unknowingly signed away partial ownership to a real estate company. The terms of the loan were such that two late payments put them on the street. The Garcias were referred to a Legal Aid attorney and their case is ongoing. Once again, we see the absence of legitimate players in Latino neighborhoods being quickly filled by predators. We firmly believe there is still time to save the homes of thousands of families. Counseling, rescue loans, and strong enforcement will redirect families to sustainable homeownership.

Let me close with just a couple of recommendations on how this can happen. We need a national campaign against foreclosure. It has to combine broad public awareness and enforcement against the scammers. We need funding for housing counseling of at least $100 million. And, finally, Congress must authorize FHA to create a foreclosure rescue program. Safe loans can put families back on the road to the middle class.

[The prepared statement of Ms. Bowdler can be found on page 133 of the appendix.]

The CHAIRMAN. Next, Mr. David Berenbaum from the NCRC.

STATEMENT OF DAVID BERENBAUM, EXECUTIVE VICE PRESIDENT, NATIONAL COMMUNITY REINVESTMENT COALITION

Mr. BERENBAUM. Thank you, Chairman Frank. I would like to thank you and Ranking Member Bachus for holding this critical hearing today. I do not think anyone could have expected the importance of the hearing, considering that today the Supreme Court has issued a ruling in the *Waters* v. *Wachovia* case, which I think is overshadowing the discussions today.

The National Community Reinvestment Coalition—

The CHAIRMAN. Let's make that explicit for people. What the Supreme Court did today was to uphold the decision by the Comptroller of the Currency and the Office of Thrift Supervision essentially to cancel all State consumer protection laws as they apply to nationally-chartered banks and thrifts. It upheld the preemption by a five to three vote. It was an obviously kosher question that someone assumed but it is now the law of the land that the great majority of the State consumer protection laws that were particularly aimed at banks or thrift institutions have been preempted. And we will now be moving on to the question of what the Comptroller and

the head of the Office of Thrift Supervision will put in place of the laws they have now preempted.

Go ahead, Mr. Berenbaum.

Mr. BERENBAUM. Thank you very much, sir. I would like to add it documents the need for strong national legislation that reaches from Main Street all the way to Wall Street so that each of the industry players, regardless of who they are, have one standard which they are required to follow.

Our experience with the Consumer Rescue Fund, which we created in 1991 in partnership with SHBC, as well as other lenders and GSEs, has been, quite frankly, that there are no easy market solutions. There is a need for the Federal Government to intervene to address issues, real issues of market failure in our systems. More often than not, consumers whom we assist, over 5,000 since the Fund began, are in situations where they are facing foreclosure because they have falsely received over-appraisals, they have received loans not because they have poor credit but because they were improperly originated to the consumers, bad products from bad lenders or substandard products from good lenders. They also are in situations where they are facing foreclosure because of the role of some of the darker side of industry. It is not simply scam artists today who are forcing or stealing equity from consumers; it is, in fact, foreclosure mills, law firms that serve at the will of securitizers, as well as lenders and servicers, who in fact rather than assessing a consumer's ability to pay, to negotiate a forbearance, to refinance, are quickly charging fees and moving a consumer incorrectly to foreclosure. Recently, Mr. Chairman, in your own community, the Boston Globe reported on the experience of a resident of Newton, Massachusetts, who had attempted to make a payment, a forbearance payment, on her loan only to receive a bill from the lawyers totaling more than $4,000, which precluded her from saving her house.

In addition, it is important to note that mediation through HUD's certified counseling, through rescue fund activities does play a role in ensuring we are not allowing predators or those who originated bad loans to profit. A core part of negotiating these loans is not simply refinancing. Getting to Mr. Watt's question earlier, about a third of the consumers need active negotiation or advocacy, legal representation because they have loans that are in fact upside down or in fact the lender is making or servicers are requiring payoffs or pre-payment penalties and unless we address those issues, we cannot successfully re-negotiate or make the consumer whole or the market safe and sound. I will add, many lenders require a release form if you were going to enter into a forbearance agreement. Often that is a waiver of any claims for the wrongful origination of a loan. These are all issues that need to be grappled with.

In addition to refinancing a loan, we believe that there should be a national rescue fund. We believe because of the market failure, and not to be an apologist for regulators or industry, NCRC strongly believes government must play a role to make up for the market failure, the regulatory inaction here. We sent a letter to the White House on March 15th saying, what has taken so long? National consumer groups have called for national legislation, greater regulatory enforcement for years. Why is it only now when Wall Street

pulls credit from the marketplace and the market is not as liquid that in fact regulators intervene? It is too little too late and we have to own up that there is a cost for the Federal Government to protect homeownership where there has been no mistake by the consumer.

Lastly, litigation and complaints play an important role. Rescue funds are not just about referring consumers to their lender to negotiate a forbearance or to refinance. Part of the public policy here needs to be for active enforcement on the part of regulators as well as to allow civil litigation as appropriate to correct the field so that in the future this never happens again.

We support what is happening with proposed guidance in the non-traditional marketplace and urge that it be expanded to include non-traditional loans in the prime marketplace as well. The marketplace as a whole is currently at risk because of payment shock issues. It is not simply a non-prime issue. And if we are going to sustain habitable communities, it is important that we address this issue.

As I begin to wind up in my last minute, I would like to also state that it is important that we look at having a stay in the foreclosure process. Too many law firms, too many servicers, subservicers and the like, rush consumers to foreclosure without assessing whether or not they have an ability to pay, they are in a predatory loan, or in fact they should be refinanced. The problem today is that we have an unregulated industry. Sheila Bair spoke with pride, and she should with the role that she is taking in her agency with her lending institutions, but they do not reach Wall Street. They do not reach the mortgage brokers. We need a strong national law that brings meaningful standards to all.

Thank you.

[The prepared statement of Mr. Berenbaum can be found on page 112 of the appendix.]

The CHAIRMAN. Next, John Dalton, president of the Housing Policy Council of The Financial Services Roundtable. Mr. Dalton?

STATEMENT OF THE HONORABLE JOHN H. DALTON, PRESIDENT, HOUSING POLICY COUNCIL, THE FINANCIAL SERVICES ROUNDTABLE

Mr. DALTON. Good afternoon, Mr. Chairman. I would like to thank you and Ranking Member Bachus for having this hearing. I appreciate the opportunity to testify before this committee on behalf of the Housing Policy Council regarding steps lenders are taking to prevent foreclosures and provide solutions to borrowers who are experiencing difficulty paying their mortgage.

Housing Policy Council members, and all responsible lenders and servicers, are actively working to assist borrowers. We recognize that this is especially important at this time with the national housing market having softened and that there are economic difficulties in certain regions of the country. I do not believe that anyone wins when there is a foreclosure. Housing Policy Council members believe that all mortgage lenders must embrace responsible lending principles, which ensure that consumers receive mortgage products they can afford. As part of this effort, Federal regulatory action or legislation on non-prime lending must strike a balance

that provides enhanced consumer protections without unintentionally limiting the availability of loans to credit-worthy borrowers.

As I stated, no one wins when there is a foreclosure. It is crucial for Americans to understand that no lender wants to foreclose. Lenders lose money and even worse, the homeowner loses his or her home. As was noted in the previous panel, the neighborhood and the community significantly suffer. If someone is having trouble making their mortgage payment, they should call their lender as soon as possible. Lenders have real options and those options can help homeowners who are having difficulty. Candid communication about the situation is essential to finding solutions.

One of our most valuable tools is the partnership that we have with the Homeownership Preservation Foundation and NeighborWorks America. As Ken Wade said, by calling 1–888–995–HOPE, a hotline that is staffed 24 hours a day, 7 days a week, homeowners in financial distress can have immediate access to HUD-approved credit counselors. I am highlighting this program for people who are concerned about their ability to pay their mortgage and who are nervous or reluctant about contacting their lender directly. Through 1–888–995–HOPE, they can get the help they need in a more comfortable environment.

Our member companies want their customers to succeed. This independent counseling approach has been crucial to helping thousands of families across the country. To help spread the word, a national Ad Council campaign will be launched in June promoting the hotline and urging homeowners in trouble to seek help. This will expand the program's reach and offer help to more distressed homeowners. This national foreclosure prevention effort is not a recent initiative. The Housing Policy Council and our member companies have been working with the Homeownership Preservation Foundation since 2004. And individual companies have long had their own customer outreach and loss mitigation programs.

I hope that Members of Congress will keep the Homeownership Preservation Program in mind and share this one pager, which is at the back of my prepared statement, with your constituents and also with your caseworkers. I think it will be particularly useful when your constituents are calling who are having difficulty in paying their mortgage. And I also urge you to consider putting this information in your newsletters. Individual lenders also have a variety of active efforts underway to help customers including refinance options, loan modifications, forbearance plans, and rescue funds.

Finally, I want to reiterate that we are also ready to work with the regulators in this committee on prospective solutions that will strengthen the housing finance market, protect consumers, and ensure credit remains available to all Americans who are working to obtain the dream of homeownership.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Dalton can be found on page 140 of the appendix.]

The CHAIRMAN. Thank you, Mr. Dalton.

Next is George Miller, who is executive director of the American Securitization Forum, and he is representing the Securities Industry and Financial Markets Association as well.

STATEMENT OF GEORGE P. MILLER, EXECUTIVE DIRECTOR, AMERICAN SECURITIZATION FORUM, ALSO REPRESENTING THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

Mr. MILLER. Thank you, Chairman Frank, for the opportunity to testify here today. There is a strong and beneficial link between mortgage lending and the capital markets. Through the process of securitization, mortgage financing has been made available to thousands of American families who otherwise may not have been able to become homeowners. The two organizations that I represent here, the American Securitization Forum and the Securities Industry and Financial Markets Association, together represent all major categories of participants in the secondary mortgage market. Those participants have played an extraordinarily important role over the past 30 years in expanding the supply of mortgage credit to prime and non-prime borrowers alike and providing them with greater product choice at lower cost.

The secondary mortgage market efficiently connects those who seek home mortgage credit, individual American borrowers, with institutional investors that have capital to invest in the mortgage finance sector. That investment capital includes the savings of millions of individual Americans via pension funds, mutual funds, insurance companies, and other investment vehicles. As with any other financial transaction, the extension of mortgage credit entails risks to borrowers, lenders, securities underwriters, and investors alike, and as recent events in the subprime mortgage market have demonstrated, sometimes this risk can be miscalculated adversely affecting all of those parties who assume it. Estimating mortgage credit performance and risk has never been an exact science and likely never will be. Some level of default and foreclosure is inevitable.

Having said this, we are deeply troubled by the recent downturn in the subprime mortgage market. As subprime lending has grown over the last 10 years, we have taken pride in playing a role in helping families achieve the dream of homeownership. Now, some of those families are suffering stress and hardship in struggling to keep their homes or dealing with the aftermath of losing them.

As has been stated here many times today, foreclosures do not benefit any participant in the mortgage market. From a secondary market perspective, foreclosures are the least desirable way to resolve a mortgage default. They are expensive and may not result in a full recovery of the balance of the loan, especially in softening real estate markets as we are seeing in much of the country right now. For those reasons, our members do everything that they can to avoid foreclosure.

Mortgage servicers have considerable flexibility under the contracts that govern their activities to assist distressed borrowers, including by modifying the terms of individual loans. Where borrowers cannot fulfill their original mortgage obligation and reasonable steps can be taken to maintain a mortgage loan in performing status, the interest of secondary market participants are aligned with the interest of borrowers and policymakers alike in avoiding foreclosure.

Many of our members have taken other steps to help families in trouble. For example, some have helped to establish, either on their own or in cooperation with community organizations, refinancing funds. These funds allow homeowners facing difficulty in meeting their mortgage obligations to refinance into long-term fixed rate loans at rates that generally are available only to prime borrowers. This can sometimes save families hundreds of dollars a month and this kind of benefit can be especially valuable for subprime borrowers who are facing significant rate adjustments on variable rate mortgages.

In response to dislocations in the subprime mortgage market, some well-intentioned policymakers have suggested drastic steps to help their constituents avoid foreclosure. Some, for example, have raised the prospect of mandatory forbearance for certain delinquent subprime borrowers or moratoriums on foreclosure. With the difficulties that some families are facing, these approaches may appear at one level to be a quick and easy fix. However, they are policy steps that we believe should be avoided. Requiring servicers to apply forbearance or to prevent foreclosures indiscriminately, outside the terms of loan and servicing agreements, would violate the sanctity of those contracts and create perverse incentives in the marketplace. That would hurt subprime investors who, in the case of pension funds or mutual funds, are investing on behalf of individuals. Such steps would also create large disincentives for investors to buy subprime mortgage-backed securities in the future, which would keep homeownership out of the reach of some worthy borrowers.

We believe, in summary, that we have a responsibility to help families in trouble avoid foreclosure. Market participants have already taken many steps, including strengthening subprime loan underwriting standards, that should help reduce foreclosures going forward. For existing subprime mortgage loans, economic and other incentives are in place to preserve loans in performing status and to help families avoid foreclosure wherever possible without resorting to inappropriate policy responses that could unduly curtail the availability of mortgage credit to those who need it most.

Thank you again for the opportunity to testify here today, and I look forward to your questions.

[The prepared statement of Mr. Miller can be found on page 157 of the appendix.]

The CHAIRMAN. Thank you.

Mr. Garver?

STATEMENT OF DOUGLAS A. GARVER, EXECUTIVE DIRECTOR, OHIO HOUSING FINANCE AGENCY

Mr. GARVER. Good afternoon, Chairman Frank, Ranking Member Bachus, and members of the House Financial Services Committee. I appreciate the opportunity to testify today on possible solutions to the national mortgage foreclosure crisis. My thanks also to Congressman Gillmor for his personal invitation to appear today and also to Congresswoman Pryce for her kind introductory remarks.

As noted by Congresswoman Kaptur and Congressman Turner in their testimony this morning, the State of Ohio has been hit especially hard by home foreclosures. I will not recite again the statis-

tics that underscore the depth and breadth of the mortgage foreclosure crisis in our great State. Unfortunately, I will point out that the crisis is not nearing its end in Ohio. At least $14 billion in adjustable rate mortgages will reset in 2007 and 2008, potentially impacting more than 200,000 Ohio homeowners.

The Ohio Housing Finance Agency is a self-supporting State housing finance agency, independently governed by an 11 member governor-appointed board. Administering both Federal and State resources, we strive to fulfill our mission of opening the doors to an affordable place to call home. Keeping those doors open became increasingly important as this crisis unfolded in Ohio. Late last year, we gathered our stakeholders to develop possible solutions to this growing problem. We recognized early on that we could not solve the problem alone, but we could be part of the solution and prevent many Ohio families from the turmoil that foreclosure brings. We quickly focused our work on developing a refinancing product to assist those families in mortgages that were no longer suitable for their particular circumstances. On April 2nd of this year, OHFA proudly unveiled the Opportunity Loan Refinance Program, which makes available affordable 30-year fixed-rate financing. Modeled after our successful first-time homebuyer program, this refinancing product will be funded by the issuance of taxable mortgage revenue bonds, which we will issue in response to underwriteable demand for this new product. Opportunity Loan assists those families in adjustable rate mortgage, interest only products, and those who have had an unplanned life event, such as a medical emergency, divorce, or change in employment. Family income may not exceed 125 percent of the area median gross income, which varies by county and ranges from $73,000 to $84,000. A full appraisal is also required on the home to assure its true value. In addition, Opportunity Loan offers a 20-year fixed-rate second mortgage option in an amount up to 4 percent of the appraised value of the home. OHFA resources fund this option. The second mortgage offers the flexibility to cover certain eligible costs, including pay-off of the existing first or second mortgage, closing costs, escrow accounts for taxes and homeowner's insurance, prepayment penalties, and other charges associated with the existing mortgage lien. The interest rate on this option is 2 percent above the rate of the first mortgage.

As has been heard earlier, education is a key component of the program and is designed to help prevent borrowers from making decisions that could lead to foreclosure in the future. A total of 4 hours of face-to-face counseling is required. Typically, this includes 2 hours during an initial interview to assess the borrower's current situation and 2 additional hours of face-to-face counseling. Proof of education must be provided prior to closing. In addition, we require post-purchase counseling in the event a mortgage is 30 days late or more.

Our efforts will be complemented by the newly created Governor's Foreclosure Prevention Task Force. Governor Ted Strickland, seeing the desperate need for solutions to this issue in his first few months in office, formed the Task Force and charged the group with developing additional strategies to assist homeowners facing foreclosure. This 25 member Task Force is made up of var-

ious stakeholders from Federal, State, and local governments, the lender community, and public advocacy groups. The Task Force plans to recommend additional options to address Ohio's home foreclosure crisis within the next 2 months.

Again, I appreciate the opportunity to address you today and welcome any questions that you may have.

[The prepared statement of Mr. Garver can be found on page 153 of the appendix.]

The CHAIRMAN. Thank you. I thank all of the panel for very direct and very timely testimony, and I am going to begin with the gentleman from Colorado.

Mr. PERLMUTTER. Thanks, Mr. Chairman. As a quick introduction, for those of you from Ohio, Colorado has been suffering along with you in terms of the numbers of foreclosures and kind of a neighborhood or a community is going to be particularly hard-hit and then it ends up depressing the prices of all the homes in the neighborhood, whether they were riskier loans or not. But I guess I am a little more laissez faire than some might think but what I am concerned about, and this is directed to you, Mr. Miller, the distance that sort of has developed between the borrower and the ultimate owner in the security package because you originally have the borrowers, then the originator, then the servicer, and then the owner. And I know in Colorado we actually had to change the laws because when a foreclosure was happening, the servicer would contact the owner, who couldn't even find the promissory note. So we made some changes to the law to allow our public trustees to go forward with foreclosures without the actual instrument. So how can we—do your securities companies or the people who own the documents, do they have a right to put these back to the originating lender so that you get closer to the borrower?

Mr. MILLER. I think there is no question that through the process of securitization the traditional borrower/lender relationship is altered. But I think it is important to keep in mind that notwithstanding securitization, I think the same incentives exist to avoid foreclosure. For example, many lenders who originate loans also service those loans that are securitized or their affiliates do. That is not true in all cases, but it is true in many cases. But even in cases where there is a unaffiliated servicer who is now in the role of servicing those loans, they are servicing them for the benefit of the investors in that securitized instrument. And under the contracts that they are obligated to observe and also those contracts call for servicers to apply generally-accepted servicing standards in terms of how they collect on the loans, in terms of how they deal with those loans that may enter into distress. In effect, what you have done is substituted a new owner of the loan, the investor, who is very interested in the credit performance of those underlying assets. That is what they are looking to for their return. And so from that perspective, the incentive structure is there for servicers even with the securitized loan to service that loan to the best of their ability and to maximize the recovery value of that asset. And, as we have heard previously today, those servicers are also really the front line for dealing with borrowers in distress and considering possible alternatives if the loan is seriously delinquent or in de-

fault, alternatives to foreclosure including loan modifications and other steps that they have available to them.

Mr. PERLMUTTER. So when the buyer buys a package of loans, there is something built in to give the servicer flexibility to work with a borrower in the event the market goes to heck and you need to forbear, that kind of flexibility is built in there?

Mr. MILLER. Yes, the provisions in servicing agreements, which are the agreements that govern this relationship, do vary and I want to make that clear, but as a general matter there is considerable flexibility built into those agreements that contemplates this very situation and does give servicers, not an unlimited ability, but some considerable ability to work with borrowers and to take steps to avoid foreclosure.

Mr. PERLMUTTER. Last question, I kind of separate predatory lending from subprime lending, predatory lending being more or less a criminal venture, fraud, trying to strip somebody of the equity that they own in a home, that kind of thing. But subprime lending, what I am worried about is, and again it is this distance between the ultimate owner and the originator, in subprime lending, whether knowingly or not, oftentimes you put somebody into an unsuitable loan, one that pretty much unless the price of the house goes up, unless the real estate values go up, 3 years hence, when the interest rate goes up, there is no way that guy can pay it back. And so how from the ultimate owners' perspective do you guys protect against somebody being put into an unsuitable loan?

Mr. MILLER. Well, I would say first of all I think the distinction that you drew between predatory lending and subprime lending is an extraordinarily important one. Not all subprime loans obviously are predatory or fraudulent or abusive. To answer the question, there is also no question that there are some mortgages, some subprime mortgages that in retrospect should not have been made. These are borrowers that do not have the ability to afford the payment and by any reasonable underwriting standard, it is difficult to see how or why that loan may have been extended. Now in many cases I think there was perhaps either willful ignorance or a knowing speculation that perhaps both lenders and borrowers engaged in. In an environment that we had in this country recently where you had sustained housing price appreciation, it may have seemed to be a logical strategy to take on that loan, hoping that housing prices would appreciate and you would build equity and ultimately be able to refinance into a new product. I think my answer to your question is that ultimately the marketplace is a pretty swift and efficient source of discipline for overextensions of credit. We have seen that happen very quickly in this marketplace and that from a market incentive standpoint, I think that is ultimately how that relationship can be regulated and constrained. And I think we have seen that happen quite recently.

Mr. PERLMUTTER. I would end with this, Mr. Chairman, I think the concern, and you sort of hit it, is if at the outset of the loan, the way you are going to handle the loan is refinance out of the loan 2 or 3 years down the road, then you know you are potentially heading into trouble. So with that, I will yield back. Thank you.

The CHAIRMAN. The gentleman from Ohio?

Mr. GILLMOR. Thank you, Mr. Chairman. Since we have a couple of Ohioans on the panel, and I know great wisdom resides in Ohio, let me ask each of them a question. First, Mr. Garver, I do want to commend you and the Housing Finance Agency for what you are trying to do. My question is, since these are going to be taxable bonds that you are issuing, at what rate do you expect to be able to borrow that money and what kind of spread are you going to have to have so at what rate do you think you are going to be able to loan the money?

Mr. GARVER. Congressman Gillmor, thank you for those questions and thank you for your kind remarks as well. We will be issuing taxable mortgage revenue bonds. As you well know in the market, that represents a higher cost of borrowing for us but it also enables us to get involved in refinancing for the first time. We are still working through some details, working very closely with our GSE partners on some of the pricing details that as you may well imagine there is risk involved in some of these loans. We will be asking for certain exceptions that enable us to target and drive down into the market that we are trying to serve in this regard. We rolled the product out on April 2nd at an announced rate of 6.75 percent. That is for all intents and purposes at our break even point given the market as we knew it at that point in time and even as we were still working through certain pricing issues. As we do in our traditional first time homebuyer program, we always try to price in a way to give maximum benefit to the customers that we serve and that will be true with this product as well. From an agency perspective, we will work towards break even. We do not intend to make a significant spread on this product. The price that it will ultimately come out at will be based on our cost of borrowing and a very minimal charge for administrative costs on the part of the agency.

Mr. GILLMOR. Thank you. Ms. Bowdler, you have suggested a 6-month moratorium on foreclosures for subprime and without taking a position on the issue of whether there should be a moratorium, let me ask. There are a number of different ways people get into a subprime mortgage. For example, the most sympathetic would be the person that is borrowing for a home to live in. But you also have some people who went in there as speculators and got a subprime mortgage to buy a property. And, third, you have a lot of what have developed, the so-called low documentation or no documentation loans and those could be made by somebody who is either going to live in the home or speculate, but they get the money with basically no documentation. And the phrase that is developed in the industry that these are "liar loans" because people get the money even though they don't tell the truth. So I guess my question to you is if there were to be a moratorium, instead of a moratorium for everybody, should there be different treatment of the person who is living in the home, for speculative purposes, and for the "liar loans?"

Ms. Bowdler. Sure, we have been talking around a little bit the issue of the moratorium and CRLR is the only group here that was part of that original press conference, although other groups have come forward to support the idea. And just to be clear about what it was that we asked for, we certainly did not ask Congress to insti-

tute a moratorium, which seems to have been inferred a little bit earlier, we asked industry leaders to step up and voluntarily take a time-out, if you will, on foreclosures of the most risky loans, those with payment shock. And what we asked them to do was to come to the table with those of us that were involved with the Leadership Conference of Civil Rights with the Housing Task Force and take a look at a strategy for how we can save as many homes as possible. And so that I really think gets to your question. NCLR certainly would not ever say that investors should not have their products and investors that go out and speculate have the potential to roll the dice and lose. Those are not the families that we are talking about. I am talking about families who were unfairly steered and unfairly put in mortgages that they were never going to be able to afford in the first place and taking the time-out instead of rushing to foreclose but find workable solutions. So to answer your question, yes, I think there is a difference between those speculators in the market and families who have been victims of steering in abusive lending.

Mr. GILLMOR. Thank you.

The CHAIRMAN. The gentleman from Missouri?

Mr. CLEAVER. Thank you, Mr. Chairman. I am not sure whether or not all of you are familiar with the quote from Tony Fratto as spokesman for the President, the White House spokesman, in the April 20th edition of the LA Times, he had a very interesting quote. And if you would allow, I would read it to you. His quote: "Individuals need to make smart decisions in taking on debt and there has to be some responsibility for making those decisions." Ms. Bowdler, do you believe that the persons who have fallen, who have become the prey of subprime lenders, are in fact responsible themselves for what has happened to them considering that with great intentionality, those subprime lenders market the poorest communities, the minority communities, and those who probably have the least financial literacy in our society? Maybe I beg the question but if you could respond.

Ms. Bowdler. No, I think it is a great question because we have been hearing a lot about it too. Those greedy borrowers, those predatory borrowers who are taking advantage of the lenders out there somehow, what are their responsibilities in all this? And borrowers do have responsibilities right now, they have responsibilities to make reasonable choices for their families and they sign a piece of paper that commits them not to commit fraud. They already have that responsibility. But we really need to look at what responsibilities do the lenders have, the lender and the broker that sit down with that family have all the information in the world. They have automated systems to make these calculations and they go out and just like you said they target these communities and they present them with information, they do not present with choices, which I think is an important distinction here. A lot of these families did not have choices when they got these bad loans. And then they push market to them. And so, sure, I think that a borrower has a responsibility not to lie on their mortgage application, and not to commit fraud, but the relationship is very uneven. All of the risk is carried by the borrower and all the information and credit en-

hancement and protections are available to the lenders and to the investors.

Mr. CLEAVER. Mr. Wade, actually this goes out to all of you, but is there something we can do? People who sell properties go to school and they have to get a license and they are regulated. People who buy homes have not gone to school and they are not regulated. So there is an imbalance when people go to buy a home. There is a knowledge base that is held by the seller, the lender, as opposed to an individual who would like a piece of the American Dream. Two questions, one, someone in one of our hearings before our work session, our spring work session when we all worked hard and perspired and wanted to hurry and get back here because it was much easier in Washington than at home, that is just an editorial comment, but someone said that every American deserves a home. Do you agree with that?

Mr. WADE. Well, I think that is clearly still part of the American Dream, whether everyone can afford to be a homeowner at a given point in time is a different issue. There are a lot of folks who just, given their circumstances, need good quality rental housing and so we need to continue to make the contribution there.

In addition, I would say that the home purchase process, home refinance process, is more complicated than it has ever been before. And for those of us who have been around the market for a long time, 30 years ago, it was a pretty straightforward process. You went to your local bank and you either took out a 15- or a 30-year mortgage and that was that. Today, it is much more complicated. Most consumers go into that transaction less prepared than when they shop for an automobile and that is, in part, because the information is not readily available to a consumer to do comparison shopping, particularly in the non-prime market. In the prime market, I can go to Web sites and I can find out how much the prime market is charging for loans. Today, if I am a subprime borrower, there is no place I can go to get that. So as a consumer I am disadvantaged right from the beginning. In addition to that—

Mr. CLEAVER. Well, if you are a subprime borrower, you do not even know that exists.

Mr. WADE. Well, that is true, you are absolutely right. And then in addition, although I would say most studies, and I think the Joint Center for Housing Studies is going to come out with something a little more empirical soon, some percentage of subprime borrowers would be able to qualify for prime loans anyway. They just ended up in the wrong place. But in addition to that, even when you think about trying to shop as a consumer, think about the disadvantage of being faced with an application fee so if I want to find out what my deal is actually going to be, I do not know what that deal is going to be until I show up at the closing table. And that is the disadvantage you have as a consumer. If I go buy a pair of shoes or a car, I will know exactly what I am going to pay when I walk in the door if I do a little bit of research. The home purchase is very complicated, and I think consumers are at a disadvantage in today's market and there is no substitute for a consumer to get access to good homebuyer education and counseling or mortgage finance assistance. It is not something that the average consumer, I think, is prepared to contend with today.

Mr. BERENBAUM. If I may also jump in, Mr. Cleaver. NCRC has conducted testing of mortgage brokers in eight metropolitan areas and African Americans and Latinos received less quotes, more expensive quotes, and were steered to non-traditional products despite being more qualified for conventional 30-year mortgages. I will add that overwhelmingly the consumers coming for refinance to our National Consumer Rescue Fund started with subprime 12 percent loans, and we were able to repackage them into loans at about 7 percent, because frankly we saw that they qualified for the prime loan at the get-go, but were steered to high-cost loans in the beginning by less than scrupulous lenders.

Mr. CLEAVER. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. We have been very clear in this committee and will continue, the Home Mortgage Disclosure Act data clearly indicates that there is a racial element to this and we intend to look at both of these and part of this is simply much tougher enforcement of Fair Housing. And one byproduct of that is, I think, there is a general consensus that if we legislate, and I hope we will, we are going to put some legal obligations on participants in the process who are not now regulated by anybody and they will get along with that a good Fair Housing enforcement. So one of the byproducts of this will be more coverage of Fair Housing obligations and better enforcement of it.

The gentlewoman from Ohio?

Ms. PRYCE. Thank you very much, Mr. Chairman. And I want to thank the panel for their patience. It has been a long day for you. I agree with Mr. Perlmutter in terms of the distance between the borrower and the eventual holder and what can be lost in that process. In the confusion and the complexity that exists, partially because of that, in terms of everything from escrow payments to the borrower actually knowing who to call when they do get into trouble, we are all encouraging them to try to locate their lender and get in touch but oftentimes they really do not even know who it is anymore. And so I think there is a lot we can do here. We have heard through the course of the morning how FHA needs to modernize. We have heard how important financial literacy is, and I cannot agree more. There is no greater example of where we need more education for American citizens than in the purchase of this kind of product. And standardization will help reduce some of the confusion and the complexity that we see and that really I think is part of the underlying problem that we are dealing with today.

Let me just go back to one of our Ohio witnesses and ask you, Mr. Garver, many people are fond of saying Ohio's problems in the mortgage area are all based upon the fact that Ohio's economy is in the tank and the loss of manufacturing jobs and they go to other indicators to explain away this problem. Do you agree with that?

Mr. GARVER. Congresswoman Pryce, as the Ohio Housing Finance Agency has looked into this problem, one of the things that we try to do at OFHA is to better understand what is going on in the markets that we serve. In order to respond appropriately, we have to understand what is impacting the market and what, if anything, we as an agency can do and where we need to partner with others in our particular industry. What we found as we reached out to our stakeholders, both public and private sector, and most cer-

tainly in some of the initial focus group we have had with the Governor's Foreclosure Prevention Task Force, we are finding that foreclosure is an incredibly complex situation. And I have heard a number of things said about the situation in Ohio, the "perfect storm," etc., etc., etc. The Columbus Dispatch wrote an article recently that pointed out that it is not just an urban problem, that it cuts across the entire State from both an urban, a suburban, and a rural perspective. And the feedback that we are getting the more we look into this problem is that there are a number of factors involved and some of them are socio-economic and have existed for years and they have been mentioned by other panelists throughout the day today. What we are finding fairly consistently is the interaction of the subprime market in exotic tools, things like interest-only loans and adjustable rate mortgages. Separately, the subprime market, for example, has been around a long time and serves a particular function. Exotic tools, like interest-only loans, make sense for certain folks, the question of suitability. The problem is, when you intermix those two, and there was some mention made I believe in the second panel that 70 percent of Americans live paycheck-to-paycheck. In that kind of situation, when you hit a reset on an adjustable rate mortgage, those folks are hit really hard. That is the kind of thing that we are seeing. Also, quite frankly, the use of exotic tools to, in some cases, purchase a more expensive home. That is happening in certain suburban areas. And the use of aggressive lending tactics. So all of those things combined create to some degree in our State a formula for the kind of situation that we are in right now.

Ms. Bowdler. Could I just jump in there? We work with two organizations, two grantees in Ohio, one of which is Homes on the Hill, which I believe works in your district, and is really on the front lines of some of the foreclosure prevention services that are going on in the Columbus area. And just a completely non-scientific anecdotal, their call volume for foreclosure prevention services has skyrocketed recently and almost all the calls that they are getting, certainly some of them—some small portion of them are economic in nature but a lot of the calls they are getting are from families who have loans they never should have gotten in the first place.

Ms. PRYCE. Well, I guess the rise in the call volume is good and bad, at least they are seeking help but it is certainly an indicator that there is a problem. The light, I guess I see the red one now. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Let me just ask one question to be directed at Mr. Miller or Mr. Dalton. Our colleague, Mr. Miller of North Carolina, was contacted by some people who said that they were troubled and that part of the problem—let me preface this by saying that I, nothing that this committee is going to do will be legally retroactive, and I appreciate Ms. Bowdler when you were talking about a moratorium, you were talking about a voluntary moratorium. The revolution has not come to this committee. We are not talking about undoing vested legal rights no matter how much you may have wished that a contract was not signed, we recognize the inappropriateness of anything retroactive, and we certainly are not going to be doing anything that is going to undue legally. We do hope that people will have financial ways to deal

with the incentives that everybody acknowledges they have to avoid foreclosure but it is voluntary. But there is one element there that has retroactive activity in other aspects of the law, and again it would not be retroactive here, but last year with bankruptcy and what our colleague from North Carolina was told was that there is an exception in the bankruptcy law for mortgages to the general principle that in bankruptcy contracts can be re-negotiated. And I am wondering, again we are not talking about doing these things retroactively, but going forward and it would not be our committee frankly, it would be the Judiciary Committee, which has jurisdiction over bankruptcy, but that is one of the things that might get addressed. I would be interested if either of you had a reaction, is it necessary for securitization for bankruptcy—for mortgages to have a protection from being rewritten in bankruptcy that very few other things have? John, Mr. Dalton?

Mr. DALTON. Mr. Chairman, I would like to answer that for the record if I could.

The CHAIRMAN. Yes, you could and same to you, Mr. Miller. It is one of these questions that came up and we are interested in an honest answer. Mr. Miller, if you want to do the same, if you would answer that for the record.

Mr. MILLER. Sure.

The CHAIRMAN. And our colleague, Mr. Watt, who is on the Judiciary Committee, may be taking that. Does the gentleman from Colorado wish to say something?

Mr. PERLMUTTER. Yes, there still is a way through bankruptcy that you can modify a mortgage through a Chapter 13, you can stretch it up by another—you can take a default and take it out another 36 months. So that is pretty much the only way left within the Bankruptcy Code.

The CHAIRMAN. Right, but the question is whether, again going forward because no one is talking about disturbing vested rights here inappropriately or even appropriately. I would be interested in your approach.

With that, I thank everybody for their diligence. And here it says—they give me these things because they think I do not know—so it says, I will read you the last thing: "Close the hearing. The hearing is adjourned."

[Laughter]

The CHAIRMAN. But it does say, before that, if any members have additional questions, they can submit them in writing and the hearing will be open for 30 days.

And now, as it says—

[Gavel]

[Whereupon, at 2:05 p.m., the hearing was adjourned.]

A P P E N D I X

April 17, 2007

Financial Services Committee
Hearing on Possible Responses to Rising Mortgage Foreclosures
Opening Statement for Congresswoman Julia Carson
April 17, 2007

Thank you, Chairman Frank and Ranking Member Bachus for holding this important hearing regarding the critical state of the United States housing market. News coverage of the recent spike in mortgage foreclosures highlights a growing crisis as subprime loans with skyrocketing rates have given rise to historical numbers of loan delinquencies.

Lack of federal and state guidance has contributed to this crisis. The time is now to develop policy goals that address not only loan foreclosure rates, but also the disparate numbers of minorities and elderly that have experienced hardship with these high-risk and often predatory lending practices.

In 1994, subprime loans accounted for a modest five percent of all loans in the mortgage market. These loans initially contributed to growth in homeownership, particularly among minorities with 42.5 percent homeownership in 1993 and 52.3 percent in 2005.

Now, however, they have grown to account for over a quarter of the market with $600 billion in business and many of those loans that enabled the initial growth in homeownership are in default as the rates have reset to levels these individuals are not able to pay. In the rush to accumulate higher profits, mortgage companies aggressively marketed subprime loans, with indifference to whether or not borrowers had the capacity to keep up with high-cost payments in the long run.

Further, it is alarming how this epidemic disproportionately affects minorities. According to the most recent Home Mortgage Disclosure Act (HMDA) data, more than 50 percent of all African American borrowers received subprime loans and 40 percent of Latinos compared to 20 percent of white mortgage consumers. This trend follows suit in subprime refinancing figures. There is increasing evidence to show that minority and elderly prospective borrowers who were creditworthy for prime loans were steered into expensive subprime mortgage and refinance loans. The practice of preying on these vulnerable borrowers is egregious and unacceptable.

HMDA data also indicates that the Midwest has been the hardest hit region for foreclosure incidence. My home state of Indiana ranked sixth in the nation for foreclosures per household; and in my district of Indianapolis, there was one foreclosure event for every twenty three households last year as reported in the Joint Economic

Committee's April 11th report. The report further reveals that in Indianapolis, South Bend and Muncie, 18 percent of subprime loans were 60 or more days delinquent in February 2007.

The shocks of these foreclosures are felt throughout families, communities, local governments and financial institutions. Foreclosures lead to bankruptcy, home equity loss in neighborhoods, lost taxes and the loss of a dream for individuals who sought homeownership. In light of a weakened housing market and the fact that 1.8 million hybrid loans are due to reset in the next two years, it is imperative we take measures now to ensure the ideal of expanded homeownership is achieved through responsible, sustainable loans rather than deceptive and predatory loans that target the elderly and minorities.

Opening Statement

Congressman Paul E. Gillmor (R-OH)

Committee on Financial Services

Hearing entitled: *"Possible Responses to Rising Mortgage Foreclosures"*

I would like to thank Chairman Frank and Ranking Member Bachus for calling this hearing today. The problem of foreclosures is one which I am acutely aware of in my district in Northwest Ohio. Even before the significant loosening of credit standards began affecting the subprime market across the country, Ohio ranked high in foreclosures. As the rest of the country experienced an expanding economy, Ohio's job market and that of Michigan and the rest of the Midwest, was slow to realize the gains and too many people suffered financial difficulties making it more difficult to pay their mortgages.

In the subprime market in Ohio and elsewhere, there is no doubt that the past several years have seen a general loosening of underwriting standards. America has one of the highest rates of homeownership in the world. That is good and we should continue to encourage homeownership.

However, you are not doing anyone a favor by putting them in a home with the type of mortgage that when interest rates go up, or they have an economic reverse, they are thrown out of their home.

When considering how best to move forward, Congress may wish to separate out the causes of foreclosure. The vast majority of homeowners in the subprime market are able to handle the complex hybrid mortgage options available, but even the most educated, well-intentioned homebuyer could have difficulties with making their payments should their job situation change around the same time as their rate.

It is also important to note that there are differences between subprime and predatory lending. They are separate animals and require separate solutions.

I would hope that as the Congress continues its investigation into the circumstances which have led us to today's subprime market crisis, it spend considerable energy considering current disclosure requirements. Much of the problem with today's mortgage market, prime and non-prime, is that the average prospective homebuyer is snowed-in with paper, much of which is difficult to understand or redundant. This is not breaking news. The federal government and the states have shared blame for the complexity of the home buying process and both must work to reform the system. Any legislation that comes before this Committee should focus on reforming RESPA and improving disclosure.

With that, I look forward to hearing from our three distinguished panels. I am particularly pleased to see the Ohio Housing Finance Agency here. Through their partnership with over 150 lenders across the state, the OHFA has shown a willingness to look for innovative solutions to the foreclosure problems in my home state.

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Statement of Congresswoman Marcy Kaptur, OH-9
Before the
Committee on Financial Services
United States House of Representatives
Hearing on Possible Responses to Rising Mortgage Foreclosures
April 17, 2007

Thank you Chairman Frank and Ranking Member Bachus for the opportunity to testify before you and the other distinguished members of the Financial Services Committee regarding the mortgage foreclosure crisis affecting our nation and certainly Ohio.[i] In the 4th quarter of 2006, Ohio experienced a higher rate of foreclosure than any other state in the nation. Indeed, our rate is three times that of the national average. As the Representative from Ohio's 9th District—one of the most impacted regions in the nation—I am acutely aware of the detrimental effect that the rising rate of foreclosures is having on our families and on our communities at large. It is estimated that Ohio's near-term credit crunch gap will approach $14 to $21 billion dollars, as up to 200,000 mortgages will reset between this year and next. These numbers play into the more than 2.2 million foreclosures that are predicted to result nationwide from subprime mortgages originated from the 3rd quarter of 1998 through 2005.[ii] The cumulative impact of irresponsible lending and the mortgage securitizing process has threatened the safety and soundness of our financial system. Simply, America can do far better.

My goals in testifying today are to:

1. Describe the Ohio foreclosure crisis.

2. Urge your committee to develop both short and long-term legislative remedies to prevent further foreclosure by:

- **Taking immediate actions to** expand federal resources to assist both the State of Ohio and other organizations attempting to meet this crisis through loan workouts, extend terms for payment plans, or sell homes to avoid foreclosure so as to protect their credit ratings. The goal should be to avoid further deterioration in mortgagees' credit leading to bankruptcy, thus aggravating growing vacancies in the real estate market.
- **Undertaking long-term solutions to** restore the three Cs of lending—character, collateral, and collectability. These principles of due diligence have been violated by a mortgage-backed security system that fails to provide accountability in underwriting, proper management of loan assets, and checks and balances for both the mortgager and mortgagee.

3. Suggest that action by this Committee may not be sufficient to address what is required and urge you to review changes to bankruptcy law and securities market regulation as essential elements of a comprehensive solution.

Nature of the Foreclosure Crisis in Ohio:

The Coalition on Homelessness and Housing in Ohio's March 2007 report, "Dimensions of Ohio's Foreclosure Crisis" outlines the extent of the problem as follows[iii]:

- **Ohio foreclosures in 2006 have increased dramatically over the last 10 years.** Data from 12 of the 13 largest Ohio counties indicate that 2006 foreclosure filings increased by roughly 25 percent over 2005, with an estimated 80,000 foreclosure filings. In 2006, all but 10 of Ohio's 88 counties saw an increase in the number of foreclosure filings. Two counties I represent, Lucas and Lorain, experienced a 210% and 445% growth, respectively, in foreclosure filings in the last 10 years.[iv]

- **Foreclosures are expected to escalate in the next two years.** The volume of foreclosures is expected to increase at a rapid pace in 2007 and 2008 because of the estimated 200,000 subprime adjustable rate mortgage (ARM) loans in Ohio scheduled to reset at significantly higher rates. In 2005, subprime loans accounted for about 13 percent of the mortgages issued nationally, compared to nearly 28 percent of the mortgages issued in Ohio. Currently, subprime loans account for 18 percent of all outstanding Ohio mortgages held by the secondary market and other loan servicers, yet they account for a staggering 70 percent of all foreclosures.

- **Subprime ARM Loans Are Fueling Foreclosures.** The most common type of subprime mortgage in Ohio is a "2/28" loan. These loans are sold with low initial rates ("teaser rates") that are fixed for the first two years of repayment. After these first two years, the interest rate increases as often as every six months, drastically increasing the cost of borrowing over the life of the loan. In addition, in many cases, loans are not underwritten to anticipate the inevitable rate escalation. This is a blatant abuse, as Ohio subprime lenders allow initial mortgage payments of up to 60 percent of a family's pretax income—which ultimately grow to be as much as 85 percent of a borrower's pretax income once the favorable rates expire.

- **Prepayment Penalties Trap Borrowers in Faulty Loans.** Many of these mortgages contain significant penalties for paying off the mortgage early. These penalties can apply for the first several years of the mortgage and can cost homeowners thousands of dollars. Brokers have incentives to sell loans with prepayment penalties, as they are compensated more for loans that include such penalties.

- **There is a Mismatch Between Home Values and Mortgage Debt.** Many borrowers with 2/28s and other ARMS are unable to refinance or sell their properties because they owe more on their property than what it is actually worth. Many borrowers were victims of fraudulent or poor underwriting with inflated appraisals or had little equity in their homes and were thus unable to adapt to a down market. Other borrowers inflated their incomes when applying for loans to increase their home purchasing power. Last year, of Ohio's eight major metropolitan areas, six experienced depreciating real estate values—as high as 7.7 percent declines—compared to the US average of 2.7 percent.

- **Loans Are Often Approved Without Sufficient Proof of Ability to Pay.** In Ohio, nearly 50 percent of subprime mortgages used stated income or alternative income verification in the application process. These loans, known by some in the industry as "liar loans," are approved on the basis of a borrower simply stating how much he or she earns, with few other safeguards to determine ability to repay. According to the Mortgage Asset Research Institute, up to 90 percent of stated income loans were overstated.

Current Efforts to Address the Foreclosure Challenges in Ohio:

- **Rescue Funds:** Some nonprofits, such as Toledo's **Neighborhood Housing Services,** have established pools of rescue funds to bail out homeowners who have fallen behind. Rescue funds, while able to help a certain class of troubled borrower, cannot reach those who are unable to make their mortgage payments for the foreseeable future. For those trying to recover from short term problems—such as a short-lived layoff or brief period of unemployment—rescue funds can help homeowners get caught up on one or two months of back mortgage payments. Your Committee should consider adding funds for such programs.

- **Financial Workouts:** The majority of troubled borrowers, though, are trapped in mortgages that are beyond their means for the long haul. **The Ohio Housing Finance Agency (OHFA)** is stepping in to serve this category of borrowers. A partner in the Strickland Administration's Foreclosure Prevention Taskforce, OHFA has developed a refinancing program backed by the sale of taxable bonds. This program, which began just two weeks ago, is expected to grow to $500 million this year—potentially helping several thousand homeowners refinance their loans. OHFA's **Opportunity Loan Refinance Program** offers favorable financing to borrowers "who feel their current loan does not fit their financial circumstances." As of April 16, 2007, OHFA's website offered the refinancing option at a favorable 6.75% interest rate. I am pleased to see that OHFA's Executive Director will be testifying before the Committee later today. I would urge the Committee to consider how federal action, such as establishing a secondary market for such specialized bond offerings could support willing states expanding their efforts to meet the full demand anticipated.

- **Other Loan Remediation Programs:** The **Northwest Ohio Development Agency (NODA)**, a community development financial institution, and **the Toledo Fair Housing Center (FHC)** run the **Restoring the Dream Program**, which is designed to help refinance loans for buyers who were victims of predatory lending practices. This program hinges on Fannie Mae's obligation to purchase the loans that are refinanced through the program, which was developed using underwriting criteria from Fannie Mae. In order to qualify for this program, FHC and NODA must demonstrate that a homeowner has been the victim of predatory lending practices and prove that homeowners actually qualified for a prime loan at the time they received the predatory loan. Despite the good intentions behind the Restoring the Dream Program, its outreach has been limited through no fault of its administrators. Of the 508 people who have applied for the program, only 42 (or 8%) have been rescued. The majority of applicants did not qualify for the program because the loan was based on an inflated appraisal and FHC was unable to make contact with the decision makers at the lending institutions to get them to agree to reduce the principal or modify the loan to an amount that the consumer could afford. These barriers need to be addressed in order to make existing programs effective.

- **Housing Counseling:** Nonprofit housing groups are attempting to respond to the needs of Ohio homeowners through housing counseling. **However, housing assistance counselors often cannot track the loan to its ultimate holder, so workouts between lenders and borrowers are not always possible.** Representatives from organizations affiliated with **NeighborWorks**, a national housing counseling service provider, report additional problems when trying to help borrowers connect with their lenders. Sometimes it takes loan servicers so long to work out the terms of their loans that lenders are in even more dire straits because of the fees and penalties that are racked up over the course of the negotiation process. Still other lenders are only willing to make minor concessions, such as granting short extensions for borrowers to catch up. For most borrowers, such extensions are not nearly enough to make good on their loan commitment and they only delay the likelihood that borrowers will default on their loans.

Nationwide Solutions We Should Employ:

Expeditious action by your Committee can help hundreds of thousands of homeowners prevent defaults and foreclosures. To meet national financial crises of this magnitude, there is a need to bring all parties to the table. With potential losers on both sides of the mortgage market table, homeowners and the lending community should realize it is in their best interests to work out solutions.

Immediate Action:

- **Engage the Presidential Working Group on Financial Markets:** I urge this Committee to invite the President's Working Group on Financial Markets—which

includes the heads of the Treasury, the SEC, the Federal Reserve and the Commodity Futures Trading Commission—to testify. This group is uniquely positioned to engage in the intervention necessary to stem foreclosures.

- **Restructure current mortgages.** The Committee should establish a mechanism through HUD and perhaps the Federal Reserve to help families restructure their loans. This is the most significant solution that can be employed to curb defaults on mortgages currently facing foreclosure. According to COHHIO, as many as twenty or more subprime lending companies have gone into bankruptcy or sold off their liabilities to mortgage portfolios. Subprime lenders, mortgage holders, loan servicers and investors need to make significant concessions in restructuring the mortgage—such as forgiving a portion of the loan, writing off late fees, setting reasonable and fixed interest rates, or extending pay out periods. While this is likely to be resisted within the industry, the alternative will probably be worse. According to COHHIO, the mortgage industry will be incentivized to make deals because it is better than bringing thousands of vacant homes into their inventories. An example it provides is of one large company in the subprime business that foreclosed on nearly 1200 mortgages in Ohio within seven months. The amount of the total debt owed was $115 million, of which only $54 million was recovered once the company sold off the properties—amounting to a 53% loss.

- **Refinancing Programs.** Programs like that of OHFA's Opportunity Loan Refinance Program need to be mirrored by other lenders. Fannie Mae, Freddie Mac, the Federal Housing Administration, and the Federal Home Loan Bank should offer refinancing products to reach eligible pools of borrowers. These products must be offered on a large scale to have significant impact on the impending crisis. In addition, Fannie Mae should make programs like the Fair Housing Center's Restoring the Dream long-term or permanent, and should provide enough support for them to be effective. The Committee should consider increased funding to enhance these programs.

- **More Support for Housing Assistance Counseling.** Housing counseling services at nonprofits are often overextended due to the high demand for help from homeowners facing foreclosure. Programs like the 888-995-HOPE counseling assistance hotline operated by NeighborWorks America are doing excellent work linking homeowners to counseling help, and additional support is needed in order to increase their reach. Foreclosure and credit counselors continue to encounter unresponsive mortgage companies that have no mechanism for dealing with problem mortgages and no organized procedures or programs to offer mortgage workouts. In addition to these services, we need a full service mortgage foreclosure hotline at HUD. This service needs to be all inclusive, well advertised, well staffed and aggressive.

- **Bankruptcy Moratorium:** As mortgage companies and subprime lenders file for bankruptcy, as has already occurred with New Century Financial, firm assets (net worth) important to refinancing mortgages at risk are being sold off to other companies through the bankruptcy courts. A moratorium should be placed on this practice so as to allow workouts to occur where possible.

- **Force Mortgage-Backed Securities to Share in Liability:** The secondary mortgage market has enabled the dramatic growth of the subprime mortgage lending industry. Without the capital backing of these financiers, the abuses would not have grown out of control. Those who have greatly benefited from the market's reckless explosion must have a hand in repairing the damage.

Long Term Solution:

- **Regulation of the Securitized Mortgage and Subprime Mortgage Industries:** Federal regulation and enforcement of the subprime mortgage industry needs to be aggressively pursued and enforced and must be extended to apply to the entire subprime industry. This should include the secondary mortgage market, which provided the investment capital without regard to the abuses that built the industry. Maximum interest rates must be capped at reasonable levels and prepayment fees should be eliminated. More stringent underwriting criteria must be adhered to—including appropriate consideration of a borrower's ability to repay the loan over the entire life of the loan, rather than simply the early years of teaser rates. Companies that engage in predatory lending must be aggressively penalized—particularly those who seek out borrowers who are actually eligible for prime loans.

I will be happy to answer any questions that you may have.

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[i] I have consulted with many consumer and advocacy groups in my region, as well as with realtors, lenders, and government entities in order to gain a firmer understanding of the state of the crisis both in Ohio and nationwide, and to gather suggested solutions from field experts. Much of my testimony is based on the extensive research of the Coalition on Homelessness and Housing in Ohio (COHHIO), as well as conversations with and data from the Northwest Ohio Development Agency, the Toledo Fair Housing Center, the Ohio Housing Finance Agency, and the Toledo Board of Realtors.

[ii] "Losing Ground: Foreclosures in the Subprime Market and Their Costs to Homeowners," Center for Responsible Lending, December 2006.

[iii] Data from this section, unless otherwise noted, is from "Dimensions of Ohio's Foreclosure Crisis," Bill Faith, COHHIO and Paul Bellamy, J.D., Ph.D, March 2007.

[iv] " Foreclosure Growth in Ohio, 2007," Jack Schiller, March 2007.

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Subprime lenders' big gifts helped lawmakers

By Sue Kirchhoff, USA TODAY

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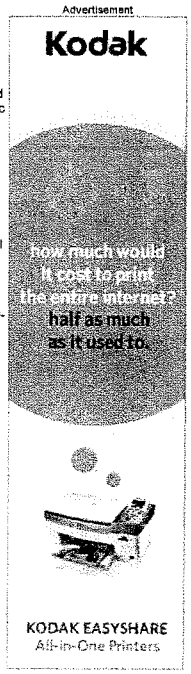

WASHINGTON -- The nation's top subprime lenders, including New Century Financial (NEWC), which has filed for Chapter 11, have lavished generous donations on homeownership programs sponsored by black or Hispanic members of Congress.

The paid sponsorships give lenders an entree to lawmakers and their constituents. Along with New Century, backers include Countrywide Financial (CFC), which settled a New York fair-lending investigation in 2006 by agreeing to compensate black and Latino borrowers for improper loans and set up a $3 million consumer-education program.

Another is Ameriquest Mortgage, which in 2006 agreed to a $295 million settlement with state attorneys general who charged it with improper lending practices.

Minority homeownership rates rose in the past several years. But the Congressional Hispanic Caucus Institute and Congressional Black Caucus Foundation today face an imploding market as subprime mortgages — higher-priced loans to consumers with impaired or scanty credit — go bad at an escalating rate. Federal regulators are tightening up on the lenders. The non-profit groups, founded by lawmakers, run education and outreach programs.

Still, a key lawmaker and caucus officials say subprime lenders remain important options. About 50% of black and Hispanic borrowers used subprime loans in 2005, compared with 17% of whites.

"Not all subprime lenders are bad," says Rep. Joe Baca, D-Calif., chair of the Hispanic Caucus Institute. "The solution ... is not to get rid of all subprime loans but instead to make sure there are safeguards."

Stephanie Ebron of the Congressional Black Caucus Foundation's program says subprime firms have never been its chief sponsors.

"I don't think there's a homeownership initiative around that hasn't changed because of subprime lending," Ebron says.

Even some critics understand why the groups turned to the lenders, noting that commercial banks don't have branches in many minority areas. "Say what you will, but in many cases they're in minority neighborhoods — for better or for worse," says Kevin Stein, associate director of the non-profit California Reinvestment Coalition.

The Congressional Hispanic Caucus Institute's "Hogar" (Spanish for hearth or home) initiative, provides fellowships, financial education and other efforts to boost homeownership in 63 congressional districts in 11 state. The group's 2007 funding has not been finalized. But in 2006, one of Hogar's "trusted friends" who paid $50,000 for a line on the caucus' website, special mention in its newsletters, listing on materials and advertising at events, was Countrywide Financial, which like a number of lenders makes both prime and subprime loans. Countrywide did not respond to interview requests.

Hogar's $25,000 Good Neighbors category, which included listing on Hogar materials and the website, invitations to events and a chance to participate in advisory committee calls, includes New Century, Ameriquest, Option One Mortgage and Wells Fargo (WFC). Caucus officials point out that two of their largest sponsors are mortgage giants Fannie Mae (FNM) and Freddie Mac (FRE), created by Congress to promote affordable homeownership.

"We're not reassessing our partners, necessarily," says Anna Alvarez Boyd, director of the Hogar initiative. "Clearly, New Century may not be around in the future and may not be able to sponsor us. They sponsored us in good faith."

The Congressional Black Caucus Foundation started its "With Ownership, Wealth" WOW initiative in 2001 to help with education, credit counseling and down payment resources. Household International, Countrywide and New Century are among the sponsors.

Peter Villegas, a first vice president of Washington Mutual, which makes prime and subprime loans, is chair of Hogar's advisory committee. Given market conditions, a focus ahead will be foreclosure prevention, Washington Mutual said.

The minority organizations aren't the only recipients of subprime lenders' largess. The industry contributes to other non-profit housing groups and lawmakers.

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Bad Loans Put Wall St. In a Swoon

Vikas Bajaj. **New York Times**. (Late Edition (East Coast)). New York, N.Y.: Mar 14, 2007. pg. C.1

Subjects:	Stock prices, Mortgages, Default, Dow Jones averages
Author(s):	Vikas Bajaj
Document types:	News
Section:	C
Publication title:	New York Times. (Late Edition (East Coast)). New York, N.Y.: Mar 14, 2007. pg. C.1
Source type:	Newspaper
ISSN:	03624331
ProQuest document ID:	1232205841
Text Word Count	1283
Document URL:	http://proquest.umi.com/pqdweb?did=1232205841&sid=2&Fmt=3&clientId=21307&RQT=309&VName=PQD

Abstract (Document Summary)

Yesterday's report by the mortgage bankers found that about 0.54 percent of all home loans entered foreclosure in the fourth quarter, the highest ever in the 37-year history of the survey. The problems were most heavily concentrated among subprime mortgages, but the default rates also increased on loans made to prime borrowers and on loans that are part of government programs.

Defaults were growing, albeit from a low base, even in relatively prosperous California, the nation's most populous state and home to some of its most heated housing markets until recently. About 2.03 percent of subprime mortgages in California entered foreclosure, which is more than the 1.83 percent of loans that were already in foreclosure there during the third quarter. Homes typically stay in foreclosure for several months.

According to the mortgage bankers' survey, 6.14 percent of all home loans were past due or in foreclosure in the fourth quarter, up from 5.72 percent. The portion of subprime loans, which are given largely to poor and minority borrowers, past due or in foreclosure rose to 17.86 percent, from 16.42 percent.

Full Text (1283 words)

Copyright New York Times Company Mar 14, 2007

Stocks fell broadly and sharply yesterday afternoon after a report on mortgage defaults indicated that the troubled housing market will weaken further before showing signs of improvement.

Though default and foreclosure rates have only recently begun rising from historic lows, the report from the Mortgage Bankers Association unnerved investors because it showed that a record number of homes entered the foreclosure process in the fourth quarter. It also indicated that problems that had previously been limited to economically weak areas were cropping up in more vibrant places like California.

With shares of financial companies leading the way, the Dow Jones industrial average dropped 242.66 points, or 1.97 percent, to 12,075.96, and the Standard & Poor's 500-stock index fell 28.65 points, or 2.04 percent, to 1,377.95. The fallout continued in Asia, with shares declining 1 percent to 3 percent in the major markets in mid-day trading today.

The slide echoed a sell-off two weeks ago driven in part by concerns about mortgages made to borrowers with weak, or subprime, credit and by a 9 percent drop in the Shanghai market. The S.& P. and Dow indexes are now down more than 5 percent since Feb. 20. [Page C11.]

Yesterday's report by the mortgage bankers found that about 0.54 percent of all home loans entered foreclosure in the fourth quarter, the highest ever in the 37-year history of the survey. The problems were most heavily concentrated among subprime mortgages, but the default rates also increased on loans made to prime borrowers and on loans that are part of government programs.

"It's a measurable weakening in credit quality across the board," said Mark Zandi, chief economist at Moody's Economy.com.

The rise in delinquencies will further strain the housing market, he said, because more houses will be put up for sale as foreclosures end in auctions, driving down home prices, which in turn will make it harder for struggling homeowners to refinance or sell their properties.

"This has a long way to play out," he said, "because it now has this self-reinforcing quality that is seemingly kicking in and will extend the housing correction."

Delinquency and foreclosure rates were highest in states like Ohio and Indiana, which are suffering from the loss of high-paying manufacturing jobs, and Louisiana and Mississippi on the Gulf Coast, where a slow pace of reconstruction has worsened the pain from hurricane damage.

But defaults were growing, albeit from a low base, even in relatively prosperous California, the nation's most populous state and home to some of its most heated housing markets until recently. About 2.03 percent of subprime mortgages in California entered foreclosure, which is more than the 1.83 percent of loans that were already in foreclosure there during the third quarter. Homes typically stay in foreclosure for several months.

Around the country, big states like Massachusetts, Colorado, Georgia and Texas also had high and rising foreclosure rates. The state statistics are not seasonally adjusted, unlike the national data.

The center of the country is exhibiting an "early warning sign of an infection that will quickly enough get to the coasts," said Edward Leamer, an economist at the University of California, Los Angeles. Both Mr. Leamer and Mr. Zandi noted that they did not expect the mortgage problems to presage a recession as long as the job market remained healthy.

Still, the mounting troubles of subprime lenders have been raising fears of a broader financial fallout. New Century Financial, one of the biggest subprime lenders, said yesterday that the Securities and Exchange Commission and a federal grand jury were seeking documents in investigations into trading in its shares and accounting errors. New Century stopped making loans last week after Wall Street banks closed off its financing.

Another subprime company, Accredited Home Lenders, said that it was facing a cash squeeze because of margin calls from its banks and was considering "strategic alternatives." Shares in the company fell 65.2 percent, to $3.97.

Residential Capital, the mortgage division of GMAC, reported an operating loss of $651 million for the fourth quarter, in contrast to a profit of $118 million a year ago, because of rising losses and reserves for future losses in its subprime business. General Motors will inject $1 billion into GMAC as a result.

According to the mortgage bankers' survey, 6.14 percent of all home loans were past due or in foreclosure in the fourth quarter, up from 5.72 percent. The portion of subprime loans, which are given largely to poor and minority borrowers, past due or in foreclosure rose to 17.86 percent, from 16.42 percent.

The default rates are at their highest since 2002 and early 2003, when the economy was a lot weaker than it is today and unemployment was hovering close to 6 percent. By comparison, at the end of last year the unemployment rate was 4.5 percent.

Senator Christopher Dodd, the Connecticut Democrat who is chairman of the Senate Banking Committee, said the

government might have to step in to provide aid to struggling homeowners. "The impact of losing 2.2 million homes I suspect will be in a lot of areas of our cities and towns that are already pretty hard hit," Mr. Dodd told reporters after a speech at the National League of Cities, according to Bloomberg News.

Douglas G. Duncan, the chief economist of the Mortgage Bankers Association, said default rates were rising and would probably peak at the end of 2007 because about half the mortgages today were issued less than three years ago and borrowers are most vulnerable during the third and fourth years of their loans.

Other industry experts add that the current rise in defaults is also a function of looser lending practices in the last two or three years. Many lenders made loans without requiring down payments or verifying borrowers' incomes with tax statements or pay stubs. Some borrowers -- though it is hard to say precisely how many -- may have also experienced payment shock from the resetting of adjustable-rate mortgages.

Furthermore, the slowing housing market has made it harder for borrowers to sell their properties or refinance, because their homes may be worth less than the outstanding balance on their loans.

Dozens of small companies that specialized in subprime lending have gone out of business or stopped making loans. Other companies like Countrywide Financial, the nation's largest mortgage lender, are tightening standards.

In an appearance on CNBC, Angelo Mozilo, the chief executive of Countrywide, said investors were overreacting to the subprime problems. "This is now becoming a liquidity crisis, an unnecessary one," he said. "There's been a rush to judgment."

A top executive at Goldman Sachs, which was among the investment banks that financed subprime lenders, said credit problems appeared to be safely confined to the subprime category.

"I can't predict the future, but as we sit here today, we really have not seen any contagion to the credit markets," David A. Viniar, Goldman's chief financial officer, said during a conference call with analysts and journalists about the firm's record quarterly profits.

But investors pushed Goldman shares down 1.8 percent, to $199.03.

[Chart]
"Rising Delinquencies"
The number of home loans with late payments or that are in foreclosure rose in the last three months of 2006, especially among subprime borrowers, where 13.3 percent of the loans were late and another 4.5 percent were in foreclosure.
ALL HOME LOANS: 33,322,667
As of 4th quarter; percentage figures are seasonally adjusted
4th qtr 2006
PAST DUE:
30 DAYS: 3.08%
60 DAYS: 0.90
90 DAYS: 0.96
IN FORECLOSURE: 1.19
SUBPRIME LOANS: 5,971,363
As of 4th quarter; percentage figures are seasonally adjusted
4th qtr 2006
PAST DUE:
30 DAYS: 7.47%
60 DAYS: 2.73
90 DAYS: 3.13
IN FORECLOSURE: 4.53
(Source by Mortgage Bankers Association)(pg. C8)

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The New York Times

Big Money Still Learning to Lobby

Jenny Anderson. **New York Times**. (Late Edition (East Coast)). New York, N.Y.: Mar 13, 2007. pg. C.1

Subjects:	Hedge funds, Federal regulation, Lobbying
Locations:	United States, US
Author(s):	Jenny Anderson
Document types:	News
Section:	C
Publication title:	New York Times. (Late Edition (East Coast)). New York, N.Y.: Mar 13, 2007. pg. C.1
Source type:	Newspaper
ISSN:	03624331
ProQuest document ID:	1231435111
Text Word Count	1720
Document URL:	http://proquest.umi.com/pqdweb?did=1231435111&sid=3&Fmt=3&clientId=21307&RQT=309&VName=PQD

Abstract (Document Summary)

Their efforts, though, may have more to do with an unusually benign environment for regulation than any well-oiled and deep-pocketed campaign. Henry M. Paulson Jr., the Treasury secretary, was chief executive of Goldman Sachs, which services hedge funds and runs its own hedge funds; the Federal Reserve continues to take a hands-off attitude toward hedge funds; and the Democratic chairman of the Senate Banking Committee, Christopher J. Dodd comes from Connecticut, home to a large number of hedge funds.

Late last month, the President's Working Group, which includes the heads of the Treasury, the S.E.C., the Federal Reserve and the Commodity Futures Trading Commission, issued a long-awaited report on the potential risks of hedge funds. It concluded that systemic risk was best addressed through aggressive monitoring of the major financial banks and investment banks that do business with hedge funds and it determined that the S.E.C. was working well to protect unsophisticated investors from investing in hedge funds by raising the wealth standard to qualify to invest in a hedge fund.

In 2004, Mr. [James Chanos] testified before a Senate hearing on hedge funds and proposed a middle-ground approach: in exchange for having hedge funds exempt from audits, the funds would agree to provide the S.E.C. with all the critical data needed to determine the size and scope of hedge fund activity.

Full Text (1720 words)

Copyright New York Times Company Mar 13, 2007

On a cold evening in late January, Senator Charles E. Schumer invited a who's who of hedge funds to dinner at Bottega del Vino on the Upper East Side of Manhattan. More than $100 billion worth of wealth sat around the table, including Paul Tudor Jones of Tudor Capital; Steven Cohen of SAC Capital; Stanley Druckenmiller of Duquesne Capital; and James Chanos of Kynikos Capital, according to a person who was briefed on the dinner.

Mr. Schumer, the New York Democrat, had some simple advice for the billionaires in his midst: If you want Washington to work with you, you had better work better with one another. (Mr. Schumer and the hedge fund managers declined to comment).

While hedge funds confidently flex their muscles in the markets and in boardrooms, in Washington they are experiencing the awkward growing pains of a relatively new industry coming to grips with its own power. Some hedge funds like D. E. Shaw and Cerberus Capital Management have spent time and money in the capital, but most funds have been content to hope Washington will not rear its regulatory head.

Now, united by a desire to avoid stringent regulation and a healthy sense of competition -- there are three hedge fund lobbying groups -- the industry seems resigned to no longer being a wallflower and looks set to join the dance with Congress.

So far the industry's efforts have witnessed remarkable results. More than two years after the Securities and Exchange Commission required that funds register with the agency -- a move overturned by a federal appeals court last summer -- the Treasury Department, the Federal Reserve, Congress and the S.E.C. seem to agree: hedge funds are as regulated today as they should be.

"They've been extraordinarily effective in lobbying, which is pretty amazing given Long-Term Capital Management and the number of other cases involving problems with hedge funds," said David Tittsworth, head of the Investment Adviser Association, a group which represents registered investment advisers. "The hedge fund industry -- whoever they are and whoever is representing them -- has been successful in fighting a centralized and comprehensive regulatory scheme."

Their efforts, though, may have more to do with an unusually benign environment for regulation than any well-oiled and deep-pocketed campaign. Henry M. Paulson Jr., the Treasury secretary, was chief executive of Goldman Sachs, which services hedge funds and runs its own hedge funds; the Federal Reserve continues to take a hands-off attitude toward hedge funds; and the Democratic chairman of the Senate Banking Committee, Christopher J. Dodd comes from Connecticut, home to a large number of hedge funds.

For an industry drenched in money -- hedge funds manage more than $1.4 trillion today -- hedge funds have spent a pittance on winning over Washington. From 1998 through 2006, 15 hedge funds -- the sum total of those that have registered their activity -- have spent $7.7 million lobbying Congress, according to the Center for Responsive Politics.

The top spender on lobbying is Cerberus Capital Management, a hedge fund better known for its private equity investments. Cerberus spent $2.1 million from 2001 through 2006. Issues range from registration to asbestos litigation and military spending bills.

"The small proportion of money they are spending is related to the fact that they are not heavily regulated," said Tim La Pira, a lobbying researcher at the Center for Responsive Politics. "Heavily regulated industries like banking or oil and gas spend an enormous amount of money because they have a history and legacy of being regulated."

The hedge funds' main trade association does not appear to have significant financial influence either. From 1998 through 2006, the Managed Funds Association spent only $752,000 lobbying. Its political action committee raised $169,500 in 2006 and made contributions of $112,600. By way of comparison, Merrill Lynch spent $4 million in 2006 alone, and the Investment Company Institute, representing the mutual fund industry, spent $5.4 million last year.

Political contributions show a similar pattern: the numbers are growing, but pale against the wealth managed by the fast-growing industry. In 2006, individuals at hedge funds as well as their spouses (if the spouse does not list an independent source of income) contributed $6.2 million (69 percent to Democrats and 27 percent to Republicans). That was up from the 2004 election cycle when individuals gave $5 million (67 percent to Democrats and 33 percent to Republicans). Top donors include Richard Perry of Perry Capital and his wife, Lisa ($202,850 in 2006); Kenneth C. Griffin of the Citadel Investment Group and his wife, Anne, who works for Aragon Global Management ($192,857); and Robert Soros and his wife, Melissa, a filmmaker ($171,500), according to the Center for Responsive Politics.

But Washington has turned its attention to the fast-growing hedge fund industry -- as well as other alternative investment vehicles, like private equity. As members of Congress show growing interest, the industry seems increasingly resolved to make its case on Capitol Hill before another major hedge fund blow-up forces it to act on the defensive.

Representative Barney Frank, the Massachusetts Democrat who is chairman of the House Financial Services Committee, will hold hearings today on hedge funds. Last week, Senator Charles E. Grassley, Republican of Iowa, sought to offer an amendment to a Homeland Security bill that would have required hedge funds to register, but he was rebuffed before it came to a vote.

A decidedly antiregulation environment in Washington has helped the industry. Four reports have been released in the last four months contending that American capital markets are less competitive, with excessive litigation and regulation being top culprits in each report. (Citadel Investment, a huge Chicago-based hedge fund, was among the groups that paid for the report.)

Late last month, the President's Working Group, which includes the heads of the Treasury, the S.E.C., the Federal Reserve and the Commodity Futures Trading Commission, issued a long-awaited report on the potential risks of hedge funds. It concluded that systemic risk was best addressed through aggressive monitoring of the major financial banks and investment banks that do business with hedge funds and it determined that the S.E.C. was working well to protect unsophisticated investors from investing in hedge funds by raising the wealth standard to qualify to invest in a hedge fund.

Not everyone agreed with the report's conclusions. "You are talking about milk toast -- go out and do good deeds," said Mr. Tittsworth, describing the President's Working Group study.

Corralling the hedge fund industry toward the purpose of educating Washington -- and donating money, arguably a more effective tool of persuasion -- has proved to be no easy task. The M.F.A. has tried to lead the way, and today has 1,300 members including 60 of the top 100 hedge funds, according to Robert Aaron, chairman of the group.

But even its role as representative for the industry has been a rocky one. In 2003, when the S.E.C. proposed a rule to require that hedge fund managers register, the M.F.A. engaged in what critics called a scorched-earth policy, insisting that hedge funds would move offshore and that liquidity in the system would evaporate.

Many hedge funds say that they face tough standards from their investors -- sophisticated institutions like endowments and pension funds -- and that revealing information about their trading strategies would be a violation of intellectual property rights.

But other funds that were registered, or that thought that registration was a reasonable first step, balked at the resistance to registration put up by the M.F.A.

When in 2004 the S.E.C. passed the registration rule, the association was left in a tough spot. "It was the worst of all worlds," said one industry lobbyist who asked not to be identified. "At least in the past the industry's take-no-prisoners approach resulted in initiatives being killed." The industry, it seemed, proved to be just as secretive as perception had suggested.

(Mr. Aaron, who was not the chairman of the M.F.A. during the registration issue, noted that most of the association's members are now registered.)

In 2004, Mr. Chanos testified before a Senate hearing on hedge funds and proposed a middle-ground approach: in exchange for having hedge funds exempt from audits, the funds would agree to provide the S.E.C. with all the critical data needed to determine the size and scope of hedge fund activity.

The proposal failed but others in the industry expressed their support for his view. In late 2005, Mr. Chanos founded the Coalition for Private Investment Companies. To avoid any conflicts of interest, the group would not give money as a group to politicians, and so it could be effectively bipartisan. "Our members think the M.F.A. does a tremendous job as a trade association -- my own firm is a member of the M.F.A.," Mr. Chanos said. "But I do believe there was room for another voice in the public policy debate."

A goal, Mr. Chanos said, was equal treatment for all alternative investors and getting regulators to focus on activities that worry them, not just the groups engaged in them.

Since Mr. Chanos founded the coalition, another lobbying group has surfaced, this one with the intent of reviving the registration requirement. Kenneth D. Brody, co-founder of Taconic Capital Advisors and the former head of the

Export-Import Bank during the Clinton administration, hired the Rich Feuer Group, a group focused on financial services issues.

The groups say they agree on most issues and they are working together more. "The consolidated effort will grow but individual efforts will continue to take place," Mr. Aaron said. "We welcome that."

[Photograph]
Senator Charles E. Schumer had advice for hedge fund managers. (Photo by Eric Thayer/Reuters)(pg. C6)

[Chart]
"A Small Hand in Politics"
Hedge funds, which have a lot of money to spend, spend relatively little on lobbying in Washington compared with some other financial industries and large companies.
HEDGE FUNDS
1. Angelo Gordon & Company: $ 40,000
2. Och-Ziff Capital Management: 40,000
3. Cerberus Capital Management: 60,000
4. D.E. Shaw & Company: 70,000
5. Wellington Management: 100,000
6. Pequot Capital Management: 120,000
7. Elliott Association: 160,000
8. Managed Funds Association*: 340,000
9. Barclays Global Investors: 380,000
TOTAL HEDGE FUNDS: $1,310,000
OTHERS
Merrill Lynch: 3,950,000
Securities Industry and Financial Markets Association: 4,270,000
Investment Company Institute: 5,410,000
*Hedge fund industry association
Figures are rounded.
(Sources by Center for Responsive Politics; Absolute Return magazine)(pg. C1)

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The New York Times

Lender Faces Credit Crisis With Banks

JULIE CRESWELL and VIKAS BAJAJ. **New York Times.** (Late Edition (East Coast)). New York, N.Y.: Mar 13, 2007. pg. C.1

Subjects:	Bankruptcy, Mortgage companies
Companies:	New Century Financial Corp(Ticker:NCEN, NAICS: 522292)
Author(s):	JULIE CRESWELL and VIKAS BAJAJ
Document types:	News
Section:	C
Publication title:	New York Times. (Late Edition (East Coast)). New York, N.Y.: Mar 13, 2007. pg. C.1
Source type:	Newspaper
ISSN:	03624331
ProQuest document ID:	1231435011
Text Word Count	1324
Document URL:	http://proquest.umi.com/pqdweb?did=1231435011&sid=1&Fmt=3&clientId=21307&RQT=309&VName=PQD

Abstract (Document Summary)

In the last few days, several lenders have held discussions with New Century about providing debtor-in-possession financing in connection with a bankruptcy filing, according to a person briefed on the situation. The company could then pursue a sale of itself or its assets through a bankruptcy filing, this person said.

Yet, the warning flags had already gone up inside at least two of New Century's lenders -- Goldman and Citigroup.

With little cash on its balance sheet, New Century scrambled to find financing to meet the margin calls. Help came from Morgan Stanley, which provided $265 million in new financing and replaced Citigroup's $717 million credit line.

Full Text (1324 words)

Copyright New York Times Company Mar 13, 2007

During a credit crisis nearly a decade ago, New Century Financial found a white knight in U.S. Bancorp, which was willing to save the company with a fresh infusion of capital.

This time, no savior has appeared on the horizon for New Century, one of the biggest mortgage lenders to borrowers with weak, or subprime, credit.

Instead, the Wall Street banks and brokerage firms that just a few months ago welcomed New Century with open arms and gave it credit lines worth billions of dollars have quickly shut off the spigot, forcing it ever closer to bankruptcy.

New Century said in a securities filing yesterday that all its lenders had frozen their credit lines and were demanding that it buy back $8.4 billion in loans that it issued using the money it borrowed from the banks -- money New Century says it does not have.

In the last few days, several lenders have held discussions with New Century about providing debtor-in-possession

financing in connection with a bankruptcy filing, according to a person briefed on the situation. The company could then pursue a sale of itself or its assets through a bankruptcy filing, this person said.

For Wall Street banks and brokerages firms, the stakes are much higher now than they were a decade ago. In 1998, U.S. Bancorp saved New Century by acquiring 17 percent of the company for a mere $20 million.

The closest thing to a white knight for New Century, which experienced a 90 percent tumble in its stock price this year before trading was halted yesterday, had been Morgan Stanley, which offered a financing package totaling $975 million last week.

But even that lifeline has not been enough.

What is perhaps most remarkable about New Century's troubles is the speed at which its banks acted. Their quick about-face appears to have been a response to the rapid demise of the subprime segment of the mortgage business, where default rates have spiked in the last six months.

In the next two weeks, many large Wall Street banks will report first-quarter earnings, and they may make the case that their exposure to the subprime sector will be limited, in part, because they have acted quickly to stop financing mortgage companies that relaxed lending standards last year.

The banks also have been driven by a fear that if they did not move as quickly as other banks, they would find themselves compromised when and if New Century filed for bankruptcy protection, according to analysts and people with knowledge about negotiations between New Century and its lenders.

"It's just a question of confidence," said Zach Gast, an analyst with the Center for Financial Research and Analysis, a forensics accounting firm that has been following New Century's troubles. "Once the first person went, we thought everybody would go. You don't want to be the last one holding the loans."

The banks also appear to have been caught unawares by the scope of New Century's problems. For instance, a week after the company said it would have to restate its financial statements for the first nine months of last year, Goldman Sachs extended to May 14 a credit line to New Century that was set to expire on Feb. 15.

Goldman Sachs agreed to extend its credit line after nearly two weeks of negotiations with New Century. The extension was for just three months, and the investment bank changed aspects of the agreement to give itself greater control over the relationship and allow it to get out of the agreement at the first hint of trouble, according to filings with the Securities and Exchange Commission.

Goldman was not alone in betting, at least initially, that New Century might prevail even as the company sent signals that something was amiss.

On Feb. 19, Citigroup acquired 5.1 percent of New Century, a stake that was worth about $55.2 million then, on behalf of individual and institutional clients.

Over the next few days, New Century received notice from the market trading analysis division of the New York Stock Exchange that it was examining trading in the company's stock. The trading also landed the company on the radar of prosecutors with the United States attorney's office in Santa Ana, Calif., who began an investigation on Feb. 28.

Two days later, after the close of the markets on Friday, New Century announced the various investigations into trading of its stock and also disclosed it had most likely breached its lending agreements with Wall Street and was working to receive waivers of those covenants.

Yet, the warning flags had already gone up inside at least two of New Century's lenders -- Goldman and Citigroup.

On March 6, Citigroup demanded New Century put up more cash through a $80.3 million margin call and demanded that the company buy back $717 million in loans that had been financed through Citigroup's line of credit.

About that same time and just weeks after renewing a line of credit with New Century, Goldman also made a margin call and sent notice to the company that it was in default of its credit arrangements.

That same day in a conference call with all of its banks, New Century said it had received margin calls from a number of its lenders and that it paid some but would not be able to honor them all, according to a person briefed on the call.

New Century and its lenders declined to comment beyond the company's securities filing.

With little cash on its balance sheet, New Century scrambled to find financing to meet the margin calls. Help came from Morgan Stanley, which provided $265 million in new financing and replaced Citigroup's $717 million credit line.

The move -- a doubling down of its position -- surprised some of New Century's bankers, who speculated Morgan Stanley might try to acquire the company.

Others briefed on the negotiations, however, say that Citigroup's line of credit was better collateralized than some of the other banks' line of credit with a combination of loans made by New Century and a higher yielding pool of securities.

Morgan Stanley has most likely improved its standing as a lender in a possible bankruptcy, said Mr. Gast from the Center for Financial Research and Analysis. He estimates the $265 million in financing, for instance, was secured by a loan portfolio worth about $512 million.

If New Century files for bankruptcy protection, as many analysts expect, and then seeks to sell some assets, banks and investors might be interested. But they would probably want to get a better sense of how the loans are performing before they make any offers.

"I could see people wanting to go in and doing an asset sale under that scenario," Mr. Gast said. "I don't see a lot of scenarios where people would want to assume the liabilities."

[Graph]
"A Rapid Fall"
Since early February, New Century Financial's problems have mounted and its stock has plunged, leading it to the brink of bankruptcy.
Graph tracks New Century Financial daily closing stock price from Feb. 5 to March 12.
FEB. 7 -- New Century says it will restate its financial statements for the first three quarters of 2006.
FEB. 14 -- New Century is sued by shareholders.
MARCH 2 -- New Century discloses that the U.S. attorney's office is investigating trading in the company's shares and accounting errors. The Securities and Exchange Commission and the New York Stock Exchange are also examining the company.
MARCH 6 -- New Century receives a margin call for $80 million from Citigroup.
MARCH 7 -- Goldman Sachs says New Century is in default.
MARCH 8 -- Several banks say New Century is in default. The company ceases making new loans.
MARCH 9 -- One day after extending New Century new credit, Morgan Stanley says it is in default.
MARCH 12 -- New Century discloses its defaults; trading in its stock is suspended.
(Source by Bloomberg Financial Markets [stock price])(pg. C1)

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THE WALL STREET JOURNAL.

Subprime Fears Spread, Sending Dow Down 1.97%; Weak Data Fuel Concern About a Wider Malaise; GM Ponies Up $1 Billion

Mark Whitehouse and Sarah Lueck. **Wall Street Journal.** (Eastern edition). New York, N.Y.: Mar 14, 2007. pg. A.1

Subjects:	Securities markets, Stock prices, Dow Jones averages, Subprime lending
Classification Codes	9190, 1110, 8100
Locations:	United States, US
Author(s):	Mark Whitehouse and Sarah Lueck
Document types:	News
Publication title:	Wall Street Journal. (Eastern edition). New York, N.Y.: Mar 14, 2007. pg. A.1
Source type:	Newspaper
ISSN:	00999660
ProQuest document ID:	1232260661
Text Word Count	1431
Document URL:	http://proquest.umi.com/pqdweb?did=1232260661&sid=11&Fmt=4&clientId=21307&RQT=309&VName=PQD

Abstract (Document Summary)

Investors faced a litany of hard-to-swallow news from the subprime market yesterday. Accredited Home Lenders Holding Co., of San Diego, said creditors had forced it to make payments of $190 million since Jan. 1, depleting the company's cash reserves. General Motors Corp. said it had agreed to pay about $1 billion to make up for subprime-lending losses at GMAC Financial Services, a former subsidiary in which it sold a controlling stake last year. The deal isn't expected to affect GM's results, but it will cut into the big auto maker's cash cushion as it carries out a massive restructuring of its North American operations. New Century Financial Corp., another subprime lender, said it had received a subpoena from federal prosecutors in a previously disclosed criminal investigation into accounting problems and trading in the company's shares. And later in the day, tax- preparation giant H&R Block Inc. said it wouldn't be able to file its third-quarter financial statement on time, citing its need to account for "rapidly declining loan values" at its subprime-lending subsidiary.

Treasury Secretary Henry Paulson, in an interview with The Wall Street Journal, echoed that relatively upbeat assessment. He acknowledged that the wave of foreclosures has been "distressing" to "individual mortgage holders," but said that "the distress of the subprime-mortgage market is something that should have been anticipated, given the housing correction." Mr. Paulson said: "From the standpoint of the overall economy, it's largely contained."

In an interview with CNBC yesterday, Mr. [Angelo Mozilo] said Countrywide has just 7% of its loan origination coming from subprime mortgages, and only about 2% of its assets in the subprime area. He said that after the shakeout in the subprime market is over, Countrywide's mortgage business will likely find itself free of "all the irrational competitors," and that "looks very positive for us."

Full Text (1431 words)

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Mounting troubles in the market for risky home loans, together with weak economic data, rekindled investors' fears of a broader malaise, spurred calls for action from Washington lawmakers and triggered a sharp drop in the U.S. stock market.

The Dow Jones Industrial Average fell 242.66 points, or 1.97%, to 12075.96 and the price of safe Treasury bonds rose sharply as investors shied away from all kinds of assets they deemed risky -- from stocks to the bonds of companies with lower credit ratings.

Yesterday's decline in the Dow was the second-largest in four years, and erased the gains the blue-chip average had made since Feb. 27, when it plunged 416 points.

"We're kind of back to panic mode," said Stephen Stanley, chief economist for RBS Greenwich Capital in Greenwich, Conn. "It definitely reflects concerns about the mortgage area and the possibility that it would feed more broadly into the financial system as well as the economy."

Meanwhile, politicians in Washington publicly urged that something be done to bail out stretched homeowners and to bring lenders into line in the so-called subprime market, which caters to borrowers with poor or sketchy credit histories.

"If left unaddressed, the ripple effect on our communities and cities will be enormous," said Sen. Chris Dodd, a Connecticut Democrat, in a speech at a National League of Cities convention in Washington yesterday. "We need to do something on this. We need to do it soon."

Investors faced a litany of hard-to-swallow news from the subprime market yesterday. Accredited Home Lenders Holding Co., of San Diego, said creditors had forced it to make payments of $190 million since Jan. 1, depleting the company's cash reserves. General Motors Corp. said it had agreed to pay about $1 billion to make up for subprime-lending losses at GMAC Financial Services, a former subsidiary in which it sold a controlling stake last year. The deal isn't expected to affect GM's results, but it will cut into the big auto maker's cash cushion as it carries out a massive restructuring of its North American operations. New Century Financial Corp., another subprime lender, said it had received a subpoena from federal prosecutors in a previously disclosed criminal investigation into accounting problems and trading in the company's shares. And later in the day, tax- preparation giant H&R Block Inc. said it wouldn't be able to file its third-quarter financial statement on time, citing its need to account for "rapidly declining loan values" at its subprime-lending subsidiary.

In 4 p.m. trading on the Nasdaq Stock Market, Accredited shares were down 65% to $3.97, while GM shares fell 2.6% to $30.51 in New York Stock Exchange composite trading. The NYSE has suspended New Century shares and is moving to delist the stock.

A report released by the Mortgage Bankers Association showed the growing cracks in the credit of some American homeowners. As of the fourth quarter of 2006, the share of all subprime loans in arrears rose to 13.33%, the highest level since 2002. During the quarter, it said foreclosures were initiated on a seasonally adjusted 0.54% of all loans -- the highest rate since the trade group started reporting the numbers 37 years ago.

Many in the mortgage market had expected the rise in arrears, which was already apparent in lenders' results, and saw relatively low delinquency rates among borrowers with better credit as a positive. But some noted that problems among certain types of "prime" borrowers -- specifically those who had taken out loans with adjustable interest rates -- were an ominous sign.

The data "show that mortgage credit-quality problems go well beyond the subprime sector," wrote Jan Hatzius, chief U.S. economist at Goldman Sachs in New York, in a research note.

Adding to those worries, the Commerce Department offered some evidence that debt-laden consumers may be curbing their spending. It reported that retail sales rose a meager 0.1% in February from January, less than economists had expected. Excluding volatile auto sales, retail sales fell 0.1%.

Economists said that an unusually cold February probably kept many shoppers at home, but the report nonetheless led some to downgrade their estimates of first-quarter growth in real gross domestic product, an inflation-adjusted measure of economic activity. Consulting firm Macroeconomic Advisers, for example, lowered its projection of annualized first-quarter GDP growth to 1.7% from 2.1%.

Most economists, though, haven't changed their outlooks as a direct result of the subprime mess, surmising that the risk of the type of credit crunch that would trigger a recession -- though rising -- remains too small.

Treasury Secretary Henry Paulson, in an interview with The Wall Street Journal, echoed that relatively upbeat assessment. He acknowledged that the wave of foreclosures has been "distressing" to "individual mortgage holders," but said that "the distress of the subprime-mortgage market is something that should have been anticipated, given the housing correction." Mr. Paulson said: "From the standpoint of the overall economy, it's largely contained."

Mr. Paulson's comments came as Goldman Sachs Group Inc., his former employer, reported record earnings and said it is pushing deeper into the subprime-mortgage business, ramping up its own operations and pondering the purchase of a troubled lender. It didn't specify a potential target.

Angelo Mozilo, chief executive of mortgage lender Countrywide Financial Corp., also sought to allay investors' fears, saying his company could find itself with less competition and more new customers after the subprime-mortgage meltdown plays out.

In an interview with CNBC yesterday, Mr. Mozilo said Countrywide has just 7% of its loan origination coming from subprime mortgages, and only about 2% of its assets in the subprime area. He said that after the shakeout in the subprime market is over, Countrywide's mortgage business will likely find itself free of "all the irrational competitors," and that "looks very positive for us."

Still, the subprime meltdown has begun to reverberate in Washington, where Democrats in control of Congress -- and those running for president -- have begun to seize on the issue, exploring new aid to distressed borrowers, as well as new regulations on lenders.

Two presidential contenders -- Sens. Dodd and Hillary Rodham Clinton of New York -- raised the issue at the National League of Cities convention. "I share your concern about what's happening in the subprime housing market," Mrs. Clinton, the current Democratic front- runner, told the crowd. "Let's work together to curb predatory lending and abusive practices. . . ."

Mr. Dodd, as chairman of the Senate Banking Committee, has already held one hearing on the issue, a month ago. He hasn't proposed specific legislation yet but says legislation is among the options he is considering.

In the House, a Financial Services subcommittee plans a series of hearings, beginning March 27, on subprime and predatory lending. At the first hearing, federal regulators, along with industry and consumer groups, will be asked to discuss recent federal guidance encouraging lenders to be more cautious when issuing loans with "teaser" rates that adjust much higher in a few years.

The hearings are expected to lead to legislation later this year. Rep. Barney Frank, the Financial Services chairman, has said he wants to restrict the riskiest types of mortgages. In that effort, two North Carolina Democrats, Reps. Brad Miller and Mel Watt, are likely to take the lead.

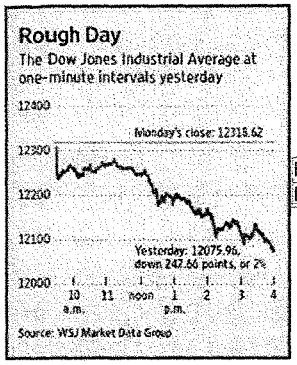
Reps. Miller and Watt have previously proposed legislation, called the Prohibit Predatory Lending Act, aimed at cracking down on what they regard as abusive practices and strengthening consumer protections without restricting low-income borrowers' access to credit. The legislation is based on a North Carolina law that limits a variety of fees and financing methods common to subprime loans, and which the two lawmakers say has been successful.

But even Democrats may find themselves divided about how far to go in limiting the loans, which, as Mr. Dodd noted, have "been a wonderful vehicle for making it possible for an awful lot of Americans who never could have even thought about owning a home to be able to get into that housing market."

Mr. Watt said in an interview yesterday that legislation is "more likely than it was last year," with Democrats in the majority, additional foreclosures and "more distress" about both predatory and subprime lending.

"The issues remain the same as they have been. . . . How do you set rules for the predatory side that don't impact access to credit on the nonpredatory side?" Mr. Watt said, adding that Democrats are trying to be "methodical" in deciding on an approach to the issue.

James R. Hagerty, John D. Stoll, Greg Hitt, Deborah Solomon and Conor Dougherty contributed to this article.



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THE WALL STREET JOURNAL.

Home Stretch: At a Mortgage Lender, Rapid Rise, Faster Fall; Wall Street Fueled Growth at New Century; A Party-Hard Culture

James R. Hagerty, Ruth Simon, Michael Corkery and Gregory Zuckerman. **Wall Street Journal.** (Eastern edition). New York, N.Y.: Mar 12, 2007. pg. A.1

Subjects:	Applications, Mortgages
Classification Codes	8110, 9190
Companies:	New Century Financial Corp(Ticker:NCEN, NAICS: 522292)
Author(s):	James R. Hagerty, Ruth Simon, Michael Corkery and Gregory Zuckerman
Document types:	News
Publication title:	Wall Street Journal. (Eastern edition). New York, N.Y.: Mar 12, 2007. pg. A.1
Source type:	Newspaper
ISSN:	00999660
ProQuest document ID:	1230763931
Text Word Count	2597
Document URL:	http://proquest.umi.com/pqdweb?did=1230763931&sid=13&Fmt=4&clientid=21307&RQT=309&VName=PQD

Abstract (Document Summary)

Wall Street firms such as Morgan Stanley and Bear Stearns also compete with subprime lenders by offering their own mortgage loans via brokers. On an online forum for mortgage brokers last week, Christopher Logan, an account executive for Morgan Stanley's recently acquired Saxon Mortgage subprime-lending arm, said his company is still eager to lend as others bow out. "With Morgan Stanley as our parent, we have the stability & strength -- which is what it takes to survive in today's subprime!" Mr. Logan wrote.

At an investor conference on Nov. 28, New Century's co-founder and chief executive, Mr. [Brad Morrice], said that despite the subprime area's problems, New Century was "well-positioned to compete and continue to profitably grow market share." Patti Dodge, an executive vice president, added that the company would continue to enjoy adequate liquidity thanks to "strong relationships with . . . Wall Street lenders."

"I just wanted to be able to eat and sleep in my house and have a roof over my head," says Ms. [Gertrude Robertson], who continues to work even though she will soon turn 90. "Every day at midnight when I go to sleep, I think maybe when I wake in the morning, they'll tell me to get out."

Full Text (2597 words)

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Ruthie Hillery was struggling to make the $952 monthly mortgage payment for her three-bedroom home in Pittsburg, Calif., last summer when a mortgage broker called. The broker persuaded the 70-year-old Ms. Hillery to refinance into a "senior citizen's" loan from New Century Financial Corp. that she thought would eliminate the need to make any payments for several years, according to her lawyer.

Instead, the $336,000 adjustable-rate loan started out with payments of $2,200 a month, more than double her income. In December, Ms. Hillery received notice that New Century intended to foreclose on the property. Then, earlier this month, after a formal demand by the lawyer, New Century agreed to refund all its fees and cancel the loan once Ms. Hillery gets refinancing elsewhere.

The lawyer, Alan Ramos, says the loan never should have been made. "You have a loan application where the income section is blank," Mr. Ramos says. "How does it even get past the first person who looks at it?"

New Century, an 11-year-old company that billed itself as "a new shade of blue chip," has become a symbol of excess in lending to subprime borrowers, people with weak credit records or high debt in relation to their income. The company has imploded over the past few months as defaults surged and accounting misdeeds surfaced. New Century's share price last week dropped 78% to $3.21 as some traders bet a bankruptcy-court filing is near.

New Century's swift rise and fall illuminates how Wall Street investment banks such as Morgan Stanley and hedge funds awash in cash helped fuel a binge in subprime lending that prolonged the housing boom. The lenders made themselves vulnerable by relying heavily on outside mortgage brokers and gunning for growth even as the boom faded. The Wall Street banks supplied the money to keep them on a roll, readily gobbling up loans and turning them into securities that global investors were avid to put into their portfolios.

With a work-hard, party-hard culture, New Century took its employees on a boozy cruise to the Bahamas and threw one bash in a train station in Barcelona, Spain, former employees say. Within a few years, the company, whose head offices are in a black-glass tower in Irvine, Calif., became one of the nation's top subprime lenders, jostling with older rivals like HSBC Holdings PLC and Countrywide Financial Corp.

Last week, New Century announced that it had stopped making loans because too many creditors had cut off funding. The company expects to report a loss for 2006 but can't yet quantify it. It is facing a federal criminal investigation of its accounting and trading in its stock before a negative announcement in February.

A New Century spokeswoman declined to comment on Ms. Hillery's case or any other aspects of the company's business.

While companies like New Century are free to lend through branch offices, Web sites or call centers, their main way of reaching customers has been via independent mortgage-brokerage firms, generally tiny local outfits. Mortgage brokers find customers, advise them on which types of loans are available and collect fees for handling the initial processing. There are more than 50,000 mortgage-brokerage firms and they are involved in 60% of all home loans, up from 40% a decade ago, says Tom LaMalfa, managing director of Wholesale Access, a mortgage research firm in Columbia, Md.

New Century and its rivals competed fiercely for business from brokers, who often favor lenders able to make loans quickly. John Waite, a mortgage broker in Appleton, Wis., says he liked working with New Century because it was "very easy." Until recently, he says, New Century rarely demanded reviews of the appraisals on which loans are based.

Thanks to the brokers, New Century ramped up its business quickly without having to hire a lot of employees or find office space. Brokers "work out of homes and cars and little offices," Mr. LaMalfa says, and they're often willing to go to customers' homes in the evening or on the weekend.

But by outsourcing much of its direct contact with consumers, New Century and other lenders also lost some control over the screening of borrowers and the presenting of loan choices. Some lenders and industry consultants say subprime lenders' dependence on brokers partly explains the industrywide surge in mortgage fraud. In a typical fraud, lenders are duped into making loans based on inflated home appraisals or income data. Some schemes involve organized rings that take the money and run without ever making a loan payment.

Fraud appears to be one reason for a recent rash of defaults occurring within the first few months of subprime loans. One hint that fraud might be a problem at New Century came in the company's disclosure last week that in December, borrowers failed to make even the first payment on 2.5% of New Century's loans. Normally people who borrow in good faith manage to make at least the first few payments.

Lenders loosened standards considerably in the first half of this decade. Home prices were climbing so fast that borrowers who couldn't keep up on payments could almost always sell their homes for a profit or refinance into a loan with easier terms. That emboldened lenders to offer loans with little or no down payment. Sometimes they let borrowers skip burdensome paperwork such as digging out tax forms to prove how much money they made.

Subprime lenders took cues from Wall Street. Investment banks and hedge funds were ravenous for the riskiest types of loans, whose higher yields made them vital ingredients in investment packages offered to investors globally. New subprime loans made in 2006 totaled about $605 billion, or about 20% of the total mortgage market, up from $120 billion, or 5%, in 2001, according to Inside Mortgage Finance, an industry newsletter.

Wall Street is deeply entrenched in the entire mortgage market, including loans to more creditworthy borrowers, on which defaults so far have remained low. Last year, banks and brokerage firms pocketed $2.6 billion in fees from underwriting bonds that use mortgages as their collateral, nearly double 2001's figure. Wall Street banks also extended billions of dollars of short-term credit, called warehouse lines, that allowed lenders like New Century to fund mortgage loans.

New Century, whose loan originations jumped to $59.8 billion in 2006 from $6.3 billion five years before, proved an especially valuable client. It has spent about $38 million in fees just for stock and bond sales since 1998. The company is structured as a real-estate investment trust and, under rules governing REITs, must pay out the vast majority of its earnings as dividends. That meant it needed to return frequently to Wall Street to raise money and keep its operations going.

Morgan Stanley has helped underwrite $9.8 billion of stock and bonds for New Century since 1998, pocketing about $17.4 million in fees, according to data-tracker Thomson Financial. Last week, Morgan Stanley helped New Century with an emergency loan even as other Wall Street banks said no. Morgan Stanley declined to comment.

Wall Street firms such as Morgan Stanley and Bear Stearns also compete with subprime lenders by offering their own mortgage loans via brokers. On an online forum for mortgage brokers last week, Christopher Logan, an account executive for Morgan Stanley's recently acquired Saxon Mortgage subprime-lending arm, said his company is still eager to lend as others bow out. "With Morgan Stanley as our parent, we have the stability & strength -- which is what it takes to survive in today's subprime!" Mr. Logan wrote.

The shakeout in the subprime area is the latest of the mortgage industry's periodic purges of dubious practices and weak lenders. In the mid- to late-1980s, savings-and-loan institutions moved into risky lending, sometimes to cover losses after interest rates turned against them. Courts found that some executives looted dying S&Ls. A 1989 government bailout ultimately cost hundreds of billions of dollars.

The collapse of many S&Ls, once the dominant force in home mortgages, opened the way for specialist mortgage-banking firms and commercial banks to take more of the business. Today, Countrywide and Wells Fargo & Co. have a combined share of around 30% of all home loans originated each year, but the rest of the market is splintered among more than 8,000 lenders. Regulation is a patchwork. Five federal agencies oversee mortgage lenders affiliated with banks, thrifts or credit unions, while New Century and others that don't take deposits are regulated by state agencies.

New Century's founders -- Edward Gotschall, Brad Morrice and Robert K. Cole -- worked together at a California mortgage lender in the early 1990s and formed New Century in 1995 with about $3 million of venture capital. It went public in 1997 and survived a scare the next year when Russian loan defaults caused investors to flee risky businesses and some subprime lenders went out of business. U.S. Bancorp of Minneapolis helped out by acquiring $20 million in New Century preferred stock.

At the height of the housing boom in 2003 and 2004, New Century executives grumbled that the stock market was undervaluing their company. They and several other subprime lenders responded by turning their companies into REITs, hoping to attract investors interested in high dividends. The move didn't have much of an effect, as investors continued to worry that earnings and dividends in the mortgage industry couldn't be sustained at boom levels. The REIT structure also made it harder for New Century to put aside earnings for a rainy day.

Despite disappointment over the share price, former New Century employees say the company was a fun and rewarding place to work. One former executive says the company made a priority of promoting from within. A former secretary to Mr. Cole took charge of investor relations.

Partying and heavy drinking were common on company outings, former employees say. David Pace, a former New Century account executive who dealt with loans in southeast Michigan, says the theme of one cruise in the Bahamas was "The Best Damn Mortgage Company. Period."

The company also sent top-producing employees to a Porsche-driving school, says James Fuller, a former project manager in New Century's information-technology department. "It was a culture of excess," says Mr. Fuller, who left in 2005.

Racing is a passion for one former top executive, Patrick J. Flanagan. While he was at New Century, a division under his control sponsored a Nascar race car. In late 2005, the company granted Mr. Flanagan a six-month leave of absence with pay of $76,445 a month (he had made nearly $4 million the year before), while he looked for new horizons. He then left the company and says he has spent part of his time competing in car races. He declined to comment on New Century.

Company executives made a splash with charitable giving. Mr. Flanagan last year pledged $500,000 to a private school attended by four of his children in Aliso Viejo, Calif. Co-founder Mr. Gotschall and his wife, Susan, gave $3 million to a hospital in Mission Viejo, Calif. In the 2006 election cycle, New Century's political action committee contributed $202,634 to political campaigns, according to the Center for Responsive Politics.

Some analysts warned of trouble long before this month. An August 2005 report from Gradient Analytics Inc., a research firm in Scottsdale, Ariz., highlighted heavy selling of shares by the company's three founders as a sign that prospects for the company were clouding.

In November 2006, the Center for Financial Research and Analysis, an accounting research firm in Rockville, Md., flagged concerns about New Century's third-quarter earnings release. CFRA analyst Zach Gast noted that the company for the first time had lumped together two categories of reserves, one for losses on defaulted loans and a second for losses on real estate that had been acquired through foreclosure. Combining those two categories allowed the company to show a small increase in reserves from a quarter earlier, he wrote. But that masked a decline of 8.7% in the reserve for losses on soured loans, to $191.6 million, he calculated.

Mr. Gast found it curious that New Century was lowering reserves at a time when defaults on subprime loans generally were surging. Had New Century maintained reserves at levels comparable with the second quarter, he estimated, earnings per share would have been at least 50% lower than the $1.12 reported.

At an investor conference on Nov. 28, New Century's co-founder and chief executive, Mr. Morrice, said that despite the subprime area's problems, New Century was "well-positioned to compete and continue to profitably grow market share." Patti Dodge, an executive vice president, added that the company would continue to enjoy adequate liquidity thanks to "strong relationships with . . . Wall Street lenders."

In fact, when the chips were down last week, some of those Wall Street firms refused to extend New Century more credit, the company disclosed last week.

In a securities filing March 2, New Century said the audit committee of its board has hired independent lawyers and forensic accountants to look into the company's methods for valuing certain risky mortgage securities known as "residuals" that it kept on its books. The company also has said it will need to correct errors in its accounting for losses on defaulted loans it has been forced to buy back from investors. That will significantly reduce earnings for the first nine months of 2006, it said.

New Century's implosion has hit big investors such as David Einhorn of Greenlight Capital Inc., a New York hedge fund that holds a 6.3% stake in the lender. After tangling with New Century's management, Mr. Einhorn won a board seat a year ago, which he gave up last week without explanation. The value of Greenlight's stake in New Century has fallen to about $11 million from $160 million in mid-2006. Mr. Einhorn declined to comment.

It isn't only investors who are smarting. In 2004, a mortgage broker at the Seattle firm Washington Loan Network Inc. offered to refinance Gertrude Robertson's mortgage into a New Century loan with lower monthly payments. The 89-year-old health aide agreed to take out a new $414,000 loan that carried a fixed rate for two years and then was set to adjust every six months.

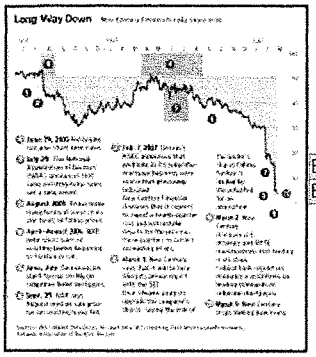
Last year, Ms. Robertson found she couldn't meet the payments, which had climbed to about $3,300 a month, leaving her without enough money to pay her other expenses. In October, she filed a lawsuit in King County Superior Court against New Century and the mortgage broker. The complaint alleges that Ms. Robertson's income was never sufficient to meet the expected payments and that information in her application was falsified.

Early this year, another mortgage broker, California Loan Co., arranged for Ms. Robertson to refinance into a new mortgage with New Century that boosted her loan balance to $450,000 and cut her monthly payments slightly, to $3,129. "New Century didn't know they had the [earlier] loan or even care," says Melissa Huelsman, a lawyer representing Ms. Robertson.

The phone number for Washington Loan Network was disconnected. Washington state's regulator says it is investigating the broker. Alex Torres, who described himself as the office manager for California Loan Co., which handled the second loan, declined to comment.

"I just wanted to be able to eat and sleep in my house and have a roof over my head," says Ms. Robertson, who continues to work even though she will soon turn 90. "Every day at midnight when I go to sleep, I think maybe when I wake in the morning, they'll tell me to get out."

Jonathan Karp and Lingling Wei contributed to this article.



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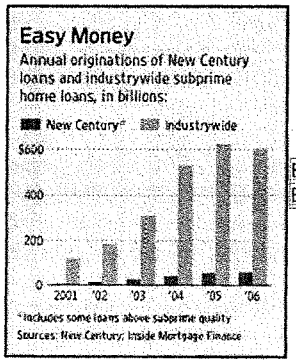

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STATEMENT OF

SHEILA C. BAIR
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

POSSIBLE RESPONSES TO RISING MORTGAGE FORECLOSURES

before the

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

April 17, 2007
2128 Rayburn House Office Building

Chairman Frank, Ranking Member Bachus and members of the Committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding our continuing efforts to address the problems faced by subprime mortgage borrowers.

As the Committee knows, the evolving problems in this market are a major concern of the FDIC. On March 1, the FDIC and the other federal banking agencies issued for comment supervisory guidance to address the underwriting and marketing of subprime adjustable mortgages. The guidance focuses on two fundamental consumer protection principles. First, a loan should be approved based on a borrower's ability to repay according to its terms (not just at the initial rate, for example). Second, borrowers should be provided the information necessary to understand a transaction at a time that will help them decide if the loan is appropriate for their needs. The FDIC and the federal and state banking agencies feel strongly that clear, common sense standards regarding the underwriting and marketing of subprime adjustable mortgages are necessary to protect consumers and reinforce market discipline, while preserving a flow of capital to fund responsible lending.

While the recent supervisory guidance is directed at preventing future abuses, there remains the urgent issue of how to address the current circumstances of many borrowers who have mortgages they cannot afford and have little prospect of refinancing given today's real estate and loan market conditions. Almost three-quarters of securitized subprime mortgages originated in 2004 and 2005 were "2/28 and 3/27"[1] hybrid loan

[1] 2/28s and 3/27s are hybrid ARMs typically marketed to subprime borrowers. These ARMs are similar to ARMs that are prevalent in the prime market (known as 3/1 ARMs), in that they have a fixed rate for 2/3

structures.[2] Most of these borrowers are having difficulty making the payments on these loans after the "reset" to higher payments – often an increase of thirty percent or more -- that occurs after the initial two or three years of loan payments. According to one study, the interest rates for an estimated 1.1 million subprime loans will reset in 2007 and an additional 882,000 subprime loans will reset in 2008.[3] Fewer and fewer of these borrowers are able to refinance because of the slowing rate of housing appreciation, higher interest rates and the problems faced by subprime lenders.

Many subprime borrowers could avoid foreclosure if they were offered products that allow for affordable mortgage payments. Restructuring their loans into more affordable products, especially 30-year fixed rate mortgages, would bring them back to good standing, allow them to repair their credit histories, and dampen the impact that foreclosures may have on the broader housing market. Most important, people would be able to stay in their homes.

In the past, lenders often worked with troubled borrowers to restructure their loans or find other ways to avoid foreclosure. Today, the growth of securitization in the subprime mortgage market has complicated the ability of interested parties to apply flexibility and creativity to assist borrowers facing difficulty. My testimony will address the growth of securitization in the subprime mortgage market, describe the roles and

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years and then adjust to a variable rate for the remaining 28/27 years. However, the spread between the initial fixed rate of interest and the fully-indexed interest rate in effect at loan origination typically ranges from 300 to 600 basis points on 2/28 and 3/27s, versus 100-250 basis points on prime 3/1 ARMs.

[2] Source: LoanPerformance database of nonprime (subprime and Alt-A), non-agency securitized mortgage originations.

[3] Christopher L. Cagan, "Mortgage Payment Reset: The Issue and the Impact," First American CoreLogic, March 19, 2007, http://www.firstamres.com/MPR2007.

responsibilities of the different participants in a securitization and identify challenges in developing workable solutions for troubled borrowers.

Growth of Securitization in the Subprime Mortgage Market

Securitization represents an essential process in U.S. mortgage markets. By packaging loans in a way that is attractive to investors, securitization has increased the volume of credit available to borrowers and improved the liquidity of the mortgage markets. The result has been the development of a wide array of lending products that have contributed to unprecedented levels of home ownership in this country.

The liquidity provided by the private label mortgage-backed securities (MBS) market has been an important factor in the growth of nontraditional and subprime mortgage lending. The share of U.S. mortgage debt held in private-label MBS more than doubled between 2003 and 2006, from 9 percent to 18 percent, while the share held by government-sponsored enterprises shrank from 52 percent to 41 percent.[4]

The growth in private-label MBS injected vast amounts of liquidity into the subprime mortgage market. This increased liquidity allowed lenders to make these mortgages more widely available. Subprime loans more than doubled as a share of all mortgage loan originations, from 7.9 percent in 2003 to 20 percent in 2005.[5] The volume of subprime loans included in private-label securitizations grew to at least $672 billion by

[4] *Federal Reserve Flow of Funds*.
[5] *Inside Mortgage Finance*, December 1, 2006.

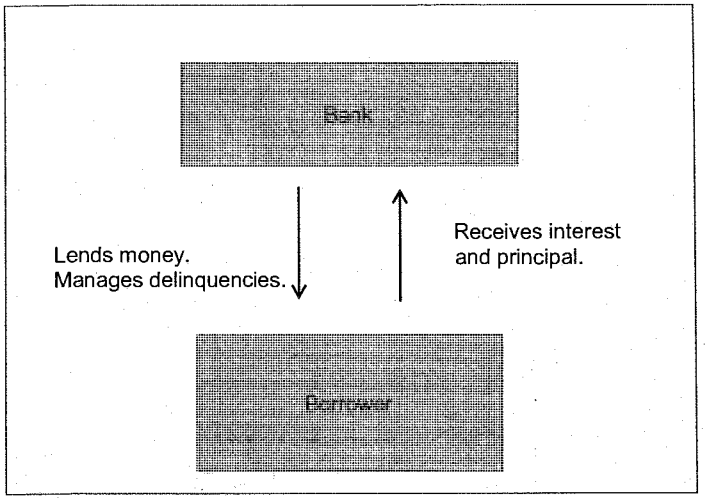
year-end 2006.[6] Approximately 75 percent of the estimated $600 billion of subprime mortgages originated in 2006 were funded by securitizations.[7] Thus, a substantial portion of subprime mortgages are ultimately funded by securitizations, and any policy responses to the expected increase in subprime foreclosures must be crafted with consideration to the legal rights and obligations of the various securitization stakeholders.

Securitization Structure

Prior to the widespread use of securitization, home finance typically involved a bank or savings institution granting a loan to a borrower. The lending institution would make the decision to grant credit, fund the loan, and collect payments. In the event of borrower default, the same institution could choose to restructure the loan or foreclose on the property. The lender also might have an established relationship with the borrower, and, thus, be able to evaluate the relative long-term benefits of various alternatives. This relatively simple relationship between the borrower and lender illustrated in the diagram below has given way to a far more complicated securitization structure which includes multiple parties, each with unique and often divergent interests.

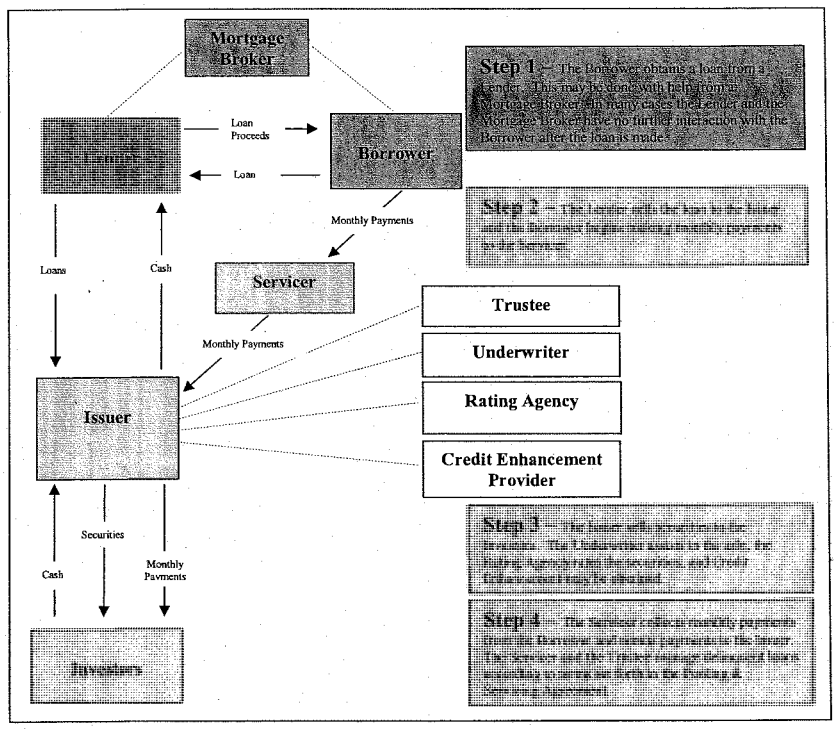
[6] LoanPerformance database of nonprime (subprime and alt-A) non-agency securitized mortgage originations. Volume represents active investor balance of subprime loans.
[7] *Standard & Poor's Weighs In On The U.S. Subprime Mortgage Market,* April 2, 2007.

Borrowing Under the Traditional Borrower/Lender Relationship



The securitization structure diagram below shows the components of a typical securitization. It is important to note that not all securitizations are identical. For example, the lender and the servicer are sometimes the same entity, or in other arrangements brokers may not play a role. Nevertheless, the diagram generally illustrates the roles of the various participants in a securitization structure.

Borrowing Under a Securitization Structure



As the terminology is used in the securitization contracts and in the diagram above, the key elements to a typical securitization include the following:

- Issuer – A bankruptcy-remote special purpose entity (SPE) formed to facilitate a securitization and to issue securities to investors.[8]
- Lender – An entity that underwrites and funds loans that are eventually sold to the SPE for inclusion in the securitization. Lenders are compensated by cash for the purchase of the loan and by fees. In some cases, the lender might contract with mortgage brokers. Lenders can be banks or non-banks.
- Mortgage Broker - Acts as a facilitator between a borrower and the lender. The mortgage broker receives fee income upon the loan's closing.
- Servicer - The entity responsible for collecting loan payments from borrowers and for remitting these payments to the issuer for distribution to the investors. The servicer is typically compensated with fees based on the volume of loans serviced. The servicer is generally obligated to maximize the payments from the borrowers to the issuer, and is responsible for handling delinquent loans and foreclosures.
- Investors – The purchasers of the various securities issued by a securitization. Investors provide funding for the loans and assume varying degrees of credit risk, based on the terms of the securities they purchase.
- Rating Agency – Assigns initial ratings to the various securities issued by the issuer and updates these ratings based on subsequent performance and perceived risk. Rating agency criteria influence the initial structure of the securities.

[8] Bankruptcy-remote means that an SPE's obligations are secure even if the lender becomes insolvent. That is, due to its legal status and balance sheet structure, the SPE and its debt issuances are not affected by the bankruptcy of the lender.

- Trustee – A third party appointed to represent the investors' interests in a securitization. The trustee ensures that the securitization operates as set forth in the securitization documents, which may include determinations about the servicer's compliance with established servicing criteria.
- Securitization Documents – The documents create the securitization and specify how it operates. One of the securitization documents is the Pooling and Servicing Agreement (PSA), which is a contract that defines how loans will be combined in a securitization, the administration and servicing of the loans, representations and warranties, and permissible loss mitigation strategies that the servicer can perform in event of loan default.
- Underwriter - Administers the issuance of the securities to investors.
- Credit Enhancement Provider – Securitization transactions may include credit enhancement (designed to decrease the credit risk of the structure) provided by an independent third party in the form of letters of credit or guarantees.

Securitization takes the role of the lender and breaks it into separate components. Unlike the more traditional relationship between a borrower and a lender, securitization involves the sale of the loan by the lender to a new owner--the issuer--who then sells securities to investors. The investors are buying "bonds" that entitle them to a share of the cash paid by the borrowers on their mortgages. Once the lender has sold the mortgage to the issuer, the lender no longer has the power to restructure the loan or make other accommodations for its borrower. That becomes the responsibility of a servicer, who collects the mortgage payments, distributes them to the issuer for payment to

investors, and, if the borrower cannot pay, takes action to recover cash for the investors. The servicer can only do what the securitization documents allow it to do. As described below, these contracts may constrain the servicer's flexibility to restructure the loans.

With so many parties and components involved, securitizations are significantly more complicated than the traditional borrower/lender relationship. The securitization is governed by securitization documents and is administered by a trustee. This separation of the functions previously done by a single lender creates a funding mechanism that has facilitated new types of financing and has expanded credit availability. However, the increased complexity of the structure and the different interests of the various securitization parties can make credit workout strategies more complicated than in a direct borrower/lender relationship.

The interests and obligations of the various parties are set forth in the securitization documents and are closely monitored by the trustee. Further complicating the situation is the fact that the interests of the participants might not be aligned – with each other or with the borrower. Generally speaking, this arrangement complicates the loan modification process.

Loan Restructuring Challenges

When difficulty arises in making payments on a securitized loan, the borrower generally will not be dealing with the local banker with whom there might be an

established relationship. Instead, the borrower will be dealing with a servicer. The servicer has responsibilities defined in the securitization documents that are substantially different than those of a lender. The servicer and the trustee are responsible for taking actions that are in the best interest of the investors who purchased portions of the securitization. Protecting the investors means determining the best alternative that would bring the maximum recovery on a defaulted loan on a present-value basis. If the servicer determines that a workout or modification of the loan achieves that goal, then there is an alignment of the investor/servicer/borrower relationship. However, if liquidation of the collateral (through a foreclosure or other means) results in the highest net present value of cash flows, the servicer may be bound by the terms of the securitization to pursue this approach to the benefit of the investor despite the resulting detriment to the borrower.[9]

Even if a modification to the loan looks like the right approach, other factors might limit the servicer's options. Most securitizations are established as Real Estate Mortgage Investment Conduits (REMICs). The REMIC structure provides considerable tax benefits, (i.e., only the investors are subject to tax, not the conduit itself) but also includes provisions that could limit the flexibility of a servicer to modify a borrower's loan terms in a proactive manner. To qualify for tax-advantaged status, the pool of loans

[9] For example, one securitization includes language that states "in the event that any mortgage loan is in default or, in the judgment of the servicer, such default is reasonably foreseeable, the servicer, may also waive, modify or vary any term of such mortgage loan (including modifications that would change the mortgage rate, forgive the payment of principal or interest or extend the final maturity date of such mortgage loan, accept payment from the related mortgagor of an amount less than the stated principal balance in final satisfaction of such mortgage loan or consent to the postponement of strict compliance with any such term or otherwise grant indulgence to any mortgagor; provided, that in the judgment of the servicer, any such modification, waiver or amendment could reasonably be expected to result in collections and other recoveries in respect to such mortgage loans in excess of net liquidation proceeds that would be recovered upon the foreclosure of, or other realization upon, such mortgage loan...."

securitized in a REMIC must generally be treated as a static pool, which usually precludes modifying loans in the pool. An exception to this general prohibition allows for modifications when default is *reasonably foreseeable.* Once a determination is made that default is reasonably foreseeable, most securitization agreements provide significant flexibility for the servicer to modify terms of the loan. This allows for modification of terms when a loan has defaulted, but may prohibit changes to loans that are current.

The Internal Revenue Service (IRS) leaves it to servicers to determine what "reasonably foreseeable" means as it relates to default, which makes these determinations dependent upon the facts and circumstances of each mortgage. In many cases, servicers would likely need to seek legal determinations from outside counsel, especially with respect to whether a default was reasonably foreseeable, in order to modify loans in the pool. Some securitization documents indicate that once a loan is delinquent for a certain amount of time, for example, 60 days, modifications of the terms may be allowed, subject to REMIC laws. In some deals, the servicer must certify with a legal opinion that a modification of loan terms would not result in an adverse REMIC event. Therefore, while some flexibility is available, the specifics are often unclear. Further clarification regarding permissible modification activities under REMIC laws would improve the servicer's ability to work through problems with the borrower.

Aside from the restraints imposed on modifications by the REMIC structure, the PSA can also impose barriers to loan modification. The language in each PSA is different and each establishes the rules about how a particular securitization operates or

what needs to be done to change those rules. Many PSAs contain more than 200 pages of dense legal verbiage. The PSA provides a blueprint as to how cash flows and losses are allocated and distributed to the various parties, and establishes the rules that the servicer must abide by in managing this critical function in the transaction. The PSA sets forth whether and how a servicer can modify the underlying loans in a securitization. The documents will also identify the other parties in the transaction who might have an important role in this decision.

If the PSA's terms and conditions regarding modifications prove to be overly restrictive, changing the PSA can be very difficult and may require extraordinary actions, such as obtaining the consent of two-thirds or all of the investors. In some deals, the PSA is quite explicit in allowing the servicer flexibility in modifying delinquent loans,[10] while in other transactions the language is vague.

Even if the servicer can arrange a modification of terms, the servicer may still be limited in the ability to take a proactive approach to modifying a loan. If a servicer foresees problems on the horizon for a group of borrowers that is currently paying as agreed, the servicer might not be able to modify the terms of the loan until the borrower enters into the "imminent default" category. For example, following Hurricane Katrina,

[10] For example "In the event that any mortgage loan is in default or is a 60+ day delinquent mortgage loan, the servicer, consistent with the standards set forth in Section 3.01, may also waive, modify or vary any term of such mortgage loan (including modifications that would change the mortgage interest rate, forgive the payment of principal or interest, extend the final maturity date of such mortgage loan or waive, in whole or in part, a prepayment premium), accept payment from the related mortgagor of an amount less than the stated principal balance in final satisfaction of such mortgage loan or consent to the postponement of strict compliance with any such term or otherwise grant indulgence to any mortgagor (any and all such waivers, modifications variance, forgiveness of principal or interest, postponements, or indulgences collectively referred to herein as forbearance)."

some banks granted blanket payment moratoria for borrowers with homes in the Gulf Coast region, but many servicers were limited in their ability to grant similar blanket moratoria for mortgages that were securitized. Instead, these servicers had to make modifications on a case-by-case basis based on the facts and circumstances of each borrower. In situations like this, waiting for the borrower to fall behind in payments may not be the most prudent course of action for any of the parties involved. If solutions could be reached to forestall a problem, the result would be greater flexibility for servicers and possibly loss mitigation.

While the servicer has an important role in the decisions relating to the underlying borrower, there are other parties involved in the transaction whose views also carry significant weight. In most older deals (and some more recent), the servicer must obtain the consent and approval of the rating agency and bond insurer before considering loan modifications in amounts greater than 5 percent of the total transaction. Yet, excessive modifications might be viewed as a negative factor when ratings are reviewed by the ratings agencies.

Financial guarantors and other credit enhancement providers have become more involved in the structured finance market as well, often providing insurance on the deeply subordinated tranches of securitizations to facilitate the sale of these more risky positions. In this role, a guarantor steps in and absorbs losses should the underlying collateral begin to deteriorate. Therefore, the guarantor has a vested interest in the decisions made by the servicer in dealing with distressed borrowers. In some transactions, the servicer is

required to gain the prior written consent of the credit enhancement provider for any modification, waiver, or amendment that would cause the aggregate number of outstanding mortgage loans which have been modified, waived or amended to exceed 5 percent of the original pool balance. Whether the credit enhancement provider, servicer, and borrower share the same interest will depend on the facts and circumstances of the specific situation. If their interests are not aligned, however, the credit enhancement provider's demands will no doubt have a large effect on the ultimate outcome.

The accounting rules also play an important role in the decisions made by the various parties. Securitization is often used as a balance sheet management strategy, whereby assets sold into a securitization are removed from the seller's books, thus freeing up resources such as capital. Lenders must meet strict accounting requirements before they can remove assets from their books, to show that they no longer "control" these assets, and that the risks and rewards associated with the loans have been transferred to the investors.

Overall, the ability to securitize pools of such mortgages certainly helped to make mortgage loans available and has reduced the cost of credit for borrowers. However, the securitization structure also has introduced a number of new participants and complexities into the loan relationship, which reduces flexibility for addressing the problems of distressed borrowers.

Dealing with Credit Distress

A key element in addressing alternatives to foreclosure for borrowers experiencing credit distress is early communication between the borrower and the servicer. It is important that a borrower contact the loan servicer, the entity to which the borrower sends the monthly payment, as soon as possible if the borrower anticipates difficulty in making payments when the loan resets. The contact information for the servicer can be found on the monthly billing statement. In addition to borrowers contacting their loan servicers, it appears that a number of loan servicers are proactively contacting borrowers several months before their loans are due to reset to determine the prospect of repayment and modifying loan terms if necessary to avoid default. This is a highly positive development that should be encouraged. Failure to establish timely communication could result in some foreclosures that might have been prevented.

In addition, borrowers should explore all financing options that might be available. Borrowers with ARMs or hybrid ARMs, such as "2/28" or "3/27" mortgage loans should inquire about traditional fixed rate products. Particularly when borrowers can document income, fixed rate products may be available at lower interest rates -- and therefore lower monthly cost -- than more exotic products.[11] I also encourage lenders and servicers to be as flexible as they can in efforts to accommodate borrowers concerned

[11] See Testimony of Chairman Sheila C. Bair on *"Subprime and Predatory Lending: New Regulatory Guidance, Current Market Conditions, and Effects on Regulated Institutions"* delivered to the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services U.S. House of Representatives on March 27, 2007.

about losing their homes. Fundamentally, borrowers should be given loans they can afford to repay both today and in the future.

My testimony up to this point has focused on borrowers who have been making steady payments but face a reset of their interest rate that will make it difficult or impossible to make the significantly higher monthly payments. It is important to note that there is another class of borrowers who immediately defaulted on their loans or obtained their loans under potentially fraudulent pretenses. It would be hard to argue that these borrowers deserve the same type of assistance that might be appropriate for borrowers who acted in good faith.

The April 16 Forum

The FDIC, along with the Office of Thrift Supervision, the Office of the Comptroller of the Currency, the Federal Reserve, the Securities and Exchange Commission, and the Office of Federal Housing Enterprise Oversight, recently announced its intention to jointly host a forum on April 16 on the issues surrounding subprime mortgage securitizations. Lenders, servicers, and other participants in the subprime market have been invited to participate in an exchange of ideas about how they can help struggling subprime borrowers avoid foreclosure while maintaining the integrity of the secondary market.

The goal of the forum is to provide an opportunity for market participants to

develop a common understanding of problems and to identify workable solutions for rising delinquencies and defaults, including alternatives to foreclosure..[12] The forum is an example of the role that the regulatory community can play in fostering dialogue with the private sector to focus efforts on important public policy goals.

Clearly there are significant issues created by the present structure of securitization vehicles and how the terms and conditions of these arrangements may complicate workable solutions. In some cases, the contracts and rules in place to restrict abuses on certain activities might have the unintended consequence of restricting a servicer's ability to make prudent decisions that are in the interest both of the investor and the borrower. To address these issues, the forum is designed to focus on three key areas:

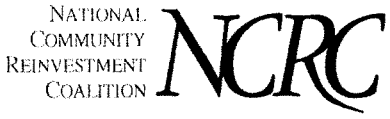
- Identifying current marketplace activities to help borrowers stay in their homes.
- Identifying whether there are legal restrictions, accounting rules, or contractual limits that unreasonably interfere with efforts to restructure borrowers' mortgages.
- Identifying alternatives to foreclosure and the strategies to implement those alternatives within the current securitization structures.

[12] The deadline for delivering this testimony to the Committee precluded a discussion in this document of the details and results of the April 16 forum.

Conclusion

Mortgage securitization represents an essential capital market process that has helped to expand the availability of credit to U.S. homebuyers and improve the ability of lenders to manage risks. While this market-driven process has evolved in remarkable ways over the years, there continue to be challenges in terms of how this process operates in a time of credit distress. Significant changes in the subprime mortgage market in recent years have substantially altered the relationship between borrowers and lenders. In some cases, this makes it more difficult to resolve troubled loans in a way that preserves the availability of credit and benefits deserving borrowers, namely, by keeping them in their homes. These issues are complex and should be approached cautiously and deliberately to avoid unintended consequences that could negatively impact credit availability. The securitization forum is a first step to bring relevant parties together to seek workable solutions. The FDIC stands ready to work with Congress and all parties to explore solutions to assist troubled borrowers.

This concludes my testimony. I would be happy to answer any questions from the Committee.



Testimony of the

National Community Reinvestment Coalition

David Berenbaum, Executive Vice President

Before the House Financial Services Committee

Possible Responses to Rising Mortgage Foreclosures

Tuesday, April 17, 2007

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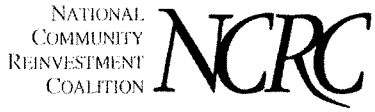


Introduction and Executive Summary

Good morning Chairman Frank and Ranking Member Bachus. My name is David Berenbaum and I serve as the Executive Vice President of the National Community Reinvestment Coalition. It is an honor to be here this morning representing Mr. John Taylor, President and CEO of the National Community Reinvestment Coalition, our Board of Directors and as the representative for the over 600 community organizations from across the country that comprise our community based members. We appreciate you convening today's hearing on an issue that all of our members have been both sounding the alarm on and working towards pragmatic solutions for several years.

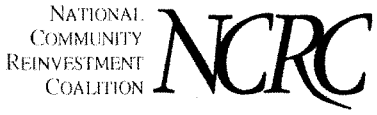
NCRC is the nation's economic justice trade association dedicated to increasing access to credit and capital for minority and working class families. Over 500 of our members and their affiliates are active in NCRC's foreclosure prevention program. NCRC's members and the "safety net" they represent are quite diverse, yet we all share the common belief that fair lending and community investment – realized through direct service, community development and related social justice activities - promote vibrant communities. Relative to the specific issue of responsible lending and sustaining homeownership, our organizational members 1) support sensible underwriting and work to ensure sustainable loans and celebrate homeownership; 2) challenge the steering of borrowers to abusive loans; 3) work towards accurate and accountable loan servicing; 4) ensure effective rights and remedies for families caught in predatory loans though counseling, advocacy and legal service; 5) preserve essential federal and state consumer safeguards; and 6), reduce foreclosures through assistance to distressed borrowers via participation in NCRC's nationally applauded Consumer Rescue Fund Homeownership Preservation Initiative.

We are on the precipice of a mortgage tsunami of foreclosures unless immediate intervention occurs. The industry has flooded the market with exotic mortgage lending such payment-only Adjustable Rate Mortgages (ARMs), and "hybrid" 2/28 and 3/27 ARMs. Borrowers we counsel every day are overwhelmed when interest rates shoot up after an introductory time period. According to the FDIC's testimony at a previous Senate hearing, interest rates are due to rise for borrowers of one million subprime loans in 2007 and another 800,000 next year.[1] As a result of the abusive lending, the nation is experiencing record foreclosure rates and more than 14% in outstanding subprime loans were delinquent by the end of 2006.[2]

Market failure is rampant and all stakeholders, industry and government alike, are collectively responsible for this failure. The lending industry has created a system in which no one is accountable when the tsunami hits borrowers. Brokers and lenders quickly sell loans into the secondary market. The secondary market has precisely

[1] "Regulators are Pressed to Take Tougher Stand on Mortgages," by Gregg Hitt and James R. Hagerty, Wall Street Journal, March 23, 2007

[2] "Subprime Defaults at Recession Level, FBR Says," Bloomberg News reproduced in the American Banker, February 5, 2007; "Regulators are Pressed to Take Tougher Stand on Mortgages," by Gregg Hitt and James R. Hagerty, Wall Street Journal, March 23, 2007.



diversified risk to the point where no one investor loses significant amounts, even when foreclosures spike. Too many servicers, appraisers, and foreclosure legal specialists have also figured out how to profit from abuses in the dangerous game of mortgage monopoly. The federal government holds ultimate responsibility for allowing the mortgage market to spin out of control.

An immediate fix for the broken marketplace is to stop foreclosures before they further devastate communities and the economy. An important tool is foreclosure prevention efforts and rescue funds.

The focus of NCRC's testimony today will be the success and challenges experienced with our nationally acclaimed Consumer Rescue Fund (CRF). Our intent will be to share how rescue funds operate and how they can play a role in stemming a foreclosure crisis.

NCRC was the first national organization to create a national remedial loan program, and the proof of our success is the excellent dialogue and track record that we have in amicably resolving matters among lenders, servicers, and our community based membership and consumers. In fact, two thirds of the loans that we receive are resolved through direct negotiation with the existing note holder or servicer. This requires extensive file review and interaction with local housing counseling and credit organizations, whom NCRC funds to provide these services.

These direct services are further complimented by our CRF training programs coordinated with the Freddie Mac Don't Borrow Trouble Initiative, our own NCRC Training Academy and numerous other counseling organizations on a national, state, and local level. Further, close to 50% of consumers contact NCRC directly through our website – www.fairlending.com or due to press surrounding the issue. NCRC also works closely with Neighborworks and the National Federation of Consumer Credit Counseling Agencies.

Since its inception, NCRC's rescue fund has assisted over 5,000 consumers, including over 1,600 victims of predatory lending and/or servicing. We have reduced loan payments by an average of $276 per month, reduced interest rates from an average 9.6% to 5.7%, and we have saved consumers over $100 million in equity or fees. We have successfully intervened and have stayed or prevented over 1,000 foreclosures. This year, NCRC will bolster the CRF program by establishing a Community Development Financial Institution (CDFI) that will offer rescue refinance loans.

Recently, we have become focused on the issues of law firms that act as foreclosure mills, profiting from consumer hardship and rushing consumers to homelessness, even as we try to negotiate forbearance agreements for consumers who can afford to stay in their homes. This greed in the legal system as attorneys represent investors or servicers is one of the reasons that we support stronger servicing protections and a foreclosure "stay" that will be discussed further in my testimony.

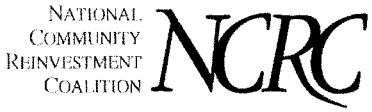
NCRC has found that the CRF consumers are disproportionately minority and working class Americans who have suffered from multiple abuses committed at all stages of the lending process. Many of these consumers are facing hardship or foreclosure through no fault of their own – simply because they were steered to an inappropriate loan product based on the advice of mortgage professionals. When interest rates increased in 2006, the demographics of consumers began to change as more consumers who were predominantly middle income became concerned about "payment shock" issues. This mortgage tsunami will only gain strength as interest rates rise. We must use this calm in the storm to offer remedial loans now.

Our testimony will include a number of case studies, such as a hard-working African American couple, the Wests, who took out a refinance loan to consolidate debt and ended up with unaffordable mortgage payments due to abusive underwriting that inflated their incomes and put them in a 2/28 ARM loan and a piggyback loan at a 13% interest rate. The CRF program has encountered 27 abusive practices and loan terms described in the testimony. Considering that several abuses appear in each and every CRF case, the clear conclusion is that bad loans are responsible for the looming mortgage market crisis, not irresponsible consumers. Regulatory oversight, or the lack thereof, clearly plays a role in the volume of bad loans originated. It is an unfortunate truth that the media has served as a more effective "watchdog" on this issue then the regulators.

The CRF program has been valuable in informing policy and best practices. A few years ago, NCRC's documentation of abuses on ARM loans in the CRF program convinced the Office of Thrift Supervision (OTS) to disallow state-chartered thrifts and mortgage companies from ignoring state limits on prepayment penalties as applied to adjustable rate mortgages. More recently, appraisal fraud documented by the CRF program propelled NCRC and industry leaders to create a Center for Responsible Appraisals and Valuations.[3] Lenders, appraisers, and other industry partners agree to an ethical code and also agree to submit disputes regarding fraudulent appraisals for arbitration. The alternative dispute resolution of the Center promises to expeditiously settle cases of appraisal fraud and to promote industry-wide changes in practices, for example by establishing best practices and avoiding thousands of foreclosures in the area of sub-prime fee based servicing.

NCRC CRF specialists have become extremely adept at negotiating the traps and tricks of abusive servicers and foreclosure attorneys. CRF staff report, however, that increased Congressional attention would be very valuable in putting the industry on notice and increasing their willingness to work out problematic loans. In addition, a national source of financing for rescue funds would assist the CRF program and other community-based rescue programs to significantly increase the numbers of consumers rescued.

[3] See http://www.responsibleappraisal.org/.



NCRC is extremely proud of the work of the CRF in saving the homes of hard-working Americans. At the same time, however, the dimensions of market failure are too pervasive to rely upon loan rescues as only way out of this looming mortgage crisis, although a national rescue fund is imperative. NCRC therefore urges Congress and the regulators to take a series of additional steps: 1) Congress must pass a strong national anti-predatory law, 2) the regulatory agencies must quickly implement their proposed guidance on subprime lending, 3) Congress must enact a stay on foreclosures, and 4) Congress and the Administration must re-tool the FHA program so that it can also serve to rescue thousands of families from foreclosure.

Contrary to the claims of some, the market will not work its way back to "equilibrium." Others have suggested that foreclosures and the "contagion" in the subprime market will not spread to the broader mortgage marketplace. These assertions, however, ignore the fact that millions of borrowers in both the prime and subprime market have been afflicted with exploding ARM loans and that entire suburban and urban neighborhoods have also been devastated by high foreclosures and inflated appraisals. The contagion will spread much quicker and impact the economy faster than laissez faire proponents realize. In order to stop the contagion, strong and comprehensive legal, regulatory, and programmatic changes must occur swiftly.

NCRC calls on stakeholders to do the following:

Enact a Strong Anti-Predatory Law – Abuse is widespread in all stages in the loan process from the broker, loan officer, appraiser to the servicer and secondary market actors. Certain terms and conditions are inherently abusive such as mandatory arbitration, onerous prepayment penalties, and single premium credit insurance. In order to stop the wave of foreclosures, a strong national law is needed to halt the abuses in the origination and servicing of loans. Financial penalties must be swift and certain in order to prevent the evasion of accountability by the various segments of the lending industry. NCRC calls on Congress to enact a strong anti-predatory law building upon the best state laws.

Implement the Proposed Regulatory Guidance – The proposed subprime guidance issued by the federal regulators is necessary but not sufficient as a means to stem the exotic and toxic mortgage lending plaguing American neighborhoods. Lenders must underwrite ARM subprime loans at their fully indexed rate, not the initial lower rate, so that borrowers can afford them. But the proposed guidance only covers a portion of subprime lending conducted by banks. While the Conference of State Bank Supervisors has pledged to persuade states to also apply the guidance to mortgage companies, not all states may do so. In addition, the subprime guidance does not apply to the actions of abusive appraisers, servicers, and secondary market investors. Thus, a national anti-predatory lending law is needed.

Industry Loan Modifications & Servicing Best Practices – NCRC applauds Freddie Mac for adopting the practices outlined in the proposed regulatory guidance on subprime

lending. We call upon Fannie Mae and lending institutions to do the same. We also urge the industry to embark upon an aggressive program of secondary review and loan modifications to deal with the millions of ARM prime and non-prime mortgages expected to reset in the upcoming years.

Stay on Foreclosures - In order to assist CRF and other foreclosure prevention efforts, NCRC believes that Congress needs to establish uniform and reasonable time periods for the foreclosure process. Standardization of time periods would be particularly helpful in states with non-judicial foreclosure procedures that often leave borrowers defenseless in their efforts to save their homes from rapid foreclosures. Consumers should receive written notice with a list of HUD certified counseling agencies and legal aid offices in their area before the foreclosure starts and then should receive a stay on the foreclosure proceeding. A stay gives the borrowers who currently have the least ability to find their way to someone to help them work things out with a small window of time. This recommendation does not require any funding and will not impede the market or how it operates.

A stay on foreclosures could be instrumental in helping industry and consumer representatives deal with the millions of loans resetting and then becoming delinquent. A stay provides sufficient time to modify or refinance loans instead of allowing problematic loans to hurtle towards foreclosure.

Some say that remedial loan programs represent a "bail-out." NCRC strongly and affirmatively disagrees with this over simplification of a very complex issue. Lenders, servicers and securizers first and foremost most work with homeowners to restructure or refinance existing loans. Those who have profited at the expense of consumers should not net the proceeds of a problematic loan, for example a home that has been fraudulently over appraised. It is an appropriate government role to facilitate and ensure an effective and efficient mortgage marketplace. Both the public and private sector should be motivated to collaborate to ensure this.

FHA Rescue Loans - FHA should also be re-tooled so that it can offer refinance loans on a large scale to victims of predatory lending. If FHA could offer these loans on a large scale, it could play a vital role in saving American's homes, reducing high delinquency and foreclosure rates, and saving communities from the devastation of widespread foreclosures and property abandonment. FHA should waive its requirement that a borrower be current in their loan payments so that borrowers victimized by deceptive ARM loans will be able to refinance into FHA products. FHA as a rescue tool would not be a bailout to lenders since they would incur significant loses. Members of Congress are seriously considering this proposal and a number of industry representatives are also favorably inclined to it.

A National Rescue Fund - NCRC believes that a national rescue program administered by not for profit organizations modeled on our experience with the NCRC Consumer Rescue Fund Homeownership Preservation Program must be instituted to save families

and communities from the devastation of large scale foreclosures. NCRC agrees with Senator Schumer that a national rescue fund is likely to require hundreds of millions of dollars annually.[4] In fact, a national rescue fund may very well need a few billion dollars each year based on the numbers of estimated foreclosures due to predatory lending.

While Senator Schumer suggested public financing of the rescue fund, NCRC believes that the industry ought to bear the costs for cleaning up their mess. One possible model could be the FDIC deposit insurance fund. Each lender in America is charged an annual fee for a rescue fund. The fee is based on the riskiness of the institution's loan portfolio and the number of foreclosed loans in its portfolio. Lenders would therefore have an incentive to eliminate predatory practices since their contributions to a foreclosure fund would decline as the safety and soundness of their loans improves. Another approach would be to apportion a nominal fee at settlement from the parties to the transaction, including the lender, mortgage broker, title company, and consumer as appropriate, to capitalize a fund.

Finally, NCRC agrees strongly with the recommendations of Senators Schumer, Menendez and Brown that nonprofit organizations receive financing from the rescue fund for assisting borrowers (via refinances and loan modifications) and saving their homes.[5] Nonprofit organizations are regarded as trusted advisors and counselors by communities. Community residents are more likely to ask a nonprofit organization for assistance than other entities, including lending institutions and government agencies.

CRA Modernization

At the same time that Congress is enacting an anti-predatory bill, NCRC also believes that Congress must pass the CRA Modernization Act of 2007, or HR 1289. HR 1289 would strengthen CRA as applied to banks and would apply CRA to non-bank institutions including independent mortgage companies. Federal Reserve research has demonstrated that CRA encourages banks to increase their prime lending, particularly in geographical areas in which their branches are located. CRA, therefore, acts to introduce product choice in traditionally underserved neighborhoods, meaning that these neighborhoods are less susceptible to steering and abusive lending.[6]

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[4] Alison Vekshin, Senators Urge Hundreds of Millions in Subprime Aid via Bloomberg.com, last accessed April 11, 2007.

[5] Bloomberg.com article, op cit and Joint Economic Committee, *Sheltering Neighborhoods from the Subprime Foreclosure Storm,* April 11, 2007.

[6] Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, *Higher-Priced Home Lending and the 2005 HMDA Data* in the Federal Reserve Bulletin, September 2006.

NCRC's Consumer Rescue Fund

Mechanics of the CRF Fund

Through the national anti-predatory lending Consumer Rescue fund (CRF), NCRC works with victims of predatory lending so their mortgage payment becomes more affordable and foreclosure can be avoided. NCRC's member groups and their communities are an integral part of this program. The CRF identifies consumers who are in predatory mortgages and fixes the mortgages through mediation with lenders or arranging for refinance loans.[7] Consumers contact NCRC member organizations participating in the CRF program. In a number of instances, the NCRC members in the CRF program are counseling agencies assisting consumers experiencing delinquency and default on their loans.

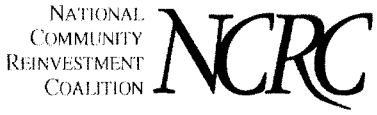
The consumers are families occupying their residences. CRF does not assist investors or consumers experiencing difficulties paying off mortgages on their vacation homes. Qualifying consumers are assisted free of charge. To date, over 5,000 consumers have been helped through the CRF's alternative dispute resolution, mediation, consumer counseling and financial education.

NCRC and over 30 participating member organizations in Arizona, Ohio and New York launched the CRF initiative in October 2001 to help victims of predatory loans and/or individuals at risk of foreclosure. Today, the CRF has a nationwide reach, serving consumers in 17 states. NCRC member organizations (counseling agencies, Community Development Corporations, fair housing organizations, and others) identify families facing foreclosure and/or bankruptcy as a result of problematic loans.

Each of these agencies, every day, hear the cries for help; witness the misery of people, so near their aspirations, topple back into poverty, trying to cling to their homes. We see the threatened neighborhoods, pocked with empty and boarded-up houses; we can attest to the hardship and sadness that either hardship or a problematic loan has wrought.

Therefore, in the face of the growing mortgage crisis created by market concerns about the performance of non-prime non-traditional mortgage products, the role of the CRF or equivalent programs as a mechanism to sustain homeownership, prevent foreclosure, and give consumers a fresh start could never be more critical. To that end, NCRC has created a "safety net" made up of community based organizations in urban, suburban and rural communities across the nation. These include a diverse group of HUD certified counseling agencies, CDFI's and CDE's, fair housing organizations, CRA coalitions, CDC's and counseling agencies ranging from legal service providers to our network of

[7] HSBC North America provides refinance loans for the CRF program and supports CRF counseling. Other sponsors of the CRF program include Select Portfolio Servicing, Inc, the Ford Foundation, Freddie Mac, The Fannie Mae Foundation, Fannie Mae, The JP Morgan Chase Foundation, and The Heron Foundation.



member organizations in key markets, including the AARP, the NAACP, and Freddie Mac Don't Borrow Trouble initiative, in addition to the aforementioned groups.

Fair lending specialists at NCRC review loan documents including the Good Faith Estimate, income verification statements, and other forms in order to determine if the loans are in fact predatory. If NCRC staff conclude that the loans are predatory or problematic, NCRC staff pursue a number of options.

CRF intervenes in the following manners to turnaround a predatory lending situation:

- *Mediation and Loan Modification* – NCRC will engage in mediation with the lender or servicer to have abusive terms eliminated and to delay or stop foreclosure proceedings. Mediation is an effective means of assisting consumers since it is less time consuming and resource intensive than refinancing a problematic loan. Also, in a number of cases, a lender will seek to remedy an abusive loan and thus save the costs associated with foreclosure and other legal action. Lenders themselves have often been victimized by unscrupulous brokers or aberrant loan officers who have made abusive loans.

- *An affordable refinance loan.* NCRC has partnered with HSBC North America, which refinances the loans of predatory lending victims. The predatory loans are replaced with market-rate or below market-rate loans. The new loans also do not contain prepayment penalties, balloon payments, or credit insurance.

- *Litigation and/or Regulatory Complaints:* If NCRC discovers a pattern and practice of abusive lending or servicing on the part of a financial institution, NCRC will pursue legal redress when necessary. NCRC has filed complaints with the Department of Housing and Urban Development (HUD) arising from systematic abuses uncovered by the CRF program. The complaint process often ends before a formal trial when a lender makes a commitment to change an underwriting or marketing practice.

It is important to note that though the CRF frequently renegotiates loans with the existing note holder or servicer, we also counsel the consumer regarding their rights and options, including potential regulatory enforcement of civil complaints. We also caution borrowers regarding waiver forms that lenders often require. These release forms are a significant impediment in many cases to consumers avoiding foreclosure. Requiring consumers to waive their rights or keep their home is an unacceptable "catch twenty two."

The decision about how to assist borrowers with loan modifications or refinances occurs after an initial analysis of a borrower's situation. During the intake process, CRF staff evaluate a borrower's income and ability to repay. For example, a borrower with limited and fixed incomes and with 2/28 ARM loans and/or some other exotic mortgage will

generally need a rescue refinance loan. In contrast, loan modifications are possible for consumers with steady incomes in the prime of their working lives.

The decision to arrange for a loan modification or refinance also depends on the loan's characteristics. An abusive term such as a prepayment penalty that matches or exceeds the reset time period can often be dealt with through a refinance. In contrast, a loan modification can effectively make a loan more affordable by reducing the rate or loan margin.

As well as re-negotiating loan terms and conditions, CRF staff negotiates over loan amounts in some cases. NCRC will negotiate with lenders to help customers whose appraisals have been inflated or whose mortgage debt are greater than their homes' worth because of predatory loans. NCRC will also attempt to have part of the loan forgiven.

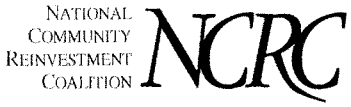
CRF staff report that the industry has become more amenable to loan modifications. As more ARM loans have introductory rates re-setting to higher rates, lenders have realized that they do not want to lose customers' business. Recently, CRF staff have executed many more loan modifications than refinances.

As Wall Street plays a larger and larger role in securitizing portfolios, it is our experience to date with loan servicers that loans generally fall into three categories. The first category is cases when the servicer cannot modify the loan in any way without securitzer approval. The second case occurs when the servicer can modify within set parameters that are part of the securitization or special purpose vehicle. The third case is when the servicer has great latitude. Because most loans today are securitized, it demands that both consumer advocates and lenders actively review and discuss files to ensure that we continue to sustain each family in their home.

As these practices become institutionalized by servicers and securitizers alike, we will be able to act proactively to address the foreclosure problem. For example, many lenders and servicers that the NCRC CRF has discuused these issues with are proactively reaching out to mortgage holders who have HELOC's, ARM's, and other non-traditional mortgages to assess if the consumer is interested or better served by a loan modification or refinance to sustain homeownership. This is a positive development. For those loans that require securitizer approval for the modification, it certainly makes sense to modify a loan rather then to foreclose upon it. Any policy activity in this area will also have to examine the tax implications for securitizer and homeowner alike.

The CRF program operates on a first come, first serve basis expect in the case of impending foreclosure. CRF staff prioritize the cases of borrowers receiving foreclosure notices and are usually successful in negotiating a stay of 60 days. This time period has been effective in resolving the foreclosure situation and rescuing the borrower.

Another critical component of the CRF program is financial education and credit counseling that occurs over a period of several months. NCRC staff and member



organizations counsel CRF borrowers through the remediation process and coach them on how to avoid predatory lending situations in the future. The counseling occurs before the loan modification or refinance and continues after an intervention to make sure borrowers can succeed in their new loan.

NCRC also has an early default and delinquency process. Once every two weeks, HSBC North America provides NCRC with a list of CRF borrowers that have just fallen behind on their payments. A CRF fair lending specialist will then work with these borrowers in early delinquency. The early intervention has been effective. CRF staff have negotiated temporary work-outs and forbearance of payments for a few months. Another arrangement has been adding delinquent payments to the outstanding mortgage amount. For the continued success and expansion of programs like CRF, early delinquency intervention and post loan counseling is necessary.

The CRF program will mediate loans made in any state. Refinancing services are currently available in the following 17 states: Alabama, Arizona, California, Florida, Georgia, Illinois, Indiana, Maryland, Massachusetts, Nevada, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, Texas, and Wisconsin. This year, with support from a growing list of sponsors and new product offerings, the program will be available nationwide.

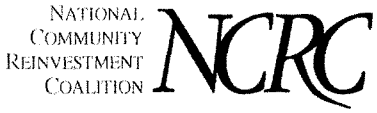
CRF's Success: At Least $100 million in Equity Saved

The refinance loans of the CRF program have saved borrowers and their communities millions of dollars. In a sample of 112 cases, the median principal amount of the loans was approximately $157,000. The mortgage rates of the previous predatory loans ranged between 5.5% and 17%. The median prior mortgage rate was 9.38%.

Analysis of loan terms before and after refinance

	Principal Amount	Prior Mortgage Rate	New Mortgage Rate	% points difference	Old Monthly Payment	New Monthly Payment	$ Savings
Average	$156,986.2	9.58%	5.74%	3.84%	$1,198.4	$922.0	$276.5
Median	$161,280.4	9.38%	6.00%	3.38%	$1,165.8	$941.7	$224.1

The interest rates of the refinance loans were considerably lower than the rates of the previous predatory loans. The new loans had interest rates ranging between 1% and 8%. The median rate of the new refinance loans rate was 6.00%. The difference between the median rate of the previous loans (9.38%) and the new loan (6%) was 3.38 percentage points, which results in substantial amount of equity saved over the life of a loan.



CRF customers have been able to save millions of dollars of wealth by refinancing out of abusive loans. The average monthly payment was $1,198 for the abusive loans. For the new refinance loans, the average monthly payment was only $922. As a result of the refinancing, the average monthly savings was $276.50, which equates to $3,318 annually. Assuming a 30 year loan term, the total savings on an average loan would be $100,000. Given that the CRF program has assisted at least 1,000 victims through either refinancing or loan modifications, the program has saved borrowers approximately $100 million in equity.

Influencing Best Practices and Public Policy

While offering invaluable help to several thousand consumers and families, the CRF program has also achieved a national impact by influencing industry-wide practices, reforms, and federal policy. NCRC and our lending institution partners have gained much knowledge about predatory lending that has provided insights into needed reforms. Through dialogues between community groups and lending institutions, the CRF program has contributed to a consensus regarding which products and practices should be discontinued and others that should be limited.

One important area of influence has been the servicing of high-cost subprime loans. CRF consumers have encountered a number of abuses in the servicing of their loans including force-placed insurance and the on-time payments not being recorded by servicers. After encountering widespread abuses of this nature, NCRC challenged fee-based servicers to reform their practices. These discussions with servicers also influenced the federal guidelines on servicing that were developed by the Federal Trade Commission a few years ago.

In 2002, the Office of Thrift Supervision (OTS) proposed changing its regulation implementing the Alternative Mortgage Transaction Parity Act (AMTPA) to prohibit state-chartered thrifts and mortgage companies from ignoring state law regarding prepayment penalties and late fees as applied to adjustable rate mortgages and other types of so-called "alternative" mortgages. Using a sample of CRF loans, NCRC was able to document onerous prepayment penalties and abusive fees levied by these lenders. When the OTS issued its final rule prohibiting state-chartered institutions from evading state law on prepayment penalties and late fees, the OTS cited NCRC's evidence of abuses culled from the CRF program.[8]

More recently, the CRF program, as documented below, has uncovered a pattern of appraisal fraud. The CRF cases and other research of widespread abuses lead NCRC and industry partners to establish a Center for Responsible Appraisals and Valuations.[9] Lenders, appraisers, and other industry partners agree to an ethical code and also agree to

[8] Federal Register, September 26, 2002 (Volume 67, Number 187), pages 60542-60555, see footnote 28 which specifically references data collected from the CRF program.
[9] See http://www.responsibleappraisal.org/.

submit disputes regarding fraudulent appraisals for arbitration. The alternative dispute resolution of the Center promises to expeditiously settle cases of appraisal fraud and to promote industry-wide changes in practices when a critical mass of industry stakeholders participate in the Center.

In addition, the CRF program continues to document the role of abusive brokers. CRF staff indicate that the majority of predatory loans in the CRF program are loans involving brokers. The fee packing and targeting of minority customers in the CRF program suggested that brokers were involved in questionable loan practices. Under a Department of Housing and Urban Development (HUD) grant, NCRC's fair housing staff conducted paired testing in order to determine if the CRF cases indicated patterns and practices of abusive behavior. The testing revealed pervasive discriminatory and predatory practices by mortgage brokers in six metropolitan areas across the country. Between February 2005 and June 2006, NCRC conducted over 100 tests in Atlanta, Georgia; Baltimore, Maryland; Chicago, Illinois; Los Angeles California; St. Louis, Missouri and the Washington, D.C. metro areas. The tests found that brokers quoted different interest rates and fees on the basis of race and steered African-American consumers to more expensive subprime products. The testing project lead to the filing of a civil rights complaint with HUD against Allied Home Mortgage Capital Corporation, the nation's largest privately held mortgage broker/banker.

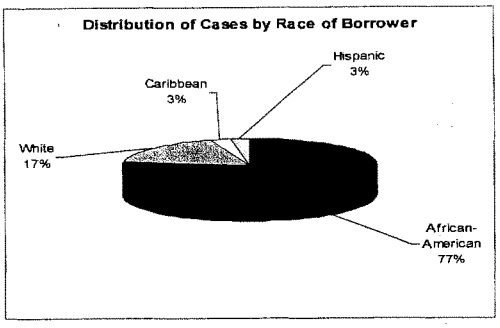
CRF Finds that Minority and Working Class Americans Targeted with Loans Containing Multiple Abuses

A NCRC review of CRF cases indicate that abusive lenders are targeting minority and low- and moderate-income borrowers and communities with high cost and exotic mortgages.[10] The graph and chart below reveal that a disproportionate number of CRF customers are people of color and have modest incomes. About 77% of the borrowers in the CRF sample were African-American. Almost half (47%) resided in low- and moderate-income neighborhoods and 83.6% of the borrowers had incomes below $45,000. The findings that CRF customers were mostly minority and low- and moderate-income is consistent with NCRC's research and other studies documenting that a disproportionate amount of high cost lending is directed towards minority and working class communities. Traditionally underserved communities suffer from less product choice and consequently are more susceptible to abusive high cost and exotic mortgage lending.

CRF Cases by Race of Borrower

[10] For more detail about the CRF fund, see the report by NCRC and the Woodstock Institute, *Asset Preservation: Trends and Interventions in Asset Stripping Services and Products*, September 2006, at http://www.ncrc.org/policy/analysis/policy/2006/2006-09_LifetimeOfAssets_NCRC-WoodstockPaper.pdf

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC



Distribution of Cases by Income of Borrower

Income of Borrower	Number	Percent
less than $15,000	6	9.84%
$15,001-25,000	14	22.95%
$25,001-35,000	16	26.23%
$35,001-45,000	15	24.59%
$45,001-55,000	5	8.20%
$55,001-65,000	2	3.28%
$65,001-75,000	1	1.64%
$75,001-85,000	2	3.28%
Total	61	100.00%

Multiple Abuses in Exotic and High-Cost Loans in CRF Sample

Minority and working class borrowers confront an array of predatory abuses described in the graph below. The CRF cases also reveal that predatory loans do not usually contain just one or two abusive terms and conditions. More often, a toxic loan in the CRF program contains several abusive features including ARM loans with lax underwriting considering only the initial rates, exaggerated borrower incomes, payments that borrowers cannot afford, exorbitant fees and yield spread premiums, piggyback lending adding excessive debt, and abusive servicing.

While some abuses have declined in recent years such as prepaid credit insurance, most loans in the CRF program have multiple abuses confronting borrowers with loans that they can no longer afford and loan terms they can no longer negotiate. If the loans had

just one or two abuses, it would be easier for the borrower to either afford the loan or succeed in modifying the loan with the lender. The multiple nature of the abuses, however, suggest that the predatory lender or broker maximized profit by designing a loan that was destined to fail or to be flipped.

The abuses revealed by the CRF program include the following:

Abuses	**Description**
asset-based lending	Lenders evaluate a loan application by looking only at the quality of the security or equity, and not at the ability of the borrower to repay the loan
forced placed insurance	Servicer assigns hazard insurance to borrower, coverage is usually much more expensive
HOEPA loan	A loan with a very high interest rate and/or fees that is covered by federal consumer protections. Predators violate the legal protections of HOEPA loans.
Mandatory arbitration	Stipulation that a borrower cannot sue a lender in a court of law, but must use an arbiter
prepaid credit insurance	Insurance financed into the loan that would cover mortgage payments in a case of disability, unemployment, death. Much more expensive than paying monthly outside of loan
abuse of right to cancel	Abusive practices that make it hard for a consumer to cancel a mortgage (ie. abusing right of rescission)
abusive collection practices	Aggressive tactics of collecting late payments
default interest rate	Increasing interest rate in case of delinquency
excessive prepayment penalty	Excessive fee for paying off a mortgage before its maturity
insincere co-signers	Adding insincere co-signers to the application in order to inflate the income of the borrowers. Abusive lenders will add children and other insincere co-signers who cannot contribute to loan payments.
loans made in excess of 100% LTV	When the loan amount exceeds the fair market value of the home
negative amortization	Loan product that requires a monthly payment that does not fully amortize a mortgage loan, thereby increasing the loan's principal balance
flipping	Persuading a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced
fraud	Example: Forging signatures on loan documents
lack of TNB	Lack of tangible net benefits that justify the origination of a new, higher-balance and high-cost loan
targeting/discrimination	Cases when lenders specifically market predatory loans to customers based on race, ethnicity, or age
predatory appraisal	Overestimating the market value of the house

balloon payment	A mortgage that has level monthly payments over a stated term but which provides for a large lump-sum payment to be due at the end of an previously specified term
equity stripping	A case when a homeowner's equity is reduced due to repeatedly refinancing, high fees, and other abuses
home improvement scam	Home improvement costs financed into the mortgage usually paid by a lender to a home improvement contractor directly.
misrepresentation	Misrepresentation of loan terms to a borrower
falsified application	Falsifying loan applications (particularly income level or adding insincere co-signers, etc.)
Stated income	Not requiring full documentation of income from tax forms and paystubs. Reduced documentation or stated income loans increase the chances of fraud.
yield spread premium	Fee paid by lenders to brokers for loans carrying interest rates above a par rate
abusive servicing practices	Servicers not recording payments, force placing insurance, applying high late fees, etc.
unfair terms	High interest rates and loan terms not justifiable by risk (consumer's credit score)
fee packing	Charging undisclosed, improper, and high fees

The sum total of the abuses equals loans that are considerably beyond borrower repayment ability. A sample of 69 CRF cases included calculations of the monthly housing payment-to-income ratio (front-end ratio) and the monthly total debt-to-income ratio (back-end ratio). The front-end and back-end ratios of the predatory loans in the CRF sample were considerably higher than common limits in standard underwriting guidelines. The median front-end ratio was 35.4%. The median back-end ratio was about 50% as shown in the graph below. Standard front-end and back-end ratios for prime loans are 28% and 36%, respectively. The considerably higher ratios of the predatory loans in the CRF sample suggest that the loans were beyond the consumers' abilities to repay, leading to financial distress and/or bankruptcy and foreclosure.

CRF Cases **Unaffordable Loans**

Debt-to-income Ratios

	Front-end Ratio	Back-end Ratio
Average	40.77%	50.28%
Median	35.43%	49.78%

Compounding the high front- and back-end ratios was the fact that most of the loans in the CRF sample did not have escrows covering property tax payments and hazard insurance. Two thirds of the borrowers in the CRF sample did not have escrow accounts.

On top of housing payments and debt levels that were unsustainable, a number of the CRF borrowers experienced payment shock when they discovered that they had thousands of additional dollars in taxes and hazard insurance payments that were not covered by the loans.

The case studies in the appendix illustrate the multiple abuses on the CRF loans, and how predatory lenders and brokers take advantage of hard-working Americans who are striving mightily to achieve or preserve their American Dream of homeownership. The case studies reveal that aggressive "push-marketing" by predators result in consumers receiving loans that are unaffordable and unsuitable, when tragically an appropriate product would have worked fine.

Removal of Barriers and Expansion of CRF Program

Expansion of the CRF program is clearly desirable and is a goal pursued vigorously by NCRC. Yet, expanding the CRF program is not a simple matter. Expanding a foreclosure prevention program involves the removal of barriers in assisting borrowers and additional sources of financing.

A significant barrier is the difficulties negotiating with abusive servicers and lenders that are rushing to foreclose upon victims of predatory lenders. "Foreclosure mills" are law firms specializing in the quick foreclosure of victimized families. NCRC's experience is that foreclosures can be rapid in states with non-judicial foreclosure procedures. Since a large number of attorneys in foreclosures proceedings are motivated by fees associated with foreclosure, they are not usually interested in dispute resolution. Consequently, when CRF staff contact these attorneys, CRF staff usually do not engage in discussions with attorneys handling the foreclosures but instead ask the attorneys for the names of the lenders involved.

Servicers are also slow to respond to pressing requests to solve disputes. They take their time in providing payment histories. The documents of payment histories are often obscure on purpose so that borrowers and their representatives cannot interpret the payment histories.

Another obstacle confronted by the CRF program is concentration of risk faced by participating lenders. Lending institutions are assuming significant risk in a CRF program since loans often involve moderate to deep subsidies to borrowers with damaged credit. In order to mitigate risk in the program, the CRF program has incorporated early delinquency intervention for CRF borrowers as mentioned above.

A method for mitigating risk is to encourage the participation of more than one lending institution in the program. At this point, HSBC North America is refinancing the entire mortgage. The CRF program originally arranged refinance loans with loan-to-value ratios as high as 100%. Now, the program uses 85% loan-to-value ratios as the underwriting guideline, with some exceptions made on a case by case basis. In order to

be most effective in reaching consumers in need, it would be desirable to secure the participation of more than one lending institution in the program. Other lenders could take on second mortgages and/or provide grants so that the loans and grants could once again provide for 100% loan-to-value ratios. The involvement of two or more lenders would therefore mitigate risk and serve a greater pool of borrowers.

NCRC's CRF program will continue to evolve in ways that can most efficiently serve the overwhelming needs for intervention. The CRF program, for example, will expand upon home preservation counseling, that is, counseling that is offered to borrowers after they have purchased their homes and/or have started experiencing trouble making payments. This type of counseling can save an enormous amount of time and resources, since borrowers in trouble often do know they can attempt to voluntarily work out a solution with their lender or servicer, whether it is forbearance of payments or modifying loan terms. CRF staff also recommend that more attention should be focused on home preservation counseling in general. Most counseling is still directed at buying a home rather than maintaining homeownership after purchasing a home.

Later this year, NCRC hopes to establish a Community Development Financial Institution (CDFI). The CDFI will engage in home and small business lending, and an important component of the CDFI will be to offer rescue loans and soft seconds, which are often needed by borrowers. It is hoped that the CDFI will be capitalized by several lenders, who are motivated to solve the foreclosure crisis and who will also be receiving points under the Community Reinvestment Act (CRA) for financing the CDFI.

Testimony Appendix

CRF Case Studies

Case Study 1 – Miami, Florida: Steering into Over-Priced and Unsuitable Loan, Fasifying income, Stated-Income and Exotic Mortgage Loan

In January of 2006, Ms. Jean-Simon of Miami, Florida was seeking to become a first-time homeowner. She had a good credit score of 747, and she had a modest income of $3,200 per month. She was a hard-worker, holding a full-time job at the University of Florida and two part-time vendor jobs at local sports stadiums. Incredulously, her mortgage broker pressured her to not use a first-time buyer program through Miami Dade County or other government programs. She was told these programs "take too long" and "require too much paperwork"

The broker falsified Ms. Jean-Simon's income to $5,000 per month. In other words, her income was exaggerated by 56%. The total loan amount was for $170,000 and was financed at 100%. Her first loan was an option ARM (four payment options, with the lowest being "negative amortization"). The maximum rate on the option ARM was 9.95%. To make matters worse, she had a piggyback loan, which was a line of credit with a maximum rate of 11.75%. Because her income was falsified, she could only afford the minimum payment. Therefore, she was increasing her principal balance through negative amortization.

Case Study 2 – Trevose, Pennsylvania: High Broker Fees, Steering, 2/28 ARM, Abusive Servicing

Sixty-nine year old Gladys Christian refinanced her home twice in her 31 years of homeownership. She used her cash equity from both transactions to pay for a car and to make home improvements. The second refinance, however, presented Ms. Christian with more problems than benefits. Ms. Christian's loan settled at the cost of over $10,000 in broker and third party fees, and also generated high monthly payments. Despite Ms. Christian's good credit history, she was qualified for an 8.9% two-year fixed, twenty-eight year adjustable rate mortgage that could climb as high as 15.90%.

Even though Ms. Christian was retired, she used her 33 years of experience in nursing to continue provide nursing services for the elderly. She used this income along with her pension and Social Security payments to keep up with her payments in order to avoid serious delinquencies on her loan. She only called Legal Aid of Southeast Pennsylvania for assistance when she became ill, missed a payment, and struggled to manage this delinquency with her lender's servicer. Rather than work out a forbearance plan, her lender and servicer initiated foreclosure proceedings.

Case Study 3 – Belgium, Wisconsin: Falsified Income, Hybrid ARM, Piggyback Loan, Risk Layering

In September 2006, Duane and April West, a vibrant young African-American couple, contacted NCRC because they could no longer afford their mortgage payments. Although the West's both worked full time jobs (Duane works for Enterprise Rent-a-Car, and April works as a loan closer for a title company), they knew that they were one or two months away from missing their mortgage payments and sinking into foreclosure.

Upon reviewing the West's loan documents, CRF staff noticed the loan had layers of financial risk. First, the West's loan relied on a combined household income that was falsified by 66%. Second, the Wests hoped their refinance loan would pay off their car note, but the loan only increased their indebtedness, left them with an unpaid car note, and not enough funds to pay off any other debt. Third, the two refinance loans were usurious and predatory. The first loan was a two-year fixed, twenty-eight year adjustable rate mortgage combined with a five-year interest only period. The second, piggyback loan was a balloon mortgage with a 13% rate. While severe payment shock was built into these refinance loans, the couple had enough experience to realize that the income falsification was presenting them with unaffordable loans before the reset.

Case Study 4 – Oakland, California: Flipping, high fees, predatory prepayment, stated income loan, ARMs, mortgage payment out of proportion with income.

Ms. Smith is an African-American who bought a home in Oakland, California in December 1999. Her income was $47,328 annually, or $3,944 monthly. She has undergone a series of unnecessary refinances, each of which has added a multitude of duplicative fees and has inflated the amount that she owes.

In December 1999, Ms. Smith purchased her home for $108,000. Approximately nine months later, she underwent her first refinance, which she thought would lower her rate and allow her to cash out a modest amount of money for roof repairs. Instead, this new mortgage for $140,250 stripped equity by paying off a prepayment penalty without her knowledge. Further, the Good Faith Estimate for this transaction also shows that Ms. Smith was to be charged lender and broker fees of 5.76 points (5.76 percent of the loan, or $8,076), an amount much greater than typical prime fees of 1 percent of the loan amount. Also, Fannie Mae and Freddie Mac have pledged not to purchase loans with fees exceeding 5 percent of the loan amount, and 5 percent is often the threshold in anti-predatory lending laws, triggering additional protections.

In August 2001, less than a year after her first refinance, Ms. Smith refinanced a second time. The new loan for $187,500 was adjustable and carried a three-year prepayment penalty. In October of 2003, Ms. Smith refinanced a *third* time, this time a 30-year fixed loan for $240,000. She refinanced for a *fourth* time in July 2004. On this loan, her income was greatly inflated at $6,000 monthly, when it in fact was only $3,944. Consequently, the monthly payment on this fourth and final refinance was $1,887, which was an overwhelming 47.87 percent of her income.

CRF Encounters Entire Devastated Communities Due to Predatory Loans and Appraisals

In the communities of Staten Island and Long Island, New York, the Consumer Rescue Fund is assisting over 100 New York City police officers and fire fighters who purchased homes from an unscrupulous housing developer and mortgage broker. The broker manipulated the origination system by quickly dumping the fraudulent loans onto the secondary market. For these heroic public employees, the American dream of owning a home has now become their nightmare.

Lastly, but importantly, NCRC's CRF program is intervening in a significant number of cases where borrowers have been victimized by appraisal fraud. A sample of CRF loans revealed that about one fifth of the homes were overvalued by more than 50% of their true value, and two thirds of the homes were overvalued by 15-50% more than their true value.[11] Inflating appraisals leave borrowers with unaffordable loans that they are unable to refinance because the loan amounts are higher than the true value of their homes, especially as the housing market cools in the next few years. The results are too often theft of homeowner wealth, equity stripping, and/or foreclosure.

[11] See NCRC's report, *Predatory Appraisals: Stealing the American Dream*, June 2005, http://www.ncrc.org/responsible-appraisal/pdfs/AppraisalReport.pdf

Protecting Latino Wealth: Alternatives to Foreclosure

Presented at:

Possible Responses to Rising Mortgage Foreclosures

Submitted to:

U.S. House Committee on Financial Services

Submitted by:

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April 17, 2007

My name is Janis Bowdler, Senior Policy Analyst on Housing at the National Council of La Raza (NCLR). NCLR is the largest national Hispanic civil rights organization in the U.S., dedicated to improving opportunities for Hispanic Americans. I conduct research, policy analysis, and advocacy on affordable homeownership, and provide technical assistance to NCLR housing counseling grantees. Prior to coming to NCLR, I worked for a large community development corporation (CDC) in Cleveland, Ohio, as a Project Manager developing affordable housing. During my time at NCLR, I have published on a number of housing issues important to the Latino community, including *American Dream to American Reality: Creating a Fair Housing System that Works for Latinos* and *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market*. In addition, I recently provided expert testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs and before the Board of Governors of the Federal Reserve. On behalf of NCLR, I would like to thank Chairman Frank and Ranking Member Bachus for inviting us to this hearing. The alarming rate of foreclosure is clearly one of the most pressing civil rights issues before us today. Latinos will be among the most affected by the coming storm unless we respond thoughtfully.

For more than two decades, NCLR has actively engaged in relevant public policy issues such as preserving and strengthening the Community Reinvestment Act (CRA) and the Home Ownership and Equity Protection Act (HOEPA), supporting strong fair housing and fair lending laws, increasing access to financial services for low-income people, and promoting homeownership in the Latino community. In addition to its policy and research work, NCLR has been helping Latino families become homeowners for nearly ten years as a sponsor of housing counseling agencies. The NCLR Homeownership Network (NHN), a network of 42 community-based counseling providers, works with 20,000 families annually, nearly 3,000 of whom become homeowners. Our subsidiary, the Raza Development Fund (RDF), is the nation's largest Hispanic Community Development Financial Institution (CDFI). Since 1999, RDF has provided $400 million in financing for locally-based development projects throughout the country, building the capacity of local nonprofits and creating opportunities for Latino communities. These relationships have increased NCLR's institutional knowledge of how Latinos interact with the mortgage market.

The rising foreclosure rates are a concern to all. We commend the members of this committee for bringing together a diverse group of stakeholders to discuss potential solutions to the problem. Much like all Americans, Latinos rely on homeownership to build wealth for their long-term financial well-being. With research predicting that one in 12 loans to Latinos will end in foreclosure,[1] the hallmark of the American Dream is threatening to leave millions of families without homes, access to credit, or a financial safety net. However, it is not too late to save the homes of thousands of hardworking Latinos across the country.

To spare thousands of Latino and other vulnerable families the devastating experience of foreclosure, NCLR is proposing three complementary approaches: increasing access to independent Department of Housing and Urban Development (HUD)-certified foreclosure prevention counseling, creating sustainable rescue loan products, and ensuring protection from predatory and fraudulent scams.

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[1] Schloemer, Ellen, Wei Li, Keith Ernst, and Kathleen Keest, *Foreclosures in the Subprime Market and Their Cost to Homeowners*. Washington, DC: Center for Responsible Lending, December 2006.

Background

Many Latino families face significant barriers to sustainable homeownership. Their unique borrower profiles – such as multiple wage earners and thin credit histories – make them unattractive to many lenders who rely heavily on automated underwriting. Many subprime lenders move quickly to fill the gap between market demand and services provided. As a result, many Latinos are finding themselves in expensive and sometimes risky mortgage products, even when they are not high-risk borrowers. Lenders and mortgage brokers have incentives to put borrowers in higher-cost loans, while borrowers have little information about what goes on behind the scenes. In this situation the borrower holds all the risk.

NCLR has responded to these challenges by investing significantly in independent homeownership counseling. NHN has been working in low- and moderate-income Latino communities for ten years. Traditionally, NHN organizations have focused their efforts on helping families build wealth through homeownership. Two years ago, we recognized the growing demand for services that help families protect and maintain their home equity. NCLR launched a pilot program within NHN to add post-purchase service lines. The pilot began with eight organizations in the first year and nearly doubled to 15 in the second year. We plan to expand the program further next year. These services have been a lifeline for many families whose homes are in jeopardy.

In addition to our programmatic services, NCLR joined other members of the Leadership Conference on Civil Rights (LCCR) Housing Task Force in calling on the industry to institute a six-month moratorium on foreclosures for families with the riskiest subprime loans – those with payment shock. A moratorium on this select group of foreclosures would give all parties involved time to identify meaningful resolutions. Our public call has become a platform for dialogue on a national strategy for helping thousands of families successfully avoid foreclosure.

Mounting foreclosures is one of the most pressing civil rights issues facing the nation. For decades many of us have worked together to build wealth in Latino and other underserved communities. Homeownership is supposed to be a family's ticket to the middle class and financial security. If we allow foreclosures to undercut this work, not only will wealth and credit be lost, but large sections of our neighborhoods will have lost their ability to send their children to college and plan for their retirement. There is still time to act, however, and protect the hard-earned gains in homeownership for vulnerable communities.

Protecting Latino Wealth

Independent homeownership counseling is critical for building Latino wealth through homeownership and avoiding foreclosure. NHN grantees are community-based organizations (CBOs) that serve as the primary point of contact for Latino families on a variety of issues. In the case of housing services, housing counselors are quickly being recognized as an important conduit for borrowers looking for safe and affordable loan products. For families facing financial crisis, CBOs have the credibility necessary to intervene between the borrower and the

servicer and investor. At the risk of sounding cliché, prevention truly is the best medicine. NCLR has long been engaged in national efforts to increase the availability of pre-purchase counseling, which research shows is an effective way to prevent foreclosures. Through research, public testimony, and direct funding, NCLR has been a champion of counseling services as a way to connect low- and moderate-income Latino and immigrant families to sustainable homeownership opportunities for more than a decade.[2]

The rising rate of foreclosure clearly signals a need for this kind of preventative service; however, not all families are going to receive pre-purchase homeownership counseling. Families in financial crisis have an immediate need for a robust foreclosure counseling industry. For Latinos and many other underserved communities, the challenges present during the purchase transaction inevitably spill over into homeownership. The secondary market and servicing industries are daunting and complicated, especially for a borrower facing unexpected financial trouble. While servicers and noteholders can modify the terms, forgive portions of principal in the case of faulty or fraudulent appraisals, or structure a payment plan for a borrower facing temporary hardship, only a handful of industry leaders have stepped up to make these tools more accessible to homeowners who need them. Furthermore, lenders responsible for families being channeled into unsustainable loans owe the families loss mitigation services, at minimum. Unfortunately, many families never learn about the loss mitigation tools a lender has available because they do not contact their servicers. Families experiencing financial hardship are often embarrassed and distracted by the event that caused their delinquency. Housing counselors have the trust of the community and the skill to interact with the industry. They act as intermediaries that help families navigate this system and save their homes.

The story of Joann V. is an excellent example of how foreclosure prevention counselors serve families. Joann came to the offices of the Spanish Coalition for Housing in Chicago, Illinois, in September 2006. She was a few months behind on her mortgage payment and was beginning to run out of options. Several months prior her monthly mortgage payment jumped from $881 to $1,434 due to an escrow shortage. With such a dramatic increase in her payments, Joann struggled to keep up with the mortgage and household expenses. Joann and her counselor called the servicer together and submitted the required information. The servicer's initial offer was for a repayment plan that would require Joann to pay $2,003.24 each month until she became current with her loan. The counselor was able to intervene again and explain the payment plan was not affordable and would not help the client to save her home. Upon completion of the necessary documents, the counselor successfully negotiated a loan modification that permanently changed the terms of her loan to make it affordable.

To expand this kind of service, the housing counseling field needs to extend its reach and build capacity. The President's budget calls for an increase in funding for the Housing Counseling Program, housed at HUD, to $50 million (up from $42 million in the previous budget). While we are pleased to see the number increasing, it is not enough to meet the demand. The field needs funding dedicated to supporting foreclosure prevention services. That said, the counseling industry cannot survive on grant funding alone. Counseling agencies must be able to charge lenders for their pre- and post-purchase services. A reliable source of fee-income will defray

[2] *Testimony on Increasing Latino Homeownership Through Housing Counseling*, presented by Lot Diaz, NCLR, before the U.S. House of Representatives Committee on Financial Services, Washington, DC, March 2004.

costs, allow counseling agencies to hire additional staff, and expand their services. In addition to funding, counselors need better access to borrowers in danger of foreclosing. Many servicers and investors understand they may not be in the best position to reach a delinquent borrower, whereas a community-based counseling agency may be. However, privacy laws prohibit investors and servicers from sharing delinquent borrower contact information with counseling agencies. Unable to connect with borrowers directly, most counseling agencies rely on local marketing and outreach efforts or word-of-mouth to attract clients before it is too late. Thus, NCLR has advocated for an "opt-in" provision that would allow borrowers to give the servicers permission to share their information with a HUD-approved counseling agency should they ever become delinquent. We applaud Congresswoman Waters for including an opt-in provision for FHA-insured borrowers as a part of the "Expanding American Homeownership Act of 2007" (H.R. 1852).

However, not all servicers have the necessary discretion over the loan to make modifications and not all lenders or investors are willing to fix the mistakes of the originator. These families need a rescue mortgage product that will transition them into a sustainable ownership position. NCLR calls on entities that have a social responsibility, such as HUD through the Federal Housing Administration (FHA) insurance program and the Government Sponsored Enterprises (GSEs) to develop safe mortgage products and make them accessible to families facing foreclosure. To be successful with Latino families, a rescue product must accommodate flexible Debt-to-Income (DTI) and Loan-To-Value (LTV) ratios and damaged credit. Families who are steered toward ill-fitting products with negative amortization or who have been trapped in a cycle of wealth-draining refinances are likely to have little equity in their home, and therefore will need products with a high LTV threshold. Similarly, families who have delinquency – whether due to sudden loss of income or payment shock – may have damaged credit as a result. They need a product that takes this into account and puts them on a path to repairing their credit.

We believe that FHA and the GSEs have the capacity to develop products that could save the home equity of thousands of families. Both already have industry-leading loss mitigation tools. The principles of these tools should be applied to the creation of market-changing rescue programs. For example, FHA's partial claim program pays an eligible FHA borrower's arrears to bring their loan current. The amount paid is added as a second lien to the property as a zero interest loan due when the first mortgage is paid or the home is sold. A similar product could be fashioned by the GSEs and applied toward their affordable housing goals. Based on our experience in the purchase market where second mortgages can be a successful affordability tool, the partial claim concept could translate into an extremely beneficial rescue product.

Finally, borrowers in crisis need protection from fraudulent and predatory foreclosure rescue scams that have been popping up across the country. Borrowers desperate to save their homes are easy targets for predatory lenders who present themselves as "foreclosure consultants" and make unrealistic promises. Many victims feel like they have few options and are pressured into signing papers they do not understand. Predators promise refinances or temporary transfer of deeds where the family believes they will rent for a short period of time and earn their way back to ownership; others completely misrepresent the documents the client signs. Calls have been flooding into the offices of NHN organizations from Latino families who trusted these predators. Mr. and Mrs. Garcia from Chicago represent one of these calls. The couple turned to The

Resurrection Project (TRP), an NHN Affiliate, for assistance when they were served an eviction notice on a home they thought they owned. Several months earlier the Garcias were having trouble making their mortgage payments and went in search of a more affordable loan. Their lender told them they could not help them, but referred them to a finance company that would be able to refinance their loan. The family followed up with the new lender and signed documents they thought were to refinance their mortgage. Instead, they are trapped in a "shared investor" scam where onerous terms make it more likely that a family will be evicted from their home than save it from foreclosure. The counselors at TRP connected the Garcias to legal assistance, and their case is ongoing. Once again, the absence of legitimate lenders and industry leaders serving Latino communities leaves a hole predators are quick to fill. Without a concentrated effort on behalf of government, industry, and legitimate housing counselors, foreclosure rescue scams will overrun our communities.

Conclusion

NCLR is deeply concerned that rising foreclosure will erode the wealth that homeownership is supposed to build. Too many of our families were steered toward loans that were not a good fit for them in the first place. We have long argued that bad loans were leaving our families in a precarious position. Now we are on the brink of large swaths of low- and moderate-income, minority, immigrant families, and the elderly losing their only financial safety net. However, we firmly believe that the impending wake of foreclosures can be avoided. To accomplish our shared goal, NCLR has proposed broad support and expansion of foreclosure prevention counseling, the creation and delivery of rescue loan programs, and enforcement actions against predatory and fraudulent foreclosure scams. To implement these solutions, we make the following recommendations:

- **Create a robust national campaign against foreclosure.** Borrowers facing foreclosure and financial crisis are bombarded with predatory offers to "save" the borrower from their situation. Many families do not know who to trust or what the proper next step is to resolve their situation. The federal government and private stakeholders, such as lenders, servicers, and counselors, must come together to launch a national campaign that would combine social awareness, emergency assistance, and strong enforcement against fraudulent rescue scams. Public Service Announcements (PSAs) in various media and languages can build awareness of what to do in the case of mortgage delinquency and where to turn for help. The campaign should also direct families to HUD counseling services in their neighborhood for further assistance. A national hotline or website could help facilitate the delivery of that information. We also recommend expanding the optional privacy waiver to all borrowers. To complement the public education piece, a national campaign must include strong enforcement action against predatory foreclosure rescue operations. These scams take advantage of underserved communities at their most vulnerable point. Without strong enforcement action against these predators, the education and hotline efforts will not be successful.

- **Increase funding support for foreclosure prevention counseling to $100 million.** We recommend that the House Financial Services Committee dramatically increase the authorization for housing counseling and that a portion of the increase be set aside for

foreclosure prevention counseling. In addition, lawmakers should clarify housing counseling agencies' ability to earn fees for their work to prepare families for homeownership. Doing so will greatly expand the availability of housing counseling services. In addition, NCLR calls on industry leaders to support the foreclosure intervention services through funding and partnerships.

- **Create foreclosure rescue loans.** Given FHA's mission to build wealth in underserved communities, it makes sense that they should play a role in protecting that wealth as well. We recommend that Congress authorize HUD to create a rescue mortgage that the FHA program will insure. The loan program should be built off the concept of the Partial Claim loss mitigation tool currently used for FHA-insured loans. Appropriately capitalized and promoted, such a product could help thousands of families save their homes.

TESTIMONY OF

John H. Dalton
President, Housing Policy Council

On behalf of the

HOUSING POLICY COUNCIL of THE FINANCIAL SERVICES ROUNDTABLE

Before the

COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

Tuesday, April 17, 2007

INTRODUCTION

Good morning Chairman Frank, Ranking Member Bachus, and members of the Committee. I am John Dalton, President of the Housing Policy Council of The Financial Services Roundtable. I appreciate the opportunity to testify before the Committee today on behalf of the Housing Policy Council (HPC) of The Financial Services Roundtable. [1]

The Housing Policy Council of The Financial Services Roundtable believes that all mortgage lenders should embrace responsible lending principles and work to keep people in their homes. Federal regulatory action or legislation on non-prime lending must strike a careful balance that provides enhanced consumer protections without unintentionally limiting the availability of loans to credit-worthy borrowers. Potential federal legislation to provide additional consumer protections must also establish a single uniform national standard that will provide consistent protections to consumers in all fifty states replacing state and local lending requirements. This standard should preserve the existing regulatory and enforcement authority of the federal banking regulators over federally chartered institutions and their affiliates.

Regulatory action, such as the pending federal subprime guidance, and potential national legislation should be based on the principle that lenders should only make home loans to borrowers whom they reasonably believe have the ability to repay the loans based on information available at the time the loan is made. In addition, loans should offer a demonstrable benefit to the consumer, such as purchasing a home, obtaining significant new money, converting an adjustable rate loan to a fixed rate or reducing monthly debt payments. Loan terms, features, benefits and risks should be disclosed to borrowers in ways that enable them to make an educated decision about the loan product that they choose. The timing and estimated amounts of future payment changes should be clearly communicated

[1] The twenty-three member companies of the Housing Policy Council originate and service approximately two thirds of all prime mortgages and 45% of all subprime mortgages in the United States. The Financial Services Roundtable formed HPC in April 2003 to be the premier forum to address the most critical mortgage finance and housing public policy issues. Housing finance is truly a national industry and HPC member companies seek to serve customers across the nation.

to borrowers in accordance with applicable disclosure laws and good business practices. Finally, servicers and investors should make available to borrowers appropriate options to help them sustain homeownership.

In today's testimony, we want to give the committee a more complete perspective on what our members are doing to assist their borrowers and to prevent and reduce foreclosures whenever possible.

EVERYONE LOSES IN A FORECLOSURE

First, I want to address a popular misperception- that is that lenders want to foreclose. The exact opposite is true; responsible lenders do not want to foreclose. Foreclosure is bad for everyone: the borrower, the neighborhood, the community and the lender. Lenders lose money in a foreclosure and they also lose a customer; responsible lenders want customers for life who can benefit from other services and products they offer. Lenders have options available to homeowners who are in financial difficulty. The first step is to ensure that a homeowner who is in trouble contacts his lender and asks for assistance as soon as possible.

NATIONAL PROGRAM

HPC member companies and all responsible lenders want our customers to be successful; we want our borrowers to repay our loans and enjoy the satisfaction that homeownership brings. One of the ways we are helping our customers be successful homeowners is through a national partnership with NeighborWorks® America and the Homeownership Preservation Foundation.

This national partnership is based on the successful Chicago Homeownership Preservation Initiative (HOPI), an innovative partnership between the City of Chicago, the Federal Reserve Bank of Chicago, the Neighborhood Housing Services of Chicago (a NeighborWorks affiliate), the Homeownership Preservation Foundation and several lenders who all worked together to tackle the city's rising foreclosures. Through the City of Chicago's 3-1-1 hotline, homeowners facing problems

making mortgage payments can dial 311 and immediately receive free independent counseling by certified housing counselors who are available twenty-four hours a day, seven days a week. By all measurements, this program has been a success. In the first three years of the program, over 4,000 Chicago homeowners received counseling, over 1,300 families avoided foreclosure, and the program resulted in $267 million in collective savings for the City of Chicago, its homeowners and HOPI lender partners.[2]

Building on the successful Chicago HOPI program, seventeen lenders, including fourteen HPC companies have partnered with respected national non-profits and Freddie Mac in a national foreclosure prevention campaign.[3] All participants are united in the goal of helping homeowners avoid foreclosure whenever possible. Through this new and innovative program, our member companies are taking proactive measures to help any homeowner who is experiencing a financial crisis and potential foreclosure. The goals of this partnership are:

- Linking homeowners in danger of foreclosures to the Homeownership Preservation Foundation's accredited counselors to get the financial advice they need to avoid foreclosure.
- Establishing foreclosure intervention programs in cities and localities with high rates of foreclosure.
- Conducting a national public education campaign with the Ad Council to improve contact rates for those in financial distress.
- Improving counseling capacity and providing certified training programs to foreclosure counselors across the nation.

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[2] "Home Ownership Preservation Initiative (HOPI) Partnership Lessons and Results: Three Year Final Report." Neighborhood Housing Services of Chicago, July 17, 2006.

[3] As of March 2007, the national partners of this program are: Homeownership Preservation Foundation; NeighborWorks® America; Housing Policy Council; American General Financial Services, a member of AIG, Inc.; Bank of America; Citigroup; Countrywide Home Loans; EMC Mortgage; Freddie Mac; GE; Homecomings Financial- a GMAC Company; HSBC- North America; JPMorgan Chase; LaSalle Bank Corporation- member of ABN-AMRO Group; National City Mortgage Co.; New Century Financial Corporation; Ocwen Loan Servicing, LLC; Option One Mortgage; State Farm Insurance; Washington Mutual; Wells Fargo Home Mortgage.

- Conducting industry research to better diagnose issues in the new mortgage market and advising on potential solutions.

The Homeownership Preservation Foundation (HPF) was founded in 2004 with a $20 million grant from GMAC-RFC for the purpose of reducing foreclosures across the nation. HPF established the Credit Counseling Resource Center, 888-995-HOPE, a free 24/7 hotline staffed by 80 trained housing counselors, to assist owners at-risk throughout the country. The NeighborWorks® Center for Foreclosure Solutions is an initiative of NeighborWorks America, a nonprofit organization, founded by Congress, providing financial support, technical assistance and training for communities across the nation, including the NeighborWorks network—a nationwide network of more than 245 community development organizations working in more than 4,400 urban, suburban and rural communities across America. These organizations engage in revitalization strategies that strengthen communities and transform lives. In the last five years alone, NeighborWorks organizations have generated more than $10 billion in reinvestment and helped more than 780,000 families of modest means purchase or improve their homes or secure safe, decent rental housing.

The free phone counseling, which can be reached by dialing 888-995-HOPE, is provided by the Homeownership Preservation Foundation's Credit Counseling Resource Center. Every counselor is an independent specialist in foreclosure prevention, certified by the Department of Housing and Urban Development. There is no switchboard; the phone is answered by housing counselors who are available twenty-four hours a day, seven days a week. When homeowners call the hotline, a trained counselor answers the phone and the service starts immediately. The counselor endeavors to understand the homeowner's situation and help him find a workable solution.

The counselor and the homeowner identify together the reasons why the homeowner is behind with their mortgage. Together, they review the homeowner's income, budget, loan terms and delinquency status; then, the counselor and homeowner discuss options for working out of the situation.

In about 25 percent of the counseling sessions, the homeowner is recommended for loan work-outs and the counselor helps the homeowner work with the servicer on a loan modification of some kind that fits within the financial ability of the homeowner to implement. Workout options can be a forbearance, where a homeowner makes reduced or suspended payments until re-employed or their temporary situation is resolved; a repayment plan, where the homeowner repays their past due payments over a period of time; or a loan modification, where the terms of the loan are changed.

Not all homeowners can be helped through a workout. If they have no income and little prospect for employment, there is very little that can be done. In those cases, the goal is for the homeowner to preserve the equity by selling their home. So far the frequency seems to be about 17 percent of the cases; this is more desirable for the homeowner than having it sold at auction at the end of a foreclosure proceeding.

This program can be accessed anywhere in the U.S. simply by calling 1-888-995-HOPE. In 2006, over 48,000 homeowners sought help through counseling services funded by the Homeownership Preservation Foundation; 25,000 of them called the HOPE hotline; nearly half have avoided foreclosure by engaging in a workout or by selling their home. Call volume has grown 30% since the end of 2006 and daily volume ranges from 350 to 1,000; in the First Quarter of 2007, almost 7,000 homeowners were counseled via 888-995-HOPE.

In June 2007, a national Ad Council campaign will be launched promoting this number and urging homeowners in trouble to seek help. We expect this program to continue to be an extremely valuable resource for distressed homeowners, and are committed to ensuring its success.

The partnership also performs targeted rollouts in areas of high foreclosure. In 2006 and 2007, the program was introduced in Ohio, Delaware, Baltimore, Maryland, and Atlanta, Georgia. Prior to 2006, the hotline was also introduced in Dallas, Texas and Detroit, Michigan. In these locations, the partnership has hosted a variety of events including:

- Training for in-person counselors to enable them to help homeowners in financial distress and at risk of foreclosure, hosted NeighborWorks®.
- Foreclosure prevention/homeownership preservation workshops/seminars: Homeowners in or at risk of foreclosure are invited to seminars where they can learn about their options and talk to their lender if they so choose.
- Lenders, local governments and community group discussions: Organizations involved in foreclosure prevention share best practices and collaborate on ways to best work together to keep homeowners in their home and out of foreclosure.

This national foreclosure prevention effort is not a recent initiative. The Housing Policy Council and our member companies have been working with the Homeownership Preservation Foundation since 2004 to create this national program.

We would hope that you agree this program has merit, and that you will also promote it in your districts and whenever you have an opportunity. Awareness efforts by trusted third parties such as Members of Congress will help us connect with more homeowners who are in distress, and give us an opportunity to keep them in their homes.

Our member companies and all responsible lenders take this issue very seriously. We want to help consumers be successful homeowners and to avoid foreclosures. We believe our homeownership preservation effort is a model to help homeowners in distress. Our message is that lenders want to work with all interested parties – non-profits, public officials and the media – to get the message to homeowners that help is available. The most important first step is to make the call to ask for help.

For consumers and your constituents in financial distress and in danger of facing foreclosure, they need to know:

- Foreclosure is not inevitable- you have options. The earlier you act the more options you have.

- Free trustworthy help is available all day, all night, all weekend, provided by this partnership of national non-profits, HPC and its members. Working together we are solving this problem for thousands of Americans.
- Responsible lenders do not want to foreclose; they want to work with the homeowner to prevent foreclosure.

Attached to this testimony is a one page summary of the key information on the HOPE counseling program. It is the key information on getting help for any homeowner who is behind on their mortgage and in need of help.

EFFORTS BY LENDERS

In addition to the joint HOPE foreclosure prevention effort, the individual member companies of the Housing Policy Council are actively involved in a variety of individual efforts and cooperative programs to help their customers in or near foreclosure. Our members are aggressively adopting new programs and products to address the specific difficulties subprime borrowers may have, in particular, those with adjustable rate mortgages in this challenging interest rate environment and the slowing housing market.

Our members are taking action to offer options before a borrower is in default that are designed to ensure that borrowers are in the best possible position to anticipate and manage the challenges they may face with upcoming payment adjustments.

These actions include: proactively contacting borrowers through a variety of channels – direct mail, email, interactive websites, inbound and outbound calling – to let them know of affordable refinance opportunities or of mutually agreeable payment plans that will keep borrowers in their homes.

For those borrowers who are unable to make their mortgage payments and where refinancing is not an option, lenders have adopted loss mitigation efforts to help them avoid foreclosure. These efforts include forbearance agreements of varying lengths (up to 12 months in some cases), loan modifications,

enhanced counseling programs and increased staffing to assist customers. With regard to loan modifications, lenders are reducing payment amounts, lowering interest rates and/or extending the terms of the loans held by subprime borrowers.

A member company has also initiated a relief fund that will provide qualified subprime borrowers with adjustable rate mortgages the option to refinance to fixed rate loans at a discounted rate.

Companies are also partnering with non-profits and creating rescue funds to assist homeowners in danger of foreclosure. These funds are especially intended to assist customers who have experienced a medical or financial hardship that has led to their default.

These are just a few examples of the efforts our members are taking to assist distressed subprime borrowers. We believe these efforts demonstrate our members' commitment to help subprime borrowers avoid foreclosure and remain in their homes during this difficult economic time. These options cannot work, however, if the borrower does not contact the lender when he or she is in financial distress. It is estimated that 50% of borrowers who lose their home to foreclosure never contacted their lender. Third party websites, including HUD and many community groups, urge borrowers to contact their lenders when in default or when personal financial issues are creating payment problems. We welcome assistance from any trusted third party, such as members of Congress and their staff, to help us get the word out that contacting servicers early can lead to solutions that can help homeowners stay in their homes and avoid foreclosure.

Similarly, in a Freddie Mac survey it was found that the majority of homeowners (both those in delinquency and in good standing) are not aware of services that mortgage lenders can offer to a person having trouble with their mortgage.[4]

Part of the solution to reach people who will not talk with their lender lies in creating partnerships with trusted third parties, such as nonprofit counseling agencies, local officials and advocacy groups, to create a holistic outreach. Our members have established and expanded their existing partnerships with

[4] Freddie Mac. "Foreclosure Avoidance Research." Conducted by Roper Public Affairs, a division of Gfk NOP, 2005.

local agencies, nonprofit organizations and other financial institutions to provide subprime borrowers alternative solutions to foreclosure. The following are a few specific examples of cooperative local efforts that HPC companies are supporting in addition to the targeted rollouts of 1-888-995-HOPE:

- Colorado: Partners, including several lenders, the Colorado Division of Housing, the Colorado Association of Realtors, the City and County of Denver, Freddie Mac and the Colorado Attorney General's Office established a state-wide hotline, 1-877-601-HOPE, for homeowners at risk of foreclosure.
- Cuyahoga County, Ohio: Consumers can make appointments for in-person counseling by using the United Way 2-1-1 hotline,
- Houston: The HOPE partnership is hosting several consumer homeownership preservation seminars and specifically advertising the existence of the HOPE program..
- Indiana: Momentive program was established in 2004, to provide homeownership and budget counseling to Indiana residents. It is available to consumers state-wide.
- New York City: New York's Preserve Assets and Community Equity (PACE) program was launched in 2005. The program includes participation by the New York Department of Housing, HUD certified counseling agencies and community partner organizations. The PACE initiative focuses its marketing outreach in NYC communities with the highest foreclosure rates and conducts consumer seminars.
- After Hurricane Katrina, lenders partnered with a national non-profit to attempt to contact residents who had been evacuated from the area to encourage them to contact their lender to take advantage of the extended forbearance options available to Katrina victims. In addition to canvassing New Orleans neighborhoods, volunteers knocked on doors in apartment complexes in Houston, Baton Rouge, and other cities with high concentrations of hurricane evacuees. That effort is continuing to today to reach borrowers to encourage them to apply for Road Home grants.

These are just some of the actions that HPC member companies and other lenders are taking to assist their customers who are delinquent on their mortgages and in need of assistance.

SECURITIZATION

The effort to assist borrowers is also affected by whether a loan is held in portfolio or has been sold into the secondary market. Loans in the secondary market are accumulated with other loans in a pool of loans and shares of the interest or principal payments or both are in turn sold as investments to third parties such as pension or retirement funds, insurance companies, individuals and others, both domestic and foreign. Up and down along the chain of securitization, contracts between and among the different participants establish the relationship of the parties and their duties and responsibilities.

Often the ownership of the loan and the rights to the revenues streams generated by the loans are sold and the duty and right to service the loan – i.e., collect payments, enforce the terms of the loan, maintain contact with the borrower, etc., - are sold separately or retained by the originator. As in the rest of the business model, contracts between the servicer and the other parties in the securitization establish the duties and responsibilities of the parties, as well as where loss falls if the borrower fails to pay and foreclosure must occur.

This model can become somewhat complicated as rights to different parts of the assets and streams of revenue are sold to different investors. To maintain the expected return for the investor, there are certain terms included in most contracts which govern the types of actions servicers can take with borrowers who are delinquent on their loans. These contract terms are not uniform, and servicers (who are now faced with the possibility that a number of loans they are servicing may default) are working to ensure that the actions they take toward borrowers are permissible under all the securitization contracts that govern the loans.

Our member companies are working hard with the other participants in the securitization chain to resolve issues that may limit the options that can be offered to borrowers, and while the issues are

sometimes difficult, they expect that jointly there will be fair and reasonable solutions that will permit lenders to assist borrowers early enough in distress situations to prevent foreclosure.

CONCLUSION:

Mr. Chairman and members of the Committee, the members of the Housing Policy Council recognize that there are a significant number of non-prime borrowers who need assistance. Our members are working individually and together to provide solutions to these borrowers with the goal whenever possible of enabling them to succeed as homeowners. We think these efforts will have an impact. To be candid, there is no perfect solution. We are at the end of one of the longest and most successful housing markets in our nation's history, but the end of any major economic cycle produces problems for individuals and businesses. The key is to help those homeowners who need assistance whenever possible. Our member companies are working today to help their borrowers.

In addition, we are ready to work with the regulators and this Committee going forward on prospective solutions that will strengthen the housing finance market; protect consumers and ensure that credit remains available to all Americans who are working to attain the dream of homeownership.

Having Trouble Paying Your Mortgage?

888-995-HOPE

888-995-HOPE is available:

- To any homeowner in America having trouble paying their mortgage
- Any time--24/7

888-995-HOPE offers:

- Absolutely free foreclosure prevention counseling by expert counselors at HUD-approved agencies.

When a constituent calls 888-995-HOPE:

- Service begins immediately—the counselors themselves answer the phone
- Homeowners can get budgeting help, a written financial plan, assistance contacting their lender
- If they'd like face-to-face counseling, they are referred to their local NeighborWorks® agency or other counseling agencies
- If they need additional services, they are referred to agencies in their area.

The details:

888-995-HOPE is provided free of charge by the Homeownership Preservation Foundation, a nonprofit dedicated to preserving homeownership. The Foundation partners with local governments, nonprofits, borrowers, and mortgage lenders/servicers to deliver innovative homeownership preservation opportunities.

In 2006, over 40,000 homeowners sought help through our counseling. Nearly half have avoided foreclosure by working out new loan terms or by selling their home. Currently call volume is increasing by 25% every 6-8 weeks. Callers tend to be female, married, with children, mid to lower income.

In-person counseling is provided by NeighborWorks® organizations, located around the country in all 50 states, Puerto Rico and the District of Columbia. NeighborWorks® organizations are chartered by NeighborWorks® America, a national nonprofit created by Congress to provide financial support, technical assistance, and training for community-based revitalization efforts.

Other partners: American General Financial Services, a member of AIG, Inc., Bank of America, Citigroup, Countrywide Home Loans, EMC Mortgage, Freddie Mac, GE, Homecomings Financial- a GMAC Company, Housing Policy Council, HSBC– North America, JPMorgan Chase, LaSalle Bank Corporation – member of ABN-AMRO Group, National City Mortgage Co., New Century Financial Corporation, Ocwen Loan Servicing, LLC, Option One Mortgage, State Farm Insurance, Washington Mutual and Wells Fargo Home Mortgage.

If you need more information:

About 888-995-HOPE: info@995HOPE.org
About in-person counseling: foreclosuresolutions@nw.org

homeownership HPC HOUSING POLICY COUNCIL NeighborWorks AMERICA

Prepared Testimony of
Douglas A. Garver, Executive Director
Ohio Housing Finance Agency

"Possible Responses to Rising Mortgage Foreclosures"

Before the
House Committee on Financial Services
United States House of Representatives

April 17, 2007

Good morning Chairman Frank, Ranking Member Bachus, and Members of the House Financial Services Committee. I am Doug Garver, Executive Director of the Ohio Housing Finance Agency (OHFA). Thank you for inviting me to testify today on possible solutions to the national foreclosure crisis.

The state of Ohio has been hit especially hard by home foreclosures in part because of an economy that has suffered a decline in the manufacturing sector and an increase in subprime loans. Last year, Ohio led the nation with 11.32 percent of subprime loans in foreclosure. In addition, according to the Mortgage Bankers Association[i], the state has the second highest rate of all home loans in serious delinquency, meaning the loan is either in foreclosure or more than 90 days late. This ranking puts Ohio behind Mississippi, which leads the nation in foreclosures, and in front of Louisiana, two states devastated by the 2005 hurricane season. Furthermore, the crisis is not nearing its end in Ohio. At least $14 billion in Adjustable Rate Mortgages (ARMs) will reset in 2007 and 2008, impacting potentially over 200,000 Ohio homeowners[ii].

OHFA is a self-supporting housing finance agency, independently governed by an 11 member, Governor-appointed board. Administering both federal and state resources, we strive to fulfill our mission of opening the doors to an affordable place to call home. Keeping those doors open became increasingly important as this crisis unfolded. Late last year, we gathered our stakeholders to develop possible solutions to this growing problem.

We recognized early on that we could not solve the problem alone but we could be a piece of the solution and prevent many Ohio families from the turmoil that foreclosure brings. We quickly focused our work on developing a refinancing product to assist those families in mortgages that were no longer suitable for their circumstances.

On April 2nd, OHFA proudly unveiled the Opportunity Loan Refinance Program, which makes available affordable, 30 year, fixed-rate financing. Modeled after our successful First-Time Homebuyer Program, this refinancing product will be funded by the issuance of taxable mortgage revenue bonds, which we will issue in response to underwritable demand for this new product.

Opportunity Loan assists those families in Adjustable Rate Mortgages (ARMs), Interest-Only products and those that have had an unplanned life event such as divorce or change in employment. Family income may not exceed 125% of the Area Median Gross Income (AMGI), which varies by county and ranges from $73,000 to $84,000 a year. A full appraisal is also required on the home to assure its true value.

In addition, Opportunity Loan offers a 20-year, fixed-rate second mortgage option at an amount up to four percent of the appraised value of the home. OHFA reserves fund this option. The second mortgage offers the flexibility to cover certain eligible costs including payoff of the existing first or second mortgage, closing costs, escrow accounts for taxes and homeowner's insurance, pre-payment penalties and other charges associated with the

existing mortgage lien. The interest rate on this option is two percent above the rate of the first mortgage.

Education is a key component of the program and is designed to help prevent borrowers from making decisions that could lead to foreclosure in the future. A total of four hours of face-to-face counseling is required. Typically, this includes two hours during an initial interview to assess the borrower's current situation, and an additional two hours of one-on-one counseling. Proof of education must be provided prior to closing. In addition, we require post-purchase counseling in the event a mortgage payment is 30 days late or more.

Our efforts will be complemented by the newly-created Governor's Foreclosure Prevention Task Force. Governor Ted Strickland, seeing the desperate need for solutions to this issue in his first few months in office, formed the task force and charged the group with developing additional strategies to assist homeowners facing foreclosure. This 25-member task force is made up of various stakeholders from federal, state and local governments, the lender community and public advocacy groups. The task force plans to recommend additional options to address Ohio's home foreclosure crisis within two months.

Again, I appreciate the opportunity to address you today and welcome any questions you may have.

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[i] *National Delinquency Survey* (Fourth Quarter 2006), Mortgage Bankers Association
[ii] *Dimensions of Ohio's Foreclosure Crisis*, Bill Faith, COHHIO and Paul Bellamy, J.D., Ph.D.

Statement of George P. Miller
Executive Director
American Securitization Forum

Also Representing the
Securities Industry and Financial Markets Association

Before the
Committee on Financial Services
United States House of Representatives

April 17, 2007

Thank you and good morning. I am pleased to be here representing the American Securitization Forum (ASF)[1] and the Securities Industry and Financial Markets Association (SIFMA)[2] on issues related to the subprime mortgage market. We commend you, Chairman Frank, for calling this hearing and we are grateful for the opportunity to present our views.

Summary

Home ownership is one of the most widely shared values in America and an iconic symbol of personal achievement. Federal law reflects the importance of home ownership in American culture by encouraging and assisting families to buy homes. Policies such as the home mortgage interest deduction, the exemption from capital gains on home sales, the Federal Housing Administration mortgage insurance program and the creation of Ginnie Mae, Fannie Mae, Freddie Mac and the Federal Home Loan Banks, among numerous others, have helped millions of Americans buy homes who otherwise would have been excluded from the "American dream." The capital markets have also contributed substantially to expanding the availability

[1] The American Securitization Forum is a broadly-based professional forum through which participants in the U.S. securitization market express their common interests on important legal, regulatory and market practice issues. ASF's membership—over 350 organizations in all—includes securitization issuers, investors, servicers, financial intermediaries, trustees, rating agencies, legal and accounting firms, and other securitization market participants. Additional information about the ASF, its members and activities is available at www.americansecuritization.com. ASF is an adjunct forum of SIFMA.

[2] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Market Association, is based in Hong Kong. More information about SIFMA is available on its website at www.sifma.org.

and reducing the cost of mortgage credit by linking investors and home buying families through mortgage securitization.

Mortgage securitization is the process of converting homeowners' monthly principal and interest payments from pools of home mortgages into mortgage-backed securities (MBS), which are sold to investors much like stocks, government and corporate bonds and other financial instruments. Securitization serves several purposes that all contribute to making mortgage loans more available and affordable to American families:

- Securitization provides a way for mortgage companies and other lenders to sell the loans they originate to generate capital for new loans. Mortgage companies, thrifts and others do not need to retain mortgages on their books for the entire terms of the loans.

- Securitization draws varied sources of capital to the mortgage lending market. Investors such as pension funds, insurance companies and mutual funds both inside and outside the U.S. generally do not want to hold individual mortgage loans in their investment portfolios. They are, however, active buyers of MBS, making their funds available to American families buying homes.

- Securitization distributes and reduces the risk of investing in mortgages. Participants in the MBS market have developed innovative ways of segmenting the risks associated with investing in mortgages and creating securities that allow investors to assume as much or as little risk as they desire.

Securitization helps provide capital for both "prime" mortgages—loans to homebuyers with relatively good credit—and "subprime" mortgages—loans to homebuyers with relatively weaker credit. In fact, securitization has been a driving factor in making mortgage loans available to subprime borrowers who otherwise may not have been able to purchase their own homes.

With the recent rise in delinquencies among subprime borrowers, policy-makers at the federal, state and local levels have been exploring changes in law and regulation designed to help protect homebuyers from "predatory" lenders. However, these well-intentioned efforts, if not appropriately conceived, can have the unintended effect of stifling the availability of mortgage loans for deserving subprime borrowers. Indeed, such efforts by policy-makers in some states and cities have resulted in complete shut-downs of all subprime lending activity and have been followed by hasty changes in law in order to restore the market.

Both the lending and investment markets have responded briskly to the rise in delinquencies among subprime borrowers. Dozens of subprime lenders have exited the market altogether. Those lenders who remain have tightened their lending standards. Investors are much more cautious about what securities they buy. Prices for certain securities backed by subprime loans have fallen, reflecting the heightened risk associated with the increase in delinquencies. Perhaps most important, mortgage servicers—those firms responsible for receiving monthly mortgage payments from borrowers and passing them through to MBS investors—have been working with borrowers who are in arrears on their loans to help avoid foreclosures. Servicers, who often have flexibility under their servicing contracts to help

borrowers avoid default, have taken steps such as modifying loan terms and extending deadlines for payments to help families in trouble avoid losing their homes.

Poorly crafted policies designed to further regulate subprime lending or provide relief to borrowers could have the consequence of causing MBS investors to shun the market altogether and cut off mortgage credit for worthy subprime borrowers. There are several key areas where federal policy-makers should exercise caution:

- Mandatory forbearance. Legally mandated forbearance for borrowers delinquent on their loans—as opposed to forbearance contractually permitted in loan and servicing agreements—would violate legally protected contracts, harm investors, and cause many investors to exit the MBS market, drying up funds for home buyers.

- Assignee liability. Imposing unquantifiable liability for fraudulent or abusive lending practices on investors or anyone in the secondary market who committed no abuses themselves, and who generally cannot be aware of the practices of originators. Poorly crafted assignee liability provisions would drive investors from the market and eliminate mortgage funding for many families.

- Prohibiting certain mortgage products. Prohibiting lenders from offering certain mortgage products would restrict the ability of some borrowers to obtain loans that could mean the difference between qualifying or not qualifying for home ownership.

To address current issues in the subprime mortgage market, policy-makers should focus on:

- Full and aggressive enforcement of existing laws and regulations governing loan origination.

- Educating borrowers on the risks and benefits of mortgage products they are considering and ensuring that borrowers have all the clear, concise information they need to make intelligent decisions.

- Encouraging lenders and servicers to make use of the flexibility permitted in loan and servicing contracts to help borrowers in default avoid foreclosure.

Introduction

Home mortgage credit is more widely available today and at a lower cost because of securitization and secondary mortgage market activity than ever before. The secondary mortgage market[3] efficiently links borrowers to the capital markets, and enables lenders to provide more credit at a lower price than they otherwise could. Over the past decade, securitization—the process of transforming pools of mortgage loans into securities which can be bought by investors—and the secondary market have expanded access to credit for all borrowers,

[3] In conformity with market usage, the term secondary market, as used in this paper, generally means the investor and securitization market whereby mortgages are indirectly financed through the capital markets' purchasing mortgages and mortgage related securities from lenders who directly make loans to consumers.

but especially to so-called non-prime or sub-prime borrowers[4], or borrowers with less than perfect credit.

The ASF and SIFMA share concerns expressed by members of Congress, regulators, consumer groups and others about abusive lending practices, particularly those directed at non-prime borrowers. However, we would caution policymakers to take measured and appropriately targeted actions to address perceived problems in the subprime mortgage finance market. An overly broad legislative response to the current headline issues involving non-prime loans, borrowers and lenders could have deleterious, unintended consequences that would reduce the availability and increase the costs of mortgage credit for deserving borrowers. Worsening the current market's significant tightening of credit standards could greatly increase recent home purchasers' stress as refinancing options dwindle just as many subprime borrowers may try to refinance in order to avoid the potentially higher payments resulting from mortgage rate resets for loans originated in 2005 and 2006.

The Secondary Mortgage Market

The secondary market for nonprime residential mortgages loans and the securitization of mortgage loans in particular has allowed millions of Americans to achieve the dream of home ownership while at the same time providing systemic benefits by diversifying regional mortgage risk.

Mortgage-backed securities (MBS) are securities sold to investors much like stocks, government and corporate bonds, and other financial instruments. MBS are created when originators or financial intermediaries pool large volumes of individual mortgage loans and sell securities backed by the monthly payments made by borrowers on the underlying mortgage loans.

When a homeowner whose loan has been committed to an MBS pool makes his or her monthly mortgage payment, that payment, combined with payments from other loans in the pool, forms the basis of the cash flows to investors who bought the MBS. Often, MBS are structured to address particular investor risk preferences. Investors may choose their position in the priority of payments from that pool of loans in case of defaults—either at front of the line, in a AAA-rated tranche, or in a more risky position such as a subordinate tranche that may absorb the first losses experienced in the pool but that offers a higher return. Bonds may also be structured as tranches that receive only interest collected on the underlying mortgage obligations, called interest only tranches or IOs, and tranches that receive payments only from the principal payments of the underlying mortgages, called principal only tranches, or POs.

The U.S. government has supported and encouraged the development of the MBS market by creating Fannie Mae, Freddie Mac and Ginnie Mae (generally referred to as the "Agencies" or the "GSEs") and by enacting other laws designed to facilitate a secondary market for residential

[4] As used in this paper, the term "non-prime" refers to the category of loans identified and defined in Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision, *Interagency Guidance on Subprime Lending*, Mar. 1, 1999 and *Expanded Guidance for Subprime Lending Programs*, Jan. 31, 2001 as well as Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision and National Credit Union Administration, *Proposed Statement on Subprime Mortgage Lending*, Mar. 8, 2007.

mortgages. These include the Secondary Mortgage Market Enhancement Act of 1984 and the Real Estate Mortgage Investment Conduit (REMIC) provisions of the Tax Reform Act of 1986, among others. The policy goal of these initiatives has been to expand the availability of credit to home-buying families and reduce the cost of that credit. MBS issued by these government-sponsored enterprises are known as "Agency MBS."

Approximately $10.2 trillion of 1-4 family mortgage debt was outstanding at the end of 2006[5]. Approximately $2.51 trillion of mortgages were originated in 2006, according to the Mortgage Bankers Association, and they project that $2.28 trillion will be originated in 2007[6]. Originations to subprime borrowers totaled $35 billion in 1994; this increased to $665 billion in 2005[7].

The mortgage-backed securities market is the largest fixed income market. At the end of 2006, approximately $6.5 trillion of securitized mortgage-related debt was outstanding compared to $4.3 trillion of U.S. Treasury securities and $5.4 trillion of corporate debt[8]. Total issuance of mortgage-backed securities (MBS), including private-label, agency, and home equity loan backed deals has increased threefold so far this decade, from $738 billion in 2000 to $2.4 trillion in 2006[9].

Non-agency issuance, which captures the vast majority of securitized subprime loans but which also includes prime loans that do not conform to agency underwriting standards, has grown from $157 billion in 2000 to $1.2 trillion in 2006[10]. In 2006, non-agency issuance exceeded agency issuance for the first time, achieving a 50.2 percent share of issuance[11]. Approximately 38 percent of private-label MBS issuance in 2006 was backed by subprime loans. Overall issuance of MBS backed by subprime loans has grown from $95 billion in 2001 to $450 billion in 2006[12].

Home ownership is close to its highest level in history, almost 70 percent overall.[13] This figure reflects roughly five percent growth from 1989 to 2006.[14] Non-prime mortgage loans have accounted for much of this growth in ownership; from 1998 to 2006, non-prime mortgages as a share of total originations grew from 10 percent to approximately 20 percent.[15] Increased homeownership has enabled Americans across all demographics to build wealth in residential real estate. It has also increased the stake of these home buyers in their communities and local schools. The secondary market, securitization and the liquidity they provides underlie these positive developments.

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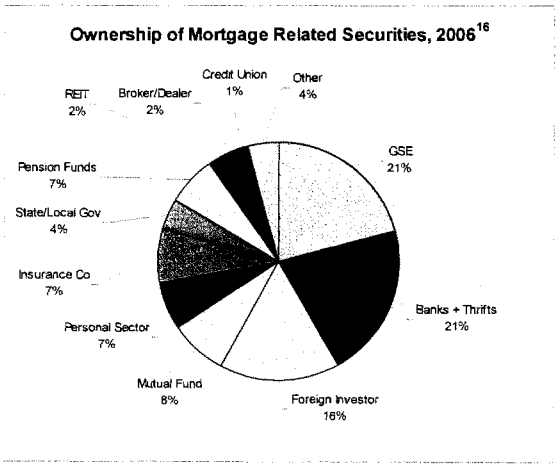
[5] Board of Governors of the Federal Reserve System, *Flow of Funds Accounts of the United States*, March 8, 2007, page 86.
[6] Mortgage Bankers Association, "MBA Mortgage Finance Forecast," March 13, 2007.
[7] Credit Suisse, *Mortgage Liquidity Du Jour: Underestimated No More*, March 12, 2007, page 22.
[8] Securities Industry and Financial Markets Association, *Research Quarterly*, February 2007, page 1.
[9] *Ibid.*, page 10. Non-Agency or "private label" MBS may be issued by a bank, finance company, or other non-government related institution.
[10] *Ibid.*
[11] *Ibid.*
[12] *Inside MBS and ABS*, January 12, 2007.
[13] Statement of Douglas G. Duncan, Mortgage Bankers Association, before the United States Senate, Committee on Banking Housing and Urban Affairs, hearing on "Preserving the American Dream: Predatory Lending Practices and Home Foreclosures," February 7, 2007, page 2.
[14] *Ibid.*
[15] *Ibid.* See also "Subprime Mortgage Origination Indicators," *Inside B&C Lending*, November 10, 2006.

Before securitization became prevalent, banks funded mortgage loans through their customers' deposits, and mortgage credit availability was dictated in part by the volume of bank deposits. Today, banks and other lenders have the option of retaining loans or selling them into the secondary market. Many lenders issue their own mortgage-backed securities backed by the loans they originate or purchase. Others do not lend directly, but purchase pools of loans from a wide-range of originators. Originators can use these pools to back issues of bonds or retain them as investments. Purchasers of such securities include institutional investors, such as pension funds, investment funds, banks and insurance companies, both throughout the United States and increasingly throughout the world.

The ability of mortgage lenders to sell mortgages in the secondary market promptly and with substantial certainty increases funds available to lend and lowers borrowing costs. The liquidity provided in the secondary market enables portfolio managers to provide capital to U.S. mortgage lending that would not otherwise be available because of their ability to adjust their exposures easily within the secondary market as required and to hedge against changes in individual risk concentrations in their portfolios over time.

Finally, the widespread securitization of residential mortgage loans has decreased the systemic risk of regional mortgage holdings in local banks. The more efficient allocation of risk to both national and international investors reduces the concentration of risk that would otherwise be borne solely by local financial institutions due to fluctuations in local real estate markets. Holdings of mortgage related securities are dispersed across a broad spectrum of industries and regions, with more than 15 percent held overseas.



[16] *"Mortgage Related Securities Holdings By Investor", Inside MBS and ABS,* March 16, 2007.

The Secondary Market and Legal Certainty

The twin benefits of widespread availability of credit for home buyers and the reduction in systemic risk in financing home purchases that are provided by a liquid secondary market depend on certain factors that make investment possible for those who cannot assess the details of every mortgage they help finance. In particular investors need to know that the risks they take at the time they make their investments will not be altered by changing the terms of the underlying contracts they finance. They also need to know that they will not have to bear liability based on the conduct of parties that they do not control or subjective determinations of whether loans were in the "best interest" of individual borrowers. The terms of most securitizations do provide, however, flexibility for servicers to accommodate particular cases of borrower distress. Risk is typically modeled at the time of purchase based on probabilities of default and severities of loss of the underlying mortgages based on historical data and loan terms remaining as they existed at the time of purchase. The analysis does not include change-of-law risk, which is unable to be effectively modeled but generally viewed as remote. Increasing change-of-law risk will inhibit the flow of funds as investors will not be able to quantify the risks they are accepting at the time of their purchase decision.

With the recent rise in delinquencies among subprime borrowers, many mortgage servicers have exercised this flexibility to help homeowners in trouble keep their homes. Some, for example, have begun using computer models to help predict which borrowers will fall behind in their payments and when, and then proactively contact those borrowers to help arrange alternatives to delinquency and default.[17] Some have added delinquent amounts to mortgage balances or arranged for borrowers to repay delinquent amounts over several months.[18] Some banks have funded programs operated by community organizations designed to provide attractive refinancing options for subprime borrowers facing difficulties with their loans.[19] In the case of most loans that back MBS, servicing agreements provide servicers with some latitude in modifying loan terms for borrowers in trouble.

However, investors cannot advance funds easily into a mortgage finance system characterized by a patchwork of different state and local laws which dictate different standards of conduct and liability. A liquid and efficient national mortgage market at its current scale in the U.S. depends to a significant degree on relative uniformity of risk and certainty that merely purchasing mortgage loans will not give rise to unmanageable liability or loss of investment.

Assignee Liability

Imposing unquantifiable assignee liability on the secondary market for abuses committed by brokers or others in the origination chain would severely affect investors' willingness to hold mortgage risk for which they might become liable through no fault of their own. This would create more rather than fewer innocent victims of predatory lending behavior and ultimately reduce the availability of capital to the mortgage market. Rather than making secondary market participants the "policemen" for the actions of originators, it would simply drive investors from the subprime market altogether, severely reducing capital available for subprime lending and raising costs for families least able to afford home ownership. This harm has been amply

[17] "Digging Out of Delinquency," *The Wall Street Journal*, April 11, 2007, page D1.
[18] *Ibid.*
[19] "Subprime Refinancings with B of A, Citi Funding," *American Banker*, April 12, 2007, page 3.

demonstrated by the market's reaction to certain extreme state anti-predatory lending laws that have not worked as anticipated. Whereas proponents of assignee liability theorize about possible benefits, this harm we describe is neither theoretical nor unprecedented.[20]

For example, one of the most poorly crafted of the state anti-predatory lending laws is the Georgia Fair Lending Act[21] ("GAFLA"), which stands as a prime example of how good intentions can go awry. When GAFLA was first enacted on October 1, 2002, it became the most stringent—but also the most damaging to legitimate subprime borrowers—anti-predatory lending law on the books. GAFLA had a complicated three-tiered loan classification system; its various prohibitions applied to "home loans," "covered loans," and "high cost loans." The definition of "points and fees" was unique and difficult to apply in practice. Most significantly, like HOEPA, GAFLA provided that, notwithstanding any other provision of law, any person who purchased or was otherwise assigned a high-cost home loan was subject to all affirmative claims and any defenses with respect to the loan that the borrower could assert against the original creditor or creditors of the loan. This expansive assignee liability was not capped or limited to individual actions.

In response to the onerous statute and its unquantifiable risks, many lenders refused to purchase or otherwise finance any Georgia loans, which dramatically reduced the liquidity of the state's mortgage markets and the availability of loans for subprime borrowers. All three of the major ratings agencies—Standard & Poor's, Fitch Ratings and Moody's—announced that they could not rate any structured finance transactions containing *any* loans subject to GAFLA. As a result of the reaction of the secondary market and its implications for mortgage origination, Georgia was forced to amend GAFLA to remove several of its worst provisions.

This pattern has been repeated in numerous jurisdictions around the country that have overreached in their efforts to manipulate the secondary market. The most recent example is Providence, Rhode Island, which rescinded an anti-predatory lending ordinance with extremely broad potential application only weeks after it had been enacted. New Jersey promulgated a statute originally very similar to GAFLA that also had to be rewritten after numerous lenders and investors were forced to stop doing business in the state. In Ohio, new lending standards issued by the state Attorney General have had the unintended effect of reducing the origination of certain subprime loans that can benefit self-employed borrowers with seasonal or irregular income.

Imposition of liability on the secondary market for origination practices is an effort to turn the secondary market into the policeman of loan originators. That is not the proper role of

[20] As an initial matter there is uncertainty and attendant risk due to fluid and imprecise definitions of "predatory lending" in most of the problematic statutes. This makes it difficult, if not impossible, to predict accurately when liability might attach. As a general matter, the "predatory lending" measures have tended to include the origination of loans or the maintenance of lending practices that have been deemed, as a matter of applicable law and regulation, to be unfair, inappropriate or unconscionable either on their face or for specific types of borrowers or specific types of borrowers in certain situations. Efforts to be more specific have focused on loan terms or lending practices such as points and fees or interest rates above a certain threshold or trigger, prepayment penalties, "packing" of fees in the amounts financed, mandatory arbitration clauses, balloon payments, negative amortization, the frequent refinancing of a loan without tangible net benefit to the borrower, and making loans to borrowers without regard to their ability to repay their loans. However, attempts to create more bright-line standards necessarily injected some measure of arbitrariness into the definition as policymakers attempted to meet conflicting goals of establishing specific triggers while preserving sufficient flexibility to address evolving circumstances and not harm deserving borrowers.

[21] Ga. Stat. Ann. § 7-6A-1 *et seq.*

the secondary market, and investors and other market participants are not suited to enforce laws that apply to originators. The law does not impose liability on purchasers of stock for corporate misconduct. It is literally impossible to ask that aggregators of loans in the secondary market be responsible for every telephone call, in person conversation or conveyance of written communication that mortgage brokers have with millions of borrowers. Similarly, it is unreasonable to impose a duty—with attendant liability—on secondary market participants to ensure that a mortgage loan meets subjective standards of appropriateness for an individual borrower, such as whether the loan confers a "net tangible benefit." The cost of policing compliance with numerous existing state anti-predatory laws in every detail cannot be shifted to the secondary market without significant and deleterious effects on the provision of capital. The secondary market is not involved in the face-to-face negotiation of credit and is not structurally an efficient arena in which to focus enforcement actions.[22]

The patchwork of inconsistent and poorly drafted state and local laws significantly increases compliance, inhibiting the purchase of mortgages on a uniform basis and artificially restricting the flow of capital. Mortgages in states with laws that impose unquantifiable assignee liability or vague standards that cannot be conclusively complied with will be excluded from purchase by secondary market participants or sold only at significant discounts, ultimately harming the very consumers these well-intentioned laws were designed to protect. If similar concepts were enacted on a national level there would be a significant contraction of mortgage credit generally and a proportionately large increase of unintended effects to deserving buyers.

The public policy challenge is to strike the balance between counteracting predatory mortgage lending practices and ensuring the flow of credit to borrowers who cannot obtain loans in the prime market. In large part that balance already has been struck. Laws already exist and impose stringent penalties on unscrupulous parties who engage in fraud and prey on the financially unsophisticated. Likewise, there are substantial civil and criminal sanctions against loan originators and loan brokers contained in the Home Ownership and Equity Protection Act of 1994. In addition, regulators recently have proposed significantly enhanced regulatory guidance designed to ensure appropriate lending standards are applied across the subprime market. Significantly, the market has also reacted swiftly to unanticipated losses and the proposed regulatory guidance. For example, according to the Federal Reserve's most recent survey of senior bank loan officers released in January, over 18 percent of domestic banks reported having tightened mortgage lending standards in the fourth quarter of 2006, the highest net fraction posted since the early 1990s.[23] In contrast, in the same survey reports released in April and July 2006, 10 percent of banks in each quarter reported easing mortgage lending standards. Moreover significant closure and bankruptcies of subprime originators attest to the sharp curtailment of credit to subprime borrowers. All of these legislative, regulatory and market forces represent significant available avenues to address the issues now visible in the subprime housing market without unduly constraining the flow of mortgages to buyers who can afford their mortgage payments if given the opportunity.

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[22] Creating liability for a downstream purchaser of a mortgage that was not directly involved in or in control of the circumstances surrounding the origination of that loan means the liability is neither manageable nor quantifiable. This again places an undue burden on secondary market participants that will almost certainly limit and disrupt the flow of legitimate credit, dramatically increase costs and potentially add a new layer of fees to deserving borrowers and historically underserved communities.

[23] Board of Governors of the Federal Reserve System, *The January 2007 Senior Loan Officer Opinion Survey on Bank Lending Practices*, table 11.

Governmentally Mandated Forbearance

Governmental mandates to modify the terms of mortgages after sale would also unfairly penalize innocent classes of investors who advanced money on the assumption that the contracts would be honored according to their original terms. Those terms reflect a negotiated and carefully balanced allocation of mortgage credit risk among transaction participants. Most nonprime securitization transactions include provisions that permit some flexibility to modify loans where a default has occurred or is reasonably foreseeable, and economic incentives are in place to ensure loan servicers use that flexibility. Altering reasonable expectations of investors regarding the operation of contracts associated with their investment would reduce dramatically the supply of capital to the mortgage market.

The various classes of investors in an MBS pool often are in a zero-sum relationship with one another in that what benefits one class will harm another. For example, the timing of principal payments, if accelerated, may be beneficial to certain principal-only classes and harmful to other interest-only classes. Investors who assumed that losses, if they occur, would be handled in one way may have hedge costs and even tax effects if those losses were handled another way. There are also potentially negative dynamic consequences to waiving defaults or altering standardized collection procedures. If servicers are unconditionally required to grant waivers of contract terms to mortgage holders, assuming they are free to do so under their particular securitization documents, it may provide incentives for others that are not in genuine distress to claim similar benefits. Individual review is also necessary to ensure that the proper course of forbearance is followed; one-size-fits-all mandates will not create the best outcome for a unique borrower. Imposing unforeseeable costs on the market would undermine the certainty required by investors and make future investments in mortgages both less available and more costly to obtain.

Recommendations

Many Americans have already obtained home purchase and home equity loans that would have been denied but for the capital provided by the secondary mortgage market. It is important to bear in mind that if a mortgage lender funds a mortgage loan to a subprime borrower and that loan defaults, this is not, absent fraud, "predatory lending." In fact, there are broad incentives for secondary market participants to avoid foreclosure; indeed, foreclosure is expensive, cumbersome and time consuming. On a broader scale, loan defaults do not indicate that a systemic market problem exists for which a legislative response is needed.

Flexible and adaptable underwriting standards are essential to ensuring that the overwhelming majority of borrowers who never experience foreclosure are able to obtain mortgage loans that meet their particular economic needs and circumstances. A zero-loss standard would shut off access to credit for the most vulnerable homebuyers, including some minorities, entrepreneurs, artists, or those with volatile earnings or a history of credit problems. Arguably objective measures such as income tests and other rigid standards could very well expose lenders to claims of discrimination under established laws such as the Fair Housing Act and the Equal Credit Opportunity Act that are intended to protect minorities' access to credit. Imposing vague and subjective standards like a duty of "suitability" would make the participation of secondary market investors in the nonprime mortgage market almost impossible, to the extent that those downstream investors were held liable for post-hoc determinations that certain mortgage loans were "unsuitable" or "inappropriate" for particular borrowers.

Market incentives and mechanisms are already operating to tighten underwriting standards. Secondary market participants do have strong economic and commercial incentives to minimize foreclosures and losses. The secondary market recognizes that it has a responsibility to assist in developing solutions to abusive and predatory lending. To that end, we recommend several steps that should be taken and express concern over potential actions that should not be taken in order to improve the provision of credit to subprime borrowers and maintain the health of the market.

Consumer Education and Disclosure

Instead of onerous laws that impose unnecessary risks on secondary market participants, the better course is to provide robust opportunities for consumer education and credit counseling to allow borrowers to select the products they need. Consumer education should be supplemented by uniform and meaningful mortgage disclosures that effectively inform consumers of the risks that they assume when taking out a particular mortgage loan. Not only will consumer education and disclosure uniformity assist borrowers in making informed choices, they will also promote greater transparency for a liquid and flexible market that enables lenders and investors to meet the needs of homebuyers responsibly.

Robust Enforcement of Existing Law

Federal, state, and local agencies should vigorously oversee and enforce existing law and regulation at the point where mortgage fraud and abuse take place - the origination process. There is also a need for consistent and comprehensive enforcement of laws applicable to mortgage brokers, appraisers and others involved in loan origination. Also, better information sharing and centralized databases would help identify bad actors. Secondary market participants already utilize robust quality control procedures consistent with due diligence and risk management business practices to screen nonprime originators and loans. Consistent and reliable access to information would enable the secondary market to improve this diligence and control procedures and further discourage predatory lending practices.

In addition, existing and proposed regulatory principals continue to exert a significant and positive effect on new originations. On September 29, 2006, the federal banking regulators jointly issued final *Interagency Guidance on Nontraditional Mortgage Products* (the "*Guidance*").[24] On November 14, 2006, the Conference of State Bank Supervisors ("CSBS") and the American Association of Residential Mortgage Regulators ("AARMR"), in an effort to provide analogous model state guidance, followed the regulators' suit by issuing *Guidance on Nontraditional Mortgage Risk* (the "*State Guidance*").[25] More than half the states have adopted the *State Guidance* in its entirety. In addition, on March 8th federal bank regulators issued for comment a proposed *Statement on Subprime Mortgage Lending* (the "*Statement*") that addresses certain risks and issues relating to subprime mortgage lending practices, including adjustable-rate mortgages ("ARMs") such as 2/28 and 3/27 loans.[26] If adopted, the *Statement* will complement the *Guidance*, which does not specifically address amortizing ARM products.

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[24] 71 Fed. Reg. 58,609 (Oct. 4, 2006).

[25] CSBS & AARMR, *Guidance on Nontraditional Mortgage Risks* (Nov. 14, 2006).

[26] 72 Fed. Reg. 10,533 (Mar. 8, 2007).

SIMFA supports many of the principals contained in the *Guidance*, the *State Guidance* and *the Statement.* Collectively, they reflect regulators' responses to concerns that borrowers, particularly non-prime borrowers, may not fully appreciate the risks and consequences of obtaining nontraditional mortgages, including ARM products. Moreover, the collective guidance sets forth both recommended underwriting criteria and factors, including payment shock, that lenders should generally consider in making such loans and recommended marketing and borrower disclosure practices to which lenders should adhere. Many lenders have already taken substantial steps to comply with the *Guidance* and *State Guidance* and most likely will take similar steps to comply with the *Statement* once it is finalized and its details satisfactorily worked out in consultation with the industry.

We believe examination scrutiny and investigation by the host of experienced and dedicated federal and state regulators regarding the underwriting and marketing of nontraditional and non-prime mortgage loans, and, when appropriate, federal and state law enforcement activity with respect to particular lenders' or lending activity will curb the vast majority of non-prime lending abuses and should ameliorate rising delinquency rates prospectively. State and federal regulators and law enforcement are responding vigorously to various issues regarding non-prime lenders that have made headlines recently to protect borrowers and address potential improper or unscrupulous activities.

Allow the Market's Response to Continue to Work

The industry reaction to losses has been swift and effective in curtailing many of the practices that led to the poor performance now visible in the originations of 2005 and 2006. Underwriting standards have been tightened and the effect can be seen in the high number of sub-prime mortgage brokers and originators that are exiting the business. Portfolios are being scrutinized heavily and professionally at even higher levels as the attributes of the loans that suffered early payment defaults are becoming well known. Tightening credit too much at this time runs the risk not only of denying future borrowers credit, but making it almost impossible for those borrowers who are about to suffer rate shock to obtain reasonable re-financings of their mortgages when their rates reset. Overly broad legislation could exacerbate the already significant stress in the subprime market.

Fair, Objective Standards

Imposing any subjective standards on the mortgage process will create tremendous problems for the mortgage and securitization industries, as well as for borrowers. Without intending to exclude, much less endorse, other vague or ambiguous criteria, we do express particular concern about the inherently subjective "suitability" duty that some have advocated. Lenders are likely to restrict the provision of credit under such a standard, and will struggle with how to reconcile it with existing fair lending laws that encourage them to make loans to members of protected classes who arguably are "unsuitable" for certain loan products. Lenders also will face the risk that, even when they act appropriately, borrowers in default or foreclosure will claim their loan was "unsuitable." A suitability standard, thus, will breed uncertainty for lenders and, in turn, secondary market investors who are not present for the innumerable phone calls, meetings and distributions of loan materials that occur throughout the country as individuals decide on which mortgage option to pursue.

The ASF and SIFMA support the adoption of uniform national lending standards applicable to lenders and brokers that are clear and objective without imposing any undue restrictions on the secondary market. To achieve a net benefit for non-prime borrowers, such standards must be national in scope and include broad preemption of state and local laws in light of today's national mortgage and secondary mortgage markets. A uniform, national standard will promote competition and market efficiencies, and will reduce the cost of mortgages.

In drafting national standards, Congress should promote risk-based pricing, avoid excessive restrictions on mortgage products or financial vehicles, avoid any suitability standard, and enhance the regulation and oversight of mortgage brokers. National standards, moreover, must be clear and concise and not assign unquantifiable liability to the secondary market for originators' practices.

National legislation also should recognize the realities of consumer lending in open and competitive markets. Lending standards aimed solely at reducing the incidence of default and foreclosure would have much graver social consequences. Many deserving purchasers who today are granted mortgages routinely would be denied the credit they need to buy their homes. Originators must underwrite with a view to reasonable target loss ratios in order to maintain the product innovation and secondary market liquidity that, in turn, has provided so many non-prime borrowers with homes. Moreover, state and federal bank regulators are specifically charged with protecting the safety and soundness of financial institutions with respect to losses.

Conclusion

Any anti-predatory lending legislation should include a single, uniform national lending standard that contains robust consumer protections and prohibits abusive lending activities, but is mindful of the efficient market mechanisms at work and the intricacies of the secondary market. This law should preempt the confusing patchwork of state anti-predatory lending laws that increase the cost of credit for consumers and impose unnecessary risks on secondary market investors. Assignee liability should not be expanded because of its deleterious effect on the provision of credit from the secondary market to homebuyers. At the same time, federal and state regulators, along with consumer advocates and the mortgage lending industry, should work together to promote consumer education initiatives to prevent consumers from obtaining inappropriate mortgage products. Uniform and simplified disclosures should be issued at the federal and state levels to clearly inform consumers of both their rights and responsibilities. At the same time, the origination process should be more consistently and transparently regulated to allow the secondary market to enhance its already robust due diligence and quality control procedures. Taking these steps will help curtail abusive lending practices while preserving the free flow of capital that has enabled the growth of the mortgage market.

STATEMENT OF BRIAN D. MONTGOMERY

Assistant Secretary for Housing – Federal Housing Commissioner
U.S. Department of Housing and Urban Development

Hearing before the House Committee on Financial Services

United States House of Representatives

"POSSIBLE RESPONSES TO RISING MORTGAGE FORECLOSURES"

APRIL 17, 2007

Good morning Chairman Frank, Ranking Member Bachus, and distinguished members of the Committee. I want to thank you for the opportunity to speak today first about the reasons for the surge in mortgage foreclosures, specifically in the subprime arena, and then on potential ways that FHA can work to curtail a number of potential future foreclosures.

As you know FHA's purpose is to serve low to moderate income homebuyers, including those who have less-than-perfect credit and little savings for a downpayment. We do this by offering mortgage insurance to qualifying borrowers that can illustrate the ability to repay the loan as well as insurance premiums in a timely manner. Knowing that the loan is backed by the full faith and credit of the U.S. government, lenders are able to offer homebuyers a loan at a prime interest rate.

I would like to clarify for the record that FHA does not insure subprime loans. FHA requires borrowers to meet strict underwriting criteria, including that they must document income, not just state it. Also, unlike most subprime mortgages, FHA does not offer teaser rates or prepayment penalties. And if borrowers do get in over their heads, if they lose their job, or become ill, or have other life events that prevent them from keeping current on their mortgage, we have one of the best loss mitigation programs. Last year we assisted 75,000 FHA-insured families by preventing foreclosure through our loss mitigation program.

FHA goes the extra yard to keep homeowners in their homes. We not only want to get them into a home but we also want them to fulfill the American dream by remaining in their homes. We fully recognize the crippling effect foreclosure has on homeowners, communities, lending institutions and real estate investors.

It is best for everyone involved that the borrower never be threatened by foreclosure in the first place. This brings me to the importance of another consumer protection tool we support, housing counseling. HUD's Housing Counseling Program supports a nationwide network of approximately 2,300 housing counseling agencies. In Fiscal Year 2006, these agencies provided critical advice and guidance to over 1.6 million households.

An increase in funding for the Program, for which $41.58 million was appropriated for Fiscal Year 2007, allows us to deliver quality housing counseling to thousands of households facing mortgage delinquency and foreclosure, making available to them aggressive loss mitigation, lender advocacy, and other tools and strategies to help them modify their loans, refinance, or otherwise escape the high interest rates, hidden costs, and prepayment penalties to name a few.

The rise in subprime foreclosures is far from a surprise to most people in this room. At my confirmation hearing before the Senate Committee on Banking, Housing and Urban Affairs in May of 2005, I mentioned that I thought many subprime borrowers would have been, and could be, better served by FHA.

I do not mean to infer that all subprime lending is harmful. The subprime market served many borrowers very well, and in many cases this option was the only way for them to achieve homeownership. I remember reading a great quote on this subject by Alan Greenspan from a 1997 speech: "So while we should applaud the "democratization" of our credit markets over the years, we must be vigilant to the risks of excess, both by lenders and by consumers."

There have been excesses by both lenders and consumers. While I recognize that even one foreclosure still hurts families, the number of borrowers that were not well served by subprime lenders is not at catastrophic levels. MBA estimates that subprime borrowers make up only fourteen percent of all home mortgages, and of those mortgages only thirteen percent are experiencing delinquencies.

Still with the Center for Responsible Lending estimating that by the end of 2006, 2.2 million households in the subprime market will have lost their homes to foreclosure or hold subprime mortgages that will fail over the next several years; we recognize the need to reach out to subprime borrowers.

My single-family team proposed procedural and process improvements that were well received by our industry partners, but they were not enough. That is when we decided to push for real change – to modernize the FHA.

In recent years, as the subprime industry grew significantly, this Committee was well ahead of the curve in understanding the role a modernized FHA could play in offering those same homebuyers a safer, more affordable financing option than subprime loans. Your leadership on this issue was well received when H.R. 5121, the FHA Modernization Act, passed the House 415 – 7.

Under the modernization proposal FHA would be given the expanded authority, to charge insurance premiums commensurate with risk, and to increase maximum loan amounts. This would allow us to "dive deeper" into the pool of homeowners who could benefit from a refinancing of their subprime loan. Modernizing FHA is the most practical and immediate way to address the needs of a large number of troubled subprime borrowers. FHA modernization legislation has already been filed in both the House and in the Senate.

With expanded authority to set insurance premiums commensurate with risk, FHA could potentially assist tens of thousands more borrowers who need an exit strategy from their subprime mortgages. Under today's restricted premium limits and maximum loan amounts, FHA simply cannot reach these borrowers who need the safety that FHA can provide. The broadest group of subprime borrowers needing to refinance is beyond FHA's ability to serve in a sound manner.

Subprime borrowers are paying interest rates up to 10 percent or more. Refinancing into an FHA-insured mortgage can, on a $200,000 mortgage, save a

qualifying borrower $3,000 to $4,000 in the first year. Thus, FHA could save borrowers substantial money and do so in a financially sound manner.

I am pleased to report that there are actually an increasing number of conventional borrowers who are currently refinancing into FHA. In today's market environment, it is safe to say that a significant portion of these loans are subprime. For the first five months of FY2007, conventional-to-FHA refinancings were up 94 percent from the same period in FY 2006. If this current trend continues, FHA will endorse over 100,000 conventional-to-FHA refinancings in FY2007. That compares with a previous peak of 64,474 in FY2002.

In efforts to assist more subprime to FHA refinances, we have been working hard on outreach. We began this type of outreach as early as October of last year. We have conducted hundreds of meetings nationwide with groups of housing counseling agencies, lenders and realtors to promote the refinancing through FHA of subprime and other high cost loans, particularly loans which are due to reset.

We have reached out to State agencies in Ohio, Pennsylvania, West Virginia and Maryland, as well as county agencies and local coalitions to create partnerships in outreach and to secure funding to "fill the gap" that exists in some instances between maximum FHA eligible mortgages and the costs to refinance a subprime loan. Our efforts at reaching out to our industry partners and ultimately to borrowers continues and remains strong.

While FHA as it stands today is witnessing an upward trend of refinances by likely subprime borrowers, and our outreach efforts are moving forward, we are still considering some programmatic changes to assist more subprime borrowers in trouble.

FHA recognizes that many subprime borrowers have mortgage debt that far exceeds the value of their homes. Being financially "upside down" in their homes can result from factors such as their inability to make the increased monthly payments after the mortgage interest resets or depreciation in the value of their home.

In addition, one factor that may prohibit many of these borrowers from refinancing out of their subprime mortgage is the cost of the prepayment penalty, a common feature of subprime loans.

Staff has been analyzing our ability to restructure our underwriting guidelines to serve more of the troubled subprime borrower pool. Keep in mind that while we would like to stabilize the mortgages of as many homeowners as possible, I have to protect the solvency of the FHA Insurance Fund, so there will be a limit to what we can accomplish.

FHA can help those who:

1.) Can afford payments on a fixed-rate loan at a market rate of interest, with FHA insurance premiums;

2.) Have a property with sufficient equity to qualify for FHA financing;

3.) Can meet other standard underwriting criteria that balance the overall risk of the mortgage; and

4.) Are owner-occupiers.

FHA more than likely cannot and should not try to help those subprime borrowers who:

1.) Took out subprime loans because of an inability to document income and assets;

2.) Are involved in speculative investments;

3.) Who have accumulated other debts that make it impossible to sustain their current property with a new fixed-rate loan with current income, or who lack sufficient positive equity in their homes.

I want to restate, we would like to help as many subprime borrowers as possible. I am very proud of the efforts HUD staff across the country have made to get the word out that FHA can help and is helping.

In closing, I would again like to thank this Committee for inviting me here today. I would also like to thank you for your leadership, and understanding of the need for FHA to be modernized to help low and moderate income families achieve the dream of homeownership – and to stay in it. Thank you.

Testimony of Daniel H. Mudd
President and Chief Executive Officer, Fannie Mae
Committee on Financial Services
United States House of Representatives
April 17, 2007

Thank you, Chairman Frank, Ranking Member Bachus, and members of the Committee for inviting me to this hearing on solutions to the subprime market turmoil. Fannie Mae is committed to being part of a solution that keeps people in homes, minimizes market disruption and improves practices and products for consumers. Congress chartered our company for times like these, to provide liquidity to the mortgage market in the bad times as well as the good. Today, a critical segment of the mortgage market and the families who depend on it need the kind of help we can provide. And we are going to help through a broad initiative we call "HomeStay."

Fannie Mae has a history of working with lenders to serve families who don't have perfect financial profiles. "Subprime" is, after all, simply the description of a borrower who doesn't have perfect credit. We see it as part of our mission and our charter to make safe mortgages available to people who don't have perfect credit. In the past several years, for example, we have designed mortgage options to give borrowers with blemished credit access to high-quality, low-cost, non-predatory loans. We also set conservative underwriting standards for loans we finance to ensure the homebuyers can afford their loans over the long term. We sought to bring the standards we apply to the prime space to the subprime market with our industry partners primarily to expand our services to underserved families.

Unfortunately, Fannie Mae-quality, safe loans in the subprime market did not become the standard, and the lending market moved away from us. Borrowers were offered a range of loans that layered teaser rates, interest-only, negative amortization and payment options and low-documentation requirements on top of floating-rate loans. In early 2005 we began sounding our concerns about this "layered-risk" lending. For example, Tom Lund, the head of our single-family mortgage business, publicly stated, "One of the things we don't feel good about right now as we look into this marketplace is more homebuyers being put into programs that have more risk. Those products are for more sophisticated buyers. Does it make sense for borrowers to take on risk they may not be aware of? Are we setting them up for failure?"

As a result, we gave up significant market share to our competitors. At the same time, we continued our careful entry into the subprime market, by and large supporting lenders, products and practices that met our standards, and which helped us meet our HUD affordable housing requirements. We also applied our strict, 11-point anti-predatory lending standards to our loan purchases. Under this policy we reject, for example, loans the borrower can't afford to pay from the start … loans with excessive points or fees … loans subject to mandatory arbitration … loans with abusive prepayment penalties … or loans with single-premium credit insurance or debt cancellation insurance. And, of course, any loans that are illegal.

Today, our exposure remains relatively minimal – less than 2.5 percent of our book of business can be defined as subprime. While our disciplined approach to the subprime market has helped to protect our company, our lenders and our borrowers from the turmoil, it has also given us some room to support the market, as Congress intended us to do. We are a secondary market mortgage company – we can't solve all the problems, but we can't wash our hands of them, either.

We want subprime borrowers to have a fair shot at homeownership. We think simple, straightforward, fixed-payment mortgages generally are the best products for these borrowers.

So Fannie Mae should not walk away and say the market turmoil is not our problem. We are concerned about a liquidity crunch in the subprime segment – the risk that as the turmoil shakes out, the flow of capital to finance subprime lending could slow to a trickle. Some may ask, why would that be a problem? Don't we want to cut off financing for this segment? The answer is no – that would only make it more difficult and costly for the least fortunate borrowers who depend on this lending to finance or refinance their homes. Robert Gnaizda of the Greenlining Institute said, "[A]rbitrary and artificial tightening of credit … may be counterproductive – that is, it may dry up credit for members of minority groups, the poor, and the 70 percent of Americans who live from paycheck to paycheck." Economic history has a way of punishing the most vulnerable first and last – we should try to avoid that as the lasting effect of the subprime clean-up.

We should also seek to get ahead of the problem and help borrowers who are not yet in trouble. This is the more immediate problem of borrowers facing imminent "payment shock," homeowners with adjustable-rate loans that are scheduled to reset at higher rates. We want to help prevent further disruption of the subprime market, which would make it tougher for these borrowers to refinance into better, safer loans.

That is where we are concentrating our efforts today. We believe the best way to influence the subprime market, and be part of the solution, is to stay engaged and provide funding for conventional loans to these borrowers that are affordable over the long term.

Fannie Mae is committed to help through a new company initiative we call HomeStay, which has three basic parts.

First, we are working with our lender partners to help homeowners avoid immediate foreclosure. Several years ago, we created an operation at Fannie Mae that focuses solely on helping people who are falling behind on their mortgage payments to avoid default. If the mortgage is on our books, we work with our lenders or loan servicers to offer borrowers a range of workout solutions, and we offer lenders financial incentives to help borrowers avoid foreclosure. Last year alone, we worked out 27,000 loan modifications. We also provide lenders with systems that help them identify borrowers most likely to

default so they can help out early in the process. If the mortgage is not on our books, we'll refer borrowers who call us to the right place.

Second, we are working with our lender partners to help homeowners avoid payment shock, and transition to safer products. We are expanding our lending options for subprime borrowers so that lenders can help them refinance out of high-reset ARMs or other loans that are a struggle for them. Our HomeStay initiative makes these products more flexible and broadly available. It includes our usual borrower-friendly options such as low down payments; long-term, fixed rates; low fees and points; a prohibition on pre-payment penalties and a ban on arbitration clauses. Right now, on a $200,000 mortgage, the monthly payment difference from a short-reset ARM to a safer, 30-year HomeStay loan is about $90 – significant, but not insurmountable. And to help with the current market needs, we are improving this loan option so that more lenders can qualify more borrowers for it. Briefly:

- We are adjusting our credit requirements so that more people can qualify. Essentially, homeowners facing imminent payment shock will be able to refinance into our loans without first having to clear up unpaid bills on their credit reports.

- We are using our experience with blemished credit by expanding the product set from a custom option available to 500 selected lenders, to HomeStay, which will make it available to about 2,000 of our lenders nationwide.

- And we're stretching the loan term from the maximum 30 years to 40 years. This will shave the monthly payment by about 5 percent, and it will allow many more borrowers to qualify.

Our message to lenders with borrowers facing resetting ARMs is this, "If your homeowner has managed his credit over the past 12 months, there's a good chance Fannie Mae can help."

Right now, we're getting at least 15,000 applications for subprime refinancing coming into our system per month. Because we have been adhering to our own prudent standards throughout, even before our new enhancements, 80 percent got a "yes." Altogether, we estimate that about 1.5 million homeowners who face resetting ARMs and potential payment shock this year and next could be eligible for our loan options. Certainly, lenders may choose someone else to buy or securitize the loans, but 1.5 million would be eligible for our options; we think this will also help establish a benchmark in the market for safe loans. These are also good alternatives for first-time homebuyers as the riskier "affordability" loans dry up.

Third, we are working with our housing partners to help counsel future homeowners. We are focusing especially on those who are most vulnerable, or for those whom a product modification alone will not save the day. We have to help people know what to do well before payment shock hits, and to avoid making the wrong mortgage choice in the first place.

- For example, we are providing $5 million in grants this year alone to support a national foreclosure prevention initiative being managed by NeighborWorks of America and the Homeownership Preservation Foundation. Such nonprofit organizations join with local governments, other nonprofit organizations, borrowers and lenders to help families overcome obstacles that could result in the loss of their homes.

- We also are launching a "Know Your Mortgage" effort, providing lenders with fact sheets with easy-to-understand descriptions of mortgage terms in English and Spanish for use with borrowers.

- In addition, we are expanding distribution of our Home Counselor Online system to lenders, organizations and agencies. This web-based application is designed to help people understand the home-buying process, how to protect or fix their credit, what to demand and what to avoid. We provide this system, free, to over 2,000 counseling agencies, and we'd like more to have it.

Finally, as we help the subprime market through this turmoil, Fannie Mae will continue to support better lending guidelines. When banking regulators finalize the new guidelines regarding teaser ARMs, which should be soon, we will work with our industry partners to comply with them. From the start, we said we believed the best course of action would be to follow the regulatory process to avoid further disruption of the subprime market and the borrowers who depend on it. That's what we're going to do. John Dugan, the Comptroller of the Currency, said of the proposed guidance, "We don't really want to unduly restrict credit to credit-worthy borrowers where the market is willing to extend that credit." We agree, and we stand ready and willing to extend that credit in a prudent and sustainable manner.

The actions I described today are first steps. Today and going forward, Fannie Mae can and will do more than our part to help lenders to protect homeowners, stabilize the subprime segment of the mortgage market, and keep affordable mortgage credit flowing to families who need it most. We look forward to working with this Committee and the Congress as we do.

Thank you, Chairman Frank and Ranking Member Bachus for giving me the opportunity to testify today.

Testimony of Richard F. Syron
Chairman and CEO, Freddie Mac
Committee on Financial Services
United States House of Representatives
April 17, 2007

Chairman Frank, Ranking Member Bachus, members of the Committee:

My name is Dick Syron. I am the Chairman and Chief Executive Officer of Freddie Mac. I greatly appreciate the opportunity to appear before the Committee to discuss current developments in the subprime market. I will also discuss what can be done to alleviate the circumstances of some current subprime borrowers, and to help this market transition to a safer source of mortgage financing going forward.

Freddie Mac's Role

Freddie Mac participates in the subprime market by investing in highly rated AAA bonds backed by subprime mortgages. Given our role as a government-sponsored enterprise (GSE), we chose this financing strategy as a prudent way to provide liquidity to a largely untested segment of the mortgage market. These investments also have been a critical to our ability to meet our annual affordable housing goals.

Our participation in the subprime market has been as a responsible investor – and we continue to take that role very seriously. As announced two months ago, beginning in September 2007, Freddie Mac will restrict our subprime investments in securities backed by short-term adjustable-rate mortgages (ARMs) to those that have been underwritten to a fully-indexed, fully-amortizing level. We will also significantly restrict the use of stated income in lieu of more traditional documentation standards. As an additional consumer protection, we will encourage subprime lenders to escrow borrower funds for taxes and insurance.

We are also working on a major effort to develop more consumer-friendly subprime products that will provide stable financing alternatives going forward. These offerings will include 30-year and possibly 40-year fixed-rate mortgages and ARMs with reduced margins and longer fixed-rate periods. We plan to have our new offerings in the market by mid-summer.

These efforts follow in a long leadership tradition. Since 2000, Freddie Mac has taken unilateral, voluntary leadership positions that have helped improve subprime market practices. These include our bans on single-premium credit life insurance, prepayment penalties greater than three years, and mortgages with mandatory arbitration contracts, and our insistence on regular credit reporting. These requirements apply to all our mortgage purchase and investment activities. As I will describe later in this testimony, some initiatives have been followed by other market participants, others not. To the degree other market participants do not follow our lead, our ability to positively influence

this market is limited.

In addition to helping set standards for sound mortgage lending, Freddie Mac also strives to help borrowers make good mortgage choices. Our Don't Borrow Trouble® consumer awareness campaign helps consumers avoid predatory lending practices, such as being charged excessive points and fees, or becoming a victim of deceitful lending practices.[1] Since 2000, we have conducted Don't Borrow Trouble campaigns in almost 50 cities and states throughout the country. These campaigns have helped inform more than 100,000 consumers across the U.S. about how to avoid predatory lending practices.

Another way we assist consumers is through our suite of multilingual credit education curriculum, CreditSmart®, CreditSmart® Espanol and CreditSmart® Asian. These programs are designed to give consumers information on establishing and maintaining good credit, the steps to homeownership, avoiding credit traps, and the benefits and responsibilities of owning a home. Freddie Mac believes that by educating consumers about smart credit habits and helping them understand the importance of obtaining and maintaining good credit, we can empower them with the skills and information necessary to achieving – and maintaining – homeownership.[2]

How We Got Here

To help understand the issue before the Committee today, it may be helpful to consider the underlying economics of what's been happening in the subprime segment of the mortgage market. Over the past decade, subprime has experienced a profound transformation in size, investor interest and mortgage type.

Using the tools of securitization and automated systems pioneered in the prime mortgage market, Wall Street and the global capital markets transformed subprime from a relatively small portfolio-based market that specialized in debt-consolidation refinances for credit impaired borrowers into a major market segment.[3] Representing about 15 percent of all single-family debt outstanding, today's subprime market provides home purchase mortgages as well as refinances to a much wider set of borrowers, including those with limited equity in their homes.

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[1] The City of Boston and the Massachusetts Community & Banking Council (MCBC) developed the original Don't Borrow Trouble campaign in 1999, which Freddie Mac later expanded nationwide. Boston's multi-faceted program reaches out to consumers through subway ads, television and radio commercials and direct mailings that direct consumers with questions to call the Boston Home Center. Consumers receive assistance depending on their problem, from homebuyer education to credit counseling to legal assistance if they are already in a predatory loan situation.

[2] See http://www.dontborrowtrouble.com/ and http://www.freddiemac.com/creditsmart/.

[3] The Federal Reserve has estimated that there was $10.2 trillion in single-family mortgage debt outstanding at the end of 2006 (*Flow of Funds Accounts of the United States*, March 8, 2007); typical estimates are that 15 percent of debt is subprime, or approximately $1.5 trillion.

In my view, three factors explain subprime's rapid growth and transformation: abundant liquidity flowing into the U.S. housing market from both domestic and international sources; a sustained period of low interest rates and relative prosperity, evidenced by sharply rising property values in many parts of the country; and an active desire on all our parts to expand homeownership to a broader segment of the U.S. population.

In response to the run-up in house-price inflation, many subprime borrowers sought mortgage products that lowered monthly payments, at least initially, to more affordable levels. Short-term hybrid ARMs, with lower initial rates, met this need. As long as house values continued to rise, equity was building up and the substantial transactions costs associated with refinancing to avoid the margin step-up could be absorbed.

On the supply side of the transaction, global liquidity drove investors to search for high-yielding instruments. One place they found more attractive risk returns was in the subprime market. To manage the higher risks inherent in these mortgages, structured subprime securities and derivatives were developed that diffuse these risks to an increasingly large and global investor base.

The confluence of strong borrower demand for low-payment mortgages and nearly insatiable investor appetite for yield fueled the origination of subprime mortgages, particularly 2/28 and 3/27 hybrid ARMs. Until recently, this set of economic factors had mutually beneficial effects. In a world of low mortgage interest rates and rising home prices, many homeowners using these products fared well.

Over time, however, intense competition in the lending market led to a relaxation of underwriting standards, such as the increased use of allowing borrowers to simply state their income on the mortgage application rather than following more traditional practices of verifying income and employment. There also were higher incidences of fraudulently inflated appraisals.

Today, the combination of rising short-term interest rates, softening house prices and lax underwriting has made these mortgages much more onerous for many borrowers. In what we believe to be the fastest downturn in housing markets in a long time, subprime loans originated in 2006 are performing far worse than prior years' originations. [4]

What's To Be Done?

Talk of market dynamics does little to allay concerns about the effects of rising foreclosures on borrowers and communities. Freddie Mac shares the Committee's deep

[4] "Early Defaults Rise in Mortgage Securitizations," Moody's Investors Service Structured Finance Special Report, January 18, 2007; and LoanPerformance, a subsidiary of First American Real Estate Solutions, TrueStandings Securities.

concern that many subprime borrowers may find themselves unable to refinance out of mortgage products that have become extremely burdensome in the current environment. We are particularly concerned that low- and moderate-income and minority families may be disproportionately hurt by the rising levels of subprime foreclosures, and that some communities with high concentrations of these mortgages will be seriously affected. We estimate that these borrowers account for roughly one-half of all subprime borrowers. In our view, these borrowers should be the focus of efforts to mitigate the effects of rising foreclosures.

To address the needs of this market going forward, Freddie Mac is working diligently with our customers to develop new products that provide more stable subprime financing. In addition to offering traditional long-term fixed-rate loans, we expect to offer ARMs of five years or more with margins at adjustment that are as much as 200 basis points below the current step-up.

To meet more immediate needs, we are considering modifications to our existing Home Possible® mortgage offering. Home Possible was designed to support our affordable housing goal requirements by targeting low- and moderate-income borrowers. It allows very high loan-to-value ratio loans to borrowers with less than stellar credit and who may be more highly financially extended relative to their income. These characteristics overlap with those in the subprime market, providing viable upstreaming opportunities for some segment of subprime borrowers.[5]

Forbearance, including loan modification of an existing mortgage, is another option. However, forbearance will be particularly challenging in subprime because of the increased use of structured securities. The terms of these securities are spelled out in legal contracts entered into by a multitude of investors worldwide. Under these agreements, servicers may choose to offer forbearance on a loan-by-loan basis in the case of default - or imminent default. However, forbearance and modification is a complicated process, and is only used to the extent that servicers believe forbearance will reduce the expected level of loss to the securities investors.

While these efforts will help cushion the expected rise in foreclosures, we need to be clear that these approaches will not provide the widespread panacea some are looking for. Many of the defaults we are seeing today are not the result of big adjustments at the two-year mark. Instead, many are occurring in the first few months after the loan was

[5] To be sure, prime products such as Freddie Mac's Home Possible represent limited solutions to the problems facing some subprime borrowers. Although Home Possible has been available in the market for a number of years, it has often not been the product of choice because it requires borrowers to provide documentation that allows an underwriter to verify the borrowers capacity to repay the mortgage. As a result, borrowers who may have misrepresented their income or assets may be unable to qualify for the tighter underwriting and documentation needed to refinance into more traditional mortgage products. In addition, it is important to realize that consumer-friendly products such as Home Possible have expected foreclosure rates that are significantly above those of standard prime loans.

originated – at the lower "teaser" interest rate. This suggests that many subprime borrowers have mortgages that should not have been made in the first place, at any price.

As we consider possible policy solutions, I would offer a few thoughts.

First, we would call on regulators and policymakers to agree on acceptable standards for disclosure, underwriting and performance that support sustainable homeownership for future subprime borrowers. While there is relatively little we can do about global capital flows and changes in interest rates, there is a place for measured regulation that protects borrowers from sharp downturns in housing and mortgage markets. Securitization may have made it possible to extend credit to virtually everyone at a price and "commoditize" mortgages like widgets, but the devastating effects of foreclosure on individuals and communities remain very real, personal and deep.

To prevent this type of situation from recurring, policymakers and regulators could play an important role in three key areas:

- Ensuring that all parties to the mortgage transactions have full and complete information. In this regard, the current focus on assuring adequate consumer disclosure is extremely important. For this to have benefit, however, new disclosures must be uniformly and consistently applied.

- Setting prudent limits on the socially acceptable level of defaults. A version of "Gresham's Law" clearly has been at work in subprime, that is, easy credit drives out prudent credit. To avoid the devastating effects of unacceptably high foreclosures, we need to set some limit on the level of risk we are willing, as a nation, to take in order to promote higher levels of homeownership.

- Ensuring a level playing field. As long as some institutions operate under different, or no, regulatory strictures, potential for these sorts of excesses and abuses will exist. As previously stated, Freddie Mac has a long history of voluntarily setting standards of prudent underwriting and of promoting greater borrower protections in subprime. However, we have to be realistic about our ability to influence lending practices in this market. Our share has declined significantly over the past four years as new investors who did not adopt our lending requirements entered the market. Relying solely on the GSEs will be ineffective because non-GSE investors account for the vast majority of subprime mortgages that have been securitized.

Second, we should carefully distinguish between those borrowers who can be "rescued" and those who cannot. I realize such a triage will not be easy or popular, but policy prescriptions such as widespread "bailouts" or foreclosure moratoriums should be considered only in certain extreme situations, such as in the aftermath of natural disasters. Broad application of such prescriptions could have lasting, unintended consequences that harm the housing finance system in the long term.

The entire housing finance system rests on the integrity and dependability of mortgage contracts between borrower and lender. Consumers need to have confidence that they understand the implications of the mortgages they take out and are able and willing to meet their obligations. Mortgage disclosures must be understandable. Having agreed to the mortgage terms, lenders must have confidence that they can enforce the terms. In the majority of instances, foreclosure is clearly an undesirable outcome for both parties, and there are strong incentives on both sides to "work things out." At the end of the day, the ability to enforce a mortgage contract, including the use of foreclosure, is critical to continued investor confidence in the U.S. housing market.

Third, we should resist the impulse to overcorrect this market. As stated earlier, many borrowers have benefited from the innovation available in subprime. Without the ability to get a subprime mortgage, many borrowers would not be homeowners today. Helping this market transition into a more stable source of financing is a desirable objective. Already there are signs a long-overdue market correction is underway; in 2007 the highest percentage of banks reported a tightening of mortgage standards since 1991.[6]

A broader point is that since resources are limited, it will be important to accurately dimension the size of the problem. There are many estimates of the projected level of subprime foreclosures – and even most conservative ones suggest a painful correction is underway, particularly in economically distressed areas.[7] Nevertheless, speaking as an economist, the data are "noisy." For example, the Colorado Division of Housing recently reported that the increase in foreclosures in that state is about one-third as much as had been reported by a prominent mortgage researcher.[8] Further, it is important to be aware that not every foreclosure filing results in an actual foreclosure. Our experience is that more than one-half of the loans that enter foreclosure are reinstated within a year.[9]

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[6] Federal Reserve Board *Senior Loan Officer Survey*, January 2007.

[7] A recent study by The Center for Responsible Lending (CRL) projects that 2.2 million subprime borrowers will lose their home to foreclosure. See "Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners," Ellen Schloemer, Wei Li, Keith Ernst, and Kathleen Keest, CRL, December, 2006. On the other hand, a study by First American projects that 400,000 foreclosures will arise from subprime payment resets. "Mortgage Payment Reset: The Issue and the Impact," Christopher Cagan, First American CoreLogic, Inc., March 19, 2007, p. 69, Table 36.

[8] "In Brief: Colorado – Foreclosures Overstated by Some," *American Banker*, Marc Hostein, March 9, 2007. An analysis of Colorado public trustee data shows that state foreclosures rose 31 percent in 2006, compared to an 85 percent increase reported by RealtyTrac Inc.

[9] See "Innovative Servicing Technology: Smart Enough to Keep People in Their Houses?" by Amy Crews Cutts and Richard K. Green. *Building Assets, Building Credit: Creating Wealth in Low-Income Communities*, Nicolas P. Retsinas and Eric S. Belsky, eds. 2005, Washington, DC: JCHS/Brookings Press, pp. 348-377.

Summary

A combination of economic and societal factors contributed to today's rising number of subprime foreclosures. These factors include low-cost mortgage money, rising house prices, including fraudulently set appraisals, pro-homeownership policies, lax underwriting, eager investors and willing consumers.

Addressing this complex situation will require multiple approaches, including self-correcting market mechanisms, targeted forbearance and innovative risk sharing arrangements, regulatory standards uniformly and broadly applied to all market participants, and the creation of new subprime mortgage products.

To be sure, as these corrective measures begin to take effect, there will be some unfortunate tradeoffs. These could include a possible reversal in homeownership gains and further softening of house prices, particularly in hard-hit communities. Regardless of the outcome, Freddie Mac remains committed to doing our part to help families while helping stabilize markets.

* * * * *

Thank you again for the opportunity to appear before the Committee today. I look forward to your questions.

Kenneth D. Wade
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Biographical Notes

As chief executive officer of NeighborWorks America, Kenneth D. Wade oversees the multimillion-dollar grant programs and training activities that support a national network of more than 240 affordable housing and community development organizations. NeighborWorks America is a public nonprofit corporation established as the Neighborhood Reinvestment Corporation by an Act of Congress in 1978. [NeighborWorks America is the organization's trade name.]

Wade, who joined NeighborWorks America in 1990, has more than 25 years of experience in community development. He most recently served for five years as NeighborWorks America's director of national programs, initiatives, and research. In this role, Wade directed all national programmatic initiatives for NeighborWorks America, including the NeighborWorks Campaign for Home Ownership, the NeighborWorks Multifamily Initiative, the NeighborWorks Insurance Alliance, the NeighborWorks Rural Initiative, and the NeighborWorks Community Building and Organizing Initiative. Wade has overseen the development of a number of national partnerships on behalf of the NeighborWorks network. In addition, he served as the director of the NeighborWorks America New England district for eight years.

Prior to joining NeighborWorks America, Wade worked for nine years with Boston's United South End Settlements. He participated in the development of the "Community Investment Plan" in Boston established by local banks and the Community Investment Coalition in 1990. He has served on a variety of boards and committees. Currently he serves on the Fannie Mae National Housing Advisory Council, the Bank of America National Community Advisory Council, the Board of Trustees of the National Housing Conference, the Board of Overseers of the School of Community & Economic Development of Southern New Hampshire University, the board for the National Association of Affordable Housing Lenders, and the Board of Trustees for The Appraisal Foundation.

Wade studied at Springfield College and University of Massachusetts College of Public and Community Service.

Statement of

Kenneth D. Wade

CEO of Neighborhood Reinvestment Corporation
(Now *doing business as* NeighborWorks® America)

Before the

House Financial Services Committee

Hearing on Possible Responses to Rising Mortgage Foreclosures

April 17, 2007

Chairman Frank, Ranking Member Bachus and Members of the Committee, my name is Ken Wade, CEO of NeighborWorks America, and I appreciate the opportunity to talk with you today about the efforts we and our partners are making to help stem the tide of foreclosures that the people, and communities, we serve are facing.

By way of background, NeighborWorks® America was established by Congress in 1978 as the Neighborhood Reinvestment Corporation and is the original community/ public/ private partnership model, with locally-driven, highly-leveraged and efficient community development as its hallmark. Over the past 28 years, we have replicated this successful model in over 4,400 communities around the country through 236 chartered local nonprofits. NeighborWorks® organizations operate in all 50 states, the District of Columbia and Puerto Rico; in America's urban, suburban and rural communities.

The mission of NeighborWorks America is to expand opportunities for people to live in affordable homes (rental and homeownership), improve their lives and strengthen their communities.

NeighborWorks® organizations provide a wide variety of services that reflect the needs of their neighborhoods and communities, and over the past five years, with the generous support of Congress, NeighborWorks® has:

- Assisted nearly 100,000 families of modest means to become homeowners (of which, 91 percent are low-income and 53 percent are ethnic/racial minorities)
- Own and manage more than 63,500 units of affordable rental housing

- Provided homeownership education and counseling to more than 317,000 families
- Trained and certified nearly 50,000 community development practitioners from over 5,000 organizations and municipalities nationwide; and
- Facilitated the investment of nearly $9 billion in distressed communities across the country.

Today, however, my testimony will focus on our response to the precipitous rise in foreclosures. The problem of foreclosure is complex, and we don't believe any single "silver bullet" will eliminate the threat, but change is desperately needed. Given the limited time available to me, I want to focus my testimony on NeighborWorks® America's contribution to people already facing foreclosure.

First, let me point out that NeighborWorks® America, as a national public nonprofit organization working to expand affordable housing opportunities and revitalize communities, has a 30-year history of supporting lending to non-conforming borrowers – including lower income families, borrowers with impaired credit and others who would not normally qualify for a conventional mortgage. By providing quality pre-purchase housing counseling, financial fitness training and working with borrowers to improve their credit rating, local NeighborWorks® organizations are typically able to present mortgage-ready borrowers who qualify for reasonably priced traditional mortgage loans and achieve sustainable homeownership.

Our commitment to quality homeownership education and counseling extends to the industry at large. In May, national standards for homeownership educators and counselors will be announced by a consortium of nonprofit and industry partners including NeighborWorks America. These standards will create a level of consistency in the industry, add to the professionalism of housing counselors and homeownership educators and allow organizations and homeownership professionals to demonstrate that all families counseled will receive a consistent level of quality service.

From our experience, we know that the best defense against delinquency and foreclosure is objective education and advice before the borrower begins shopping for a home and selecting a mortgage product. And the best home buyer counseling is provided through objective, well-trained non-profit agencies (including local NeighborWorks® organizations and other HUD-approved nonprofit housing counseling agencies) that put the consumers' and the communities' interest first. We also know that homeowners' odds of success are increased even further when they have access to reasonably priced sustainable mortgage products and post-purchase counseling and homeowner education.

NeighborWorks® America has been tracking the loan performance of the many low-income families assisted by NeighborWorks® organizations over the years, particularly with the overall rise in foreclosures in the broader marketplace. These loans continue to perform significantly better than subprime loans.

While housing counseling before the purchase of a home is definitely the best defense against foreclosure, unfortunately that advice comes too late for many families already in a problematic mortgage product or currently facing foreclosure.

NeighborWorks® America saw the problem of foreclosures coming over four years ago and, with the strong support of our Board of Directors, created the NeighborWorks® Center for Foreclosure Solutions, to preserve homeownership in the face of rising foreclosure rates.

NeighborWorks® America's foreclosure initiative was informed by "on the ground" experience and research into the causes and effects of foreclosure on individuals, families and entire communities, and is modeled on the successful trailblazing efforts of one of our local NeighborWorks® affiliates, Neighborhood Housing Services of Chicago.

Neighborhood Housing Services of Chicago noticed that while they were making strides in putting people back into the neighborhoods, other homeowners were being foreclosed on at an increasing rate. They launched the Homeownership Preservation Initiative (HOPI) to preserve sustainable homeownership for Chicago residents and to reclaim already foreclosed homes as neighborhood assets. In the first three year's of the program (from 2003 to 2006):

- More than 4,000 Chicago households were counseled;
- More than 1,300 families were able to avoid foreclosure;
- Over 330 buildings that were vacant or neglected are now homeownership opportunities; and
- An estimated $267 million in collective savings in property values, city enforcement, and property values for the City of Chicago, residents and lender partners.

It's clear that when homes go into foreclosure, it reaches far beyond the individual tragedies confronting homeowners who lose their home. Foreclosed homes quickly become a problem that can threaten entire communities. The value of surrounding homes goes down and other homeowners will have difficulty selling or refinancing their homes, leading to further disinvestment in communities. As a result, property taxes collected will be lower, affecting schools and government services, creating a downward spiral that is detrimental to the entire community.

In fact, a study in Chicago (by the Woodstock Institute) found that a single foreclosure on a given block can directly lower property values of surrounding homes by $139,000. Other studies show that one foreclosed property can end up costing a municipality as much as $30,000.

And, studies confirm that foreclosures are much more likely to occur in high minority neighborhoods, even when all other variables such as borrower credit and income are held steady. Rising foreclosure rates threaten decades of gains in minority

homeownership and community revitalization. Recent studies conducted in Atlanta, Philadelphia and Baltimore confirm that lower income, minority neighborhoods are at greater risk for concentrations of foreclosures. Rising foreclosures are also a problem in both suburban and rural parts of our nation.

For example, NeighborWorks® organizations in Montana, upstate New York, Vermont and south-eastern Ohio in the Appalachians are witnessing a troubling number of delinquent borrowers in the predominately rural communities they serve.

Indeed, foreclosures threaten to undo much of the gains community development has made. Bruce Gottschall, Executive Director of NHS of Chicago, has said, "These foreclosures could wipe out in a few years what it has taken us decades to achieve."

The NeighborWorks® Center for Foreclosure Solutions is an unprecedented partnership between the nonprofit, financial, mortgage, and insurance sectors to preserve homeownership and combat the negative impact of foreclosures on communities across the nation. As part of its efforts to assist homeowners facing foreclosure, NeighborWorks® America, in partnership with the Homeownership Preservation Foundation has established a national toll-free hotline for delinquent borrowers **(888-995-HOPE)** that is available 24/7 around the clock to provide callers with high quality telephone-based assistance (in English and in Spanish). Individuals needing more intense service than can be provided over the phone are referred to local HUD-approved housing counseling agencies. In 2006, more than 25,000 families were served through the toll-free 888-995-HOPE hotline. Over 10,000 engaged in individual, one-on-one post-purchase housing counseling, and 42 percent of the people who called in for help entered into a foreclosure avoidance workout plan.

Surveys of delinquent borrowers served by the 888-995-HOPE hotline and Neighborhood Housing Services of Chicago show that about 50 percent of delinquent borrowers had no contact with their lender or servicer prior to foreclosure.

Therefore, NeighborWorks® America in conjunction with the Homeownership Preservation Foundation is launching a public service advertising campaign supported by the Ad Council, to decrease foreclosures by directing struggling borrowers to call the 888-995-HOPE hotline. The campaign is scheduled to launch nationally in June 2007 with a special focus on areas with high rates of foreclosure. The value of donated media for a typical Ad Council campaign is around $28 million, so we anticipate that this effort will go a long way toward increasing public awareness of the 888-999-HOPE hotline.

The NeighborWorks® Center for Foreclosure Solutions is also working to:

- **Build capacity among foreclosure counselors:**
  Helping families avoid the threat of foreclosure requires skilled housing counselors across the country that support them before, during, and after the home-buying process. NeighborWorks® America has designed a professional curriculum for housing counselors – to not only help families achieve the dream of home ownership, but to be resistant to delinquency and foreclosure.

- **Research local and national trends to develop strategic solutions**
  NeighborWorks® America has researched the issue of foreclosure to obtain a clearer understanding of the causes of foreclosure, identify successful foreclosure prevention and intervention strategies, determine the significant negative effects that foreclosures have on communities, and inform cities, nonprofit organizations, and private institutions engaged in addressing a local foreclosure crisis.

  NeighborWorks® America is also working to establish a "forecasting" model that would allow us to better use our resources to get ahead of the "hot" areas that may experience significant growth in foreclosures.

- **Create sustainable foreclosure intervention programs in cities and states with high rates of foreclosure**
  NeighborWorks® America is also helping to bring together local partnerships of government and industry leaders and nonprofit counselors in foreclosure "hot spots" around the nation.

The key to helping as many people as possible through the **888-995-HOPE** hotline is to get people who are experiencing problems in paying their mortgage to call as soon as possible.

Once the call is made, service begins immediately. They are connected with a trained counselor at the outset and depending on the problems, homeowners can get budgeting help, assistance developing a written financial plan, assistance contacting their lender to discuss payment options and loan restructuring, and a referral for face-to-face counseling through local HUD-approved housing counseling agencies. Counselors are also trained to look for and respond to callers who have experienced fraud in the mortgage process with appropriate referrals to local agencies and resources.

The approach has been proven successful in helping homeowners to understand their options and identify appropriate action steps to address their financial challenges.

Additionally, nearly all major mortgage servicers improved or provided for the first time a dedicated loss mitigation "communication bridge" for 888-995-HOPE counselors' use. This information greatly improved contact rates; communication between servicer, counselor and homeowner; and understanding of each party's role.

Based on information compiled by the Homeownership Preservation Foundation as of the fourth quarter of 2006, and the feedback from the callers themselves:

- 18 percent of callers did not know what type of loan they had;
- 40 percent had a fixed rate product;
- 35 percent had an adjustable rate or interest only loan;
- 3 out of 4 households had annual income under $50,000
- 62 percent had already missed two payments before they called.

While calls came from all over the nation:

- 28 percent came from Georgia; and
- 17 percent came from Ohio,

Of course, that's reflective not only of the extent of the problem in those areas, but also the extent of publicity and news coverage the "HOPE hotline" has received in those areas.

To give you a sense of the impact that homeownership counseling is having at the human level, I've provided three brief summaries of actual people assisted.

Saving a Home: Lorraine's Story
Lorraine had lived in her home in Georgia and paid the mortgage for 18 years. When she suddenly lost her management position, she was forced to take two part-time jobs just to pay her bills. By the time she found a full-time job that paid enough, her mortgage payments were three months overdue.

Homeownership counselors provided the necessary budget counseling and support she needed to get back on track with her lender. With their assistance, Lorraine was able to set up new payment arrangements with her lender. Today, Lorraine is making timely mortgage payments once again and successfully rebuilding her finances and her credit. Most importantly, Lorraine will keep her home.

Back on Track: Veronica's Story
Veronica has lived in her home in Ohio for the past thirteen years. A child development worker, she has enjoyed raising her eight year-old-son in their own home. However, their stability was threatened in the spring of 2006, when Veronica became one of the hundreds of thousands of Americans facing foreclosure.

In March of 2006 Veronica was faced with some major car repair bills. Needing her car to get to work, she felt she had no option but to pay the burdensome bills. The large bills drained her family's finances, and she fell four months behind on her mortgage.

Veronica found NeighborWorks® and the 888-995-HOPE hotline in the phone book. She called the hotline, where a HUD-approved nonprofit counselor determined that she was a good candidate for a gap loan to help her pay back the four outstanding months and get back on track with her mortgage. The hotline put her back in touch with a local

NeighborWorks® organization, where a counselor was able to expedite a 4% interest rate catch-up loan out of their Back-on-Track pool, to be paid back over 24 months. In order to receive the loan Veronica has also enrolled in the NeighborWorks® organization's ten-hour financial fitness course.

By picking up the phone Veronica provided herself with options. Her phone call and subsequent hard work has literally saved her home. As Veronica says, "This is a great program. I was able to save the home I have lived in for thirteen years. I would recommend [calling] to anyone needing help with their mortgage. I just wish I had called them sooner."

Trapped in a High Interest Mortgage: Armand's Experience
With their own home and a very good income, Armand and his wife and their three children were living the American Dream. In an effort to pay-off old debts and pay for needed repairs on their home, this African-American couple refinanced their mortgage, but because of their old debt and other credit problems the only mortgage they could find was an adjustable-rate mortgage which reset to a rate of 10.99 percent.

Armand thought he could refinance at a lower rate once his old debt was paid off, but his poor credit status prevented that. After struggling for many months, and facing the prospect of foreclosure, Armand met with a NeighborWorks® housing counselor who helped him create a revised budget, eliminate his old debts and eventually raise his credit score from the mid-500s to over 600 (in the range required by most traditional lenders.

The NeighborWorks® counselor referred Armand to one of its lending partners to apply for a new mortgage, and the couple was able to refinance their home at a fixed interest rate of 6.375 percent – not only saving their home from foreclosure, but also providing much-needed disposable income to cover expenses for their family.

A Senior Citizen Falls Prey: Lillian's Story
When Lillian's husband died, she used most of the money she received from his life insurance policy to pay off the home they had lived in together. Although she now owned the home outright, Lillian (now a senior citizen) took out a home equity loan a few years ago to cover major repairs to the house.

Lillian soon realized that the contractor she hired to do the work had scammed her and as a result, she spent much more on the repairs than she had originally estimated. To make matters worse, Lillian had to have surgery which prevented her from working. Although she received Social Security, it was not enough to cover both her living expenses and her home equity loan.

This situation led Lillian to take on additional debt, and though she tried to keep up with her payments by making automatic payments, her account was soon overdrawn, leading to even larger debt problems.

At that point, Lillian turned to her local NeighborWorks® organization. They were able to provide her with financial fitness education and with delinquency counseling. Lillian was able to bring her loan current and is working to pay off the rest of her debts. NeighborWorks® is also helping her to find a new job that will accommodate her health challenges. Lillian is on track to become, and remain, debt-free.

Closing

[Please note that recommendations below are not necessarily the Administration's positions, and that NeighborWorks America is speaking as a public non-profit organization, as noted earlier – especially as NeighborWorks America advocates for a national housing counseling fund.]

As federal, state and local legislators, regulators and others wrestle to identify proposed actions to respond to the surge in foreclosures, I want to stress that denying credit to the type of people NeighborWorks has served for decades (lower-income, families, minorities, people with blemishes on their credit reports) is not the answer.

In my view, the real challenge continues to be how to create informed consumers and foreclosure-resistant borrowers.

In closing, let me state that from our experience, the best way to create foreclosure-resistant homeowners is through quality pre-purchase housing counseling. We challenge the real estate and mortgage industry to figure out how to make housing counseling universally available for every first time home buyer in America. Is there a homebuyer in America who should be denied a basic level of home-buyer education? Given the scale of the industry, the addition of an extremely small amount to every mortgage originated could create a national housing counseling fund to compensate counseling agencies for this essential service. An alternate approach would be to ensure that a meaningful level of housing counseling be provided to <u>any</u> borrower considering a nontraditional mortgage – such as an interest-only mortgage, a negative amortization mortgage or an option-ARM such as a 2/28 or 3/27 mortgage. It is clear that borrowers who have opted for these non-traditional mortgage products are encountering foreclosure at significantly higher rates.

NeighborWorks® America also calls for the development of a public awareness campaign to raise consumer awareness of the importance and value of pre-purchase homeowner education and counseling and create consumer demand for this vital service.

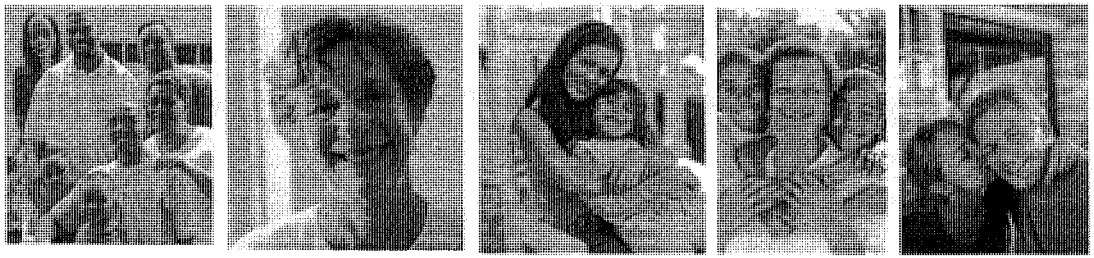
Public service advertising campaigns have made a measurable difference in our society. For example, as a result of the Ad Council's car seat-belt campaign, between the campaign launch in 1985 and 2003, seat belt usage increased from 14% to 79%, saving an estimated 85,000 lives, and $3.2 billion in costs to society.

We believe similar dramatic results could be achieved in the area of homeownership education and consumer financial literacy with such a campaign.

And finally, as credit for subprime borrowers has begun to tighten up in response to current challenges in the subprime market, there is a larger need than ever for a reasonably-priced mortgage refinance product. Such a product is needed to assist families currently trapped in high-cost mortgages, as well as to assist additional families as more than 1.5 trillion dollars in adjustable-rate mortgages prepare to reset within the next two years.

I have attached for the record, information prepared by the Homeownership Preservation Foundation providing further information regarding the activities of the 888-995-HOPE hotline.

I trust this testimony gives you a sense of some of the challenges we are facing and our response to families facing foreclosure. I stand ready to answer any questions you may have.



Homeownership Preservation Foundation (HPF)

A Report to the House Financial Services Committee

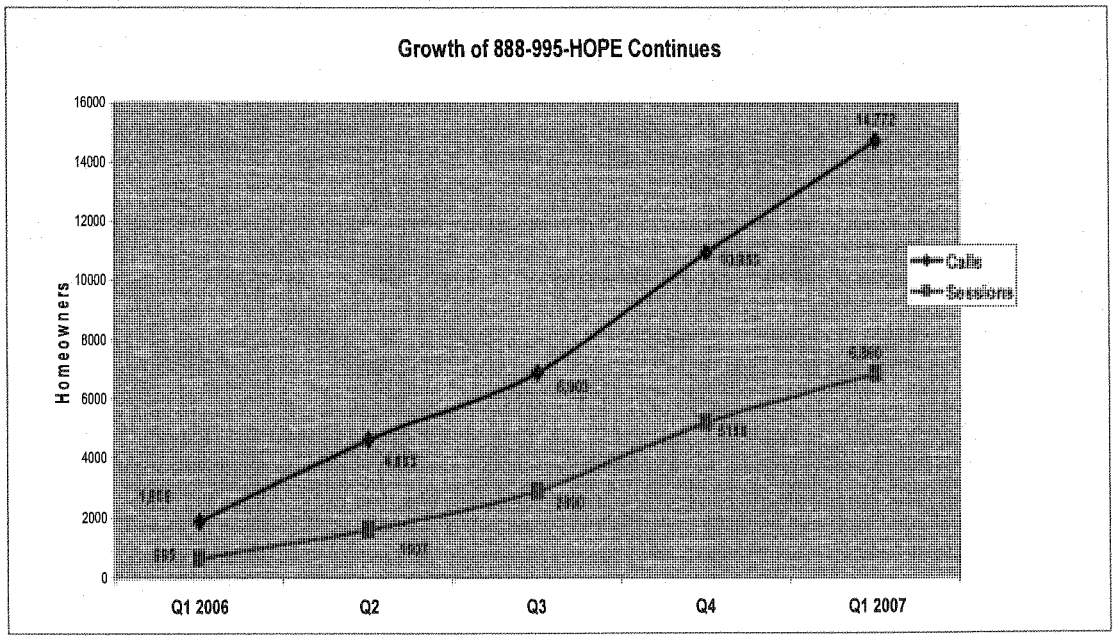
hpf homeownership preservation foundation

Highlights of Activity from 888-995-HOPE hotline

- The Homeownership Preservation Foundation is a national non-profit providing foreclosure prevention telephone counseling to tens of thousands of troubled homeowners each year.
- Any homeowner in America who may be in danger of missing a mortgage payment, or is already behind, can call the hotline and receive free, confidential, professional help, 24/7.
- In 2006, 25,000 homeowners called the hotline. Call volume has grown 30% since the end of '06; daily volume ranges from 350 to 1,000.
- 80 trained foreclosure prevention from 5 non-profit credit counseling agencies answer the phone; service begins immediately. HPF has the capacity to add more counselors as they're needed to respond to increasing demand.

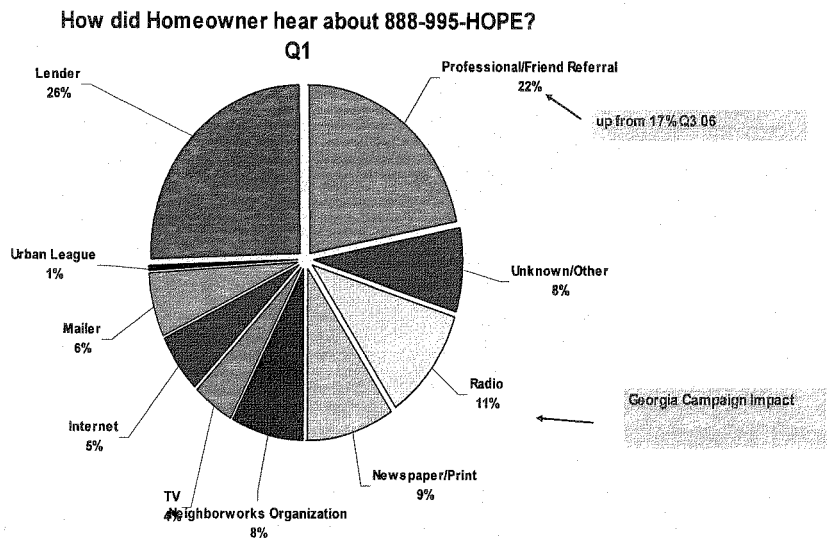
hpf

The HOPE hotline has received 14,000 calls so far this year. 46% of callers chose and completed counseling.



hpf

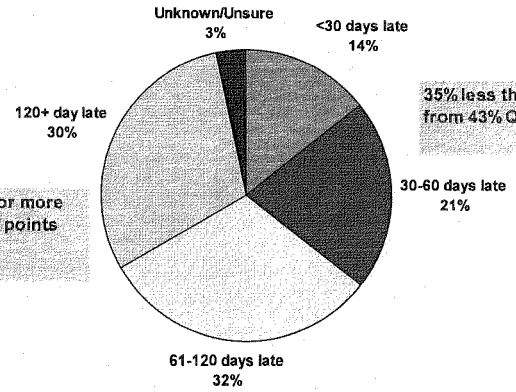
26% of callers hear about the hotline from their lender



hpf

Homeowners need to call early in the process
62% have already missed two payments when they call

Loan Status at First Contact with 888-995-HOPE
Q1

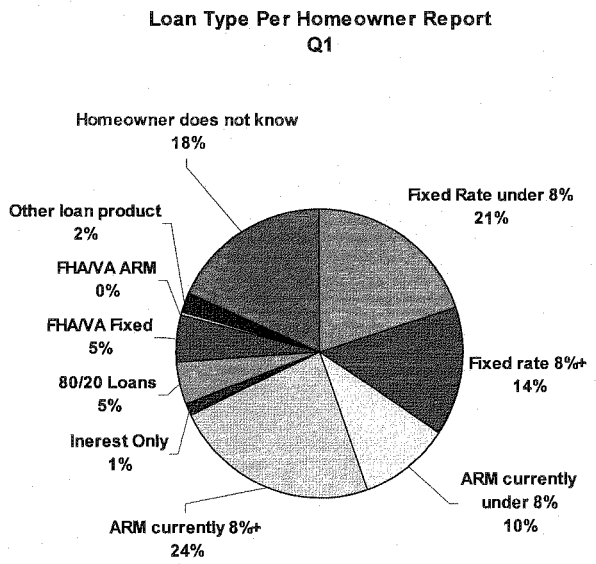


35% less than 61 days late, down from 43% Q3 06

62% have already missed two or more payments when they call, up 5 points from last quarter

hpf

Callers report having variety of loan products



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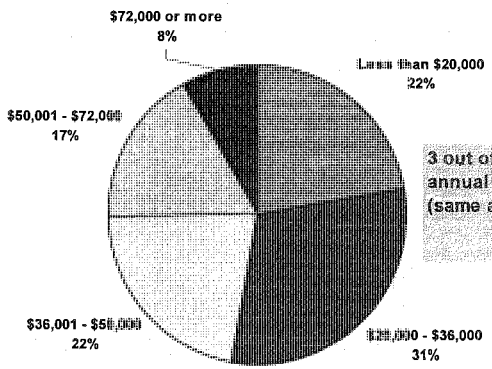
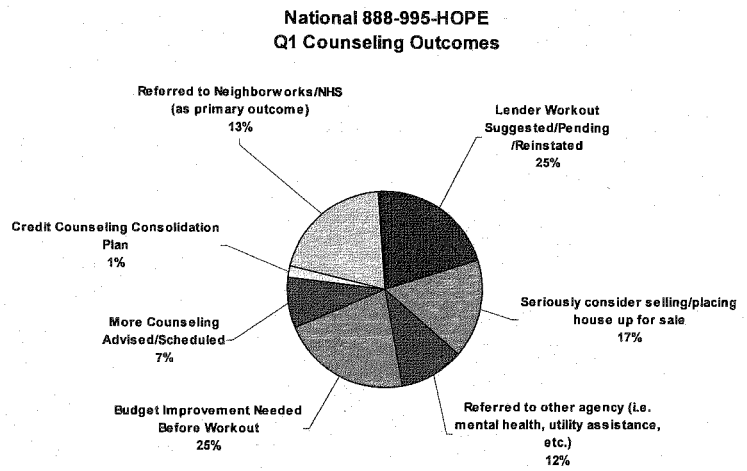
53% of callers earn less than $36,000 at time of counseling



3 out of 4 households under $50,000 annual income at time of counseling (same as Q4)

hpf

Outcomes: 13% are referred to NeighborWorks affiliates; 25% are recommended for loan workouts



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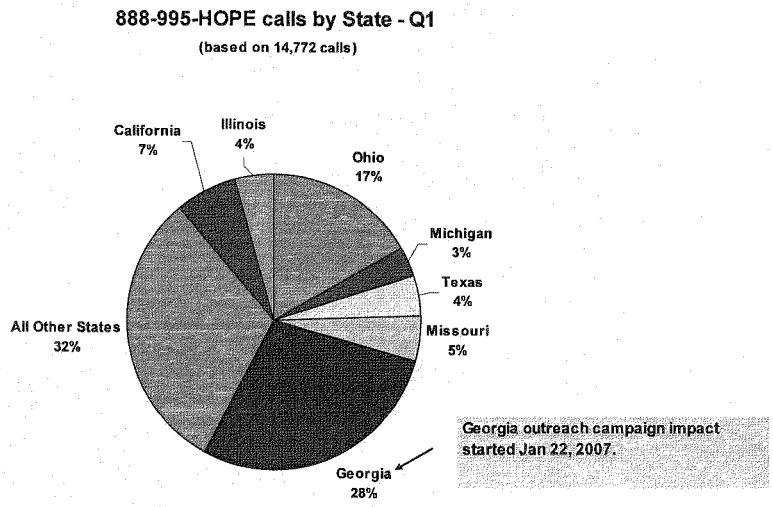
Georgia and Ohio generate the most calls



hpf

Some callers report fraud

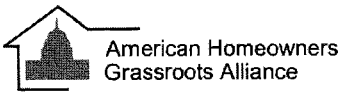
- Counselors are trained to look for and respond to callers who have experienced fraud. They cited 266 homeowners needed for legal services in Q1, 2007; many of those were fraud-related.
- The process involves reviewing the Non-profit Referral website for local agencies and resources to deal with fraud and provide legal aide in general. To date this website has resources for the top 15 metro areas where hotline calls originate from.
- HPF is steadily improving the training of counselors for the detection of fraud as well as the responses to those incidences and building a more robust response to the problem.

hpf

Foreclosure Doesn't Have to Happen

- Last year, there were 1,200,000 foreclosures completed in America.
- Only 25,000 homeowners called 888-995-HOPE in 2006.
- Help is available, free, trustworthy, professional help.
- If homeowners know about 888-995-HOPE, far fewer of them will face foreclosure.

hpf



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Defending the Interests of 75 Million U.S. Homeowners

Testimony

of the

The American Homeowners Grassroots Alliance

Submitted to the

House Financial Services Committee

Hearing on

Possible Responses to Rising Mortgage Foreclosures

April 17, 2007

The American Homeowners Grassroots Alliance (AHGA) commends the House Financial Services Committee for holding this hearing on Possible Responses to Rising Mortgage Foreclosures. AHGA is an independent consumer advocacy organization which focuses on policy issues that have a significant economic impact on homeowners and home ownership.

AHGA strongly supports a stable and healthy mortgage marketplace that will enable the expansion of U.S. home ownership. The current mortgage environment is causing untold grief for many innocent homeowners, undermining the equity of the nation's 75 million homeowners, and threatening the ability of potential future homeowners to take part in the American dream.

The nation faces a mortgage policy crisis and a mortgage policy challenge. The first is the immediate crisis faced by a very large number of homeowners who were sold unsuitable mortgages with features likely to lead to foreclose between now and the end of 2008. It is a crisis with the potential to spread beyond the subprime mortgage market and which could impact the overall economy. The window of opportunity for Congress to act to mitigate the problem is the next few months for those homeowners.

The mortgage policy challenge is determining how best to prevent a future recurrence of the current mortgage crisis, which was caused primarily by mortgage lenders' temporary abandonment of sound underwriting practices. From a policy standpoint we are currently much further along toward addressing this challenge than the crisis faced by homeowners who will lose their homes unless Congress acts in the immediate future. Both recent changes in the marketplace and a number of desirable long term regulatory reforms that have already been made or are in process have already reduced the rate of unsuitable mortgage loans now being made to homeowners. There are still gaps that need to be plugged and additional actions that Congress should consider to provide further assurance that the circumstances that have lead to the current crisis do not recur in the future, but progress to date in this area has been admirable.

Many of the worthy reforms that have been made or are in process will not address the immediate personal crisis faced by a large number of homeowners who were sold unsuitable mortgage loans and will likely face foreclosure as their mortgage rates adjust in 2007 or 2008. Although they are needed, some of those recent regulatory reforms will actually make it harder for many homeowners currently at risk of foreclosure to refinance their homes.

A recent study by First American CoreLogic Inc predicted that in the next six years, 13 percent of the 8.37 million adjustable-rate mortgages (or 1.1 million mortgages) originated between 2004 and 2006 will default, destroying $112 billion in home equity. The study, "Mortgage Payment Reset: The Issue and the Impact," also projects that for each 1 percent increase in home values, 70,000 homes can be saved from foreclosure, and conversely, that for each 1 percent decline in home values another 70,000 homes will face foreclosure. In a more

disturbing report issued on March 20, "Dissecting the Mortgage Distress," BAS analysts noted an excess supply of 800,000 existing homes currently on the market, and predicted that another 300,000 new foreclosures will soon be added to inventories. This will likely depress home values by another 5% in 2007, according to the Bank of America subsidiary.

Homeowners at risk of foreclosure as a result of unsuitable mortgage loans need immediate Congressional action to assure them affordable refinancing alternatives over the balance of 2007 and 2008 for the estimated 1.8 million of mortgagees whose loans will adjust during that period. A part of the solution is legislation that will reduce the cost of home ownership in order to make these homes more affordable to future home buyers and maintain home values. We cannot stress strongly enough that time is of the essence. Any legislation that takes the rest of this first session of Congress and most of the next session to enact will be too late to do any good.

Both Congress and mortgage lenders have already begun to take some steps that will help address the subprime mortgage crisis:

- The GSE reform bill will provide relief for homeowners as a result of funds to be set aside from GSE profits to help the economically disadvantaged achieve home ownership. This bill does not limit GSE lending, and the ability of GSEs to provide affordable mortgage financing for the largest possible segment of American homeowners is important to maintaining low interest rates and minimizing foreclosures.
- The Expanding Homeownership Act of 2007 will enable the Federal Home Administration to provide zero down and lower down payment FHA loans for homebuyers who could not otherwise make the down payment required under current FHA rules. It directs FHA to underwrite to borrowers with higher credit risk than FHA currently serves that are still creditworthy to take out a mortgage loan, but are otherwise now being driven into the subprime loan market, with much higher mortgage rates. It also authorizes zero down and lower down payment FHA loans for homebuyers who could not otherwise make the down payment required under current FHA rules, reduces FHA closing cost premiums, increases loan limits in high cost areas of the country, and permanently eliminates the current statutory volume cap on FHA reverse mortgage loans.
- More mortgage lenders are adopting loss mitigation techniques that are helping homeowners at risk of foreclosure. This growing practice is in the best interest of both lenders and homeowners. Many mortgage foreclosure investment experts advise against paying more than 65% of the fair market value for a home at a foreclosure auction. If the lender can find a way that preserves their securitization at a higher level than that it makes economic sense for the lender to find ways to do so. Techniques include loan restructuring, such as foregoing fees associated with changing into more sensible mortgage products, and allowing the "short sale" of homes. In a short sale the lender agrees to accept less than the balance owed on the mortgage when the proceeds of a home sale are

insufficient to cover the mortgage balance. From a mortgage lender's perspective the proceeds of a short sale are often greater than the proceeds of a foreclosure sale. There are many other worthy loss mitigation techniques, and mortgage lenders should be encouraged to expand the practice.

In addition to enacting this legislation as quickly as possible and encouraging more lenders to practice mortgage loss mitigation, more needs to be done in the immediate future as well:

- More and better mortgage loan standards and disclosures have been required of many, but not all, categories of mortgage lenders by some of the regulatory initiatives already in place. With the strong support of leaders of this committee, federal banking regulators last October issued interagency guidance on nontraditional mortgage products and in March proposed interagency guidance regarding subprime loans with hybrid ARM features. The Office of Federal Housing Enterprise Oversight also applied the guidance on nontraditional mortgage to Fannie Mae and Freddie Mac. The Conference of State Banking Supervisors has acted to develop parallel guidance for state regulators. It has been adopted by 30 states, with more in process. Among other requirements are discrete minimum underwriting standards, such as requiring lenders to use the fully indexed mortgage interest rate in qualifying prospective ARM borrowers. The advantage of such a discrete standard is that its impact can be quantified with respect to the ability of people to qualify and on their foreclosure rate. All mortgage lenders should be required to use these new and reasonable mortgage loan standards and provide timely, clear, plain English disclosures that include, among other information, the dollar amount of payments of a fully adjusted mortgage.
- A federal fund should be created to help victims of unsuitable subprime mortgages who are going through the foreclosure process. The fund would be used to help homeowners buy back their homes at foreclosure auction prices, which are often substantially less than their current market value, according to foreclosure experts. This fund would serve as a backup in cases where a homeowner facing foreclosure was unable to work out a solution with the mortgage lender and the lender had begun the foreclosure process. One way such a program might work is that homeowners who are threatened with foreclosure but still have sufficient income to support payments on a smaller fixed rate mortgage would be prequalified by a government approved lender for a fixed rate mortgage up to a certain amount, based on the homeowner's current income and assets. The homeowner could then bid up to that amount on their own home at a foreclosure auction. Government backing would be essential, as homeowners facing foreclosure have flawed credit and would otherwise have a very difficult time qualifying for any mortgage from any lender. This program would help homeowners who had been put in the wrong kind of mortgage keep their home and would also lessen to some degree the downward pressure that foreclosure auctions put on home values. The

risk to the government would be minimal because the purchase price would be the auction price which is a market liquidation amount that would be unlikely to drop much further. In cases where the effort was successful it would offer a modest benefit to mortgage lenders (an incrementally higher bid on the foreclosed property). It is important that this program be structured so as not to undermine the incentives for mortgage lenders to restructure loans. For example, if the fund was made available to any subprime homeowners who were simply behind in their mortgage payments, the incentive for lenders to undertake mortgage loss mitigation efforts would disappear. The cost of the program would be huge, and the fund would then be bailing out lenders who made unsound underwriting decisions. It would send the message that there is no need to restore sound underwriting procedures in the future, because taxpayers will bail you out if you don't. For that reason the program should apply to cases where the lender has already made a business decision not to apply loss mitigation procedures and is in the foreclosure process.

- Congress should establish minimum national professional/educational standards for sales professionals who counsel homeowners on mortgage financing. There are currently no state or federal professional/educational standards for mortgage salespersons and few standards for mortgage brokers. The person who sold you a mortgage last year may have sold aluminum siding the year before and may be selling used cars today. He or she has little stake in the mortgage lending profession, having invested neither time nor money in it. He or she may have little knowledge of sound lending practices and has little ability to provide suitable guidance on mortgage alternatives to consumers. Real estate agents and brokers are also in many cases de facto mortgage counselors to home buyers. In many cases they are the ones who convinced a prospective buyer to make an offer to buy a home that was beyond their means. Even though real estate agents currently owe a fiduciary duty to their clients and have at least minimal professional/educational standards, they too should be required to achieve higher levels of knowledge of mortgage financing. Legislation providing the framework for the eventual establishment of specific minimum national professional/educational standards for mortgage and real estate brokers and their agents should be one of the immediate steps. The legislation should provide for input from the mortgage lending, real estate brokerage, and consumer advocacy communities, and the appropriate federal agencies in developing those standards
- Many homeowners facing unaffordable payment adjustments on their subprime loans have enough equity to be able to pay off the mortgage with the proceeds of the home's sale, but there would not be enough left over to cover the traditional 5-6% real estate sales commission. The median price of a U.S. home is over $200,000, and the traditional 5-6% commission can be more than $12,000. In some states real estate brokers are allowed to list homes in the multiple listing services that distribute the listings extensively on the Internet for a few hundred dollars. However, in

many states traditional full service real estate brokers have successfully lobbied to prohibit this limited service business model. These current artificially high real estate transaction costs are a barrier to the sale of many homes that could be sold by subprime mortgagees under duress, if those transaction costs could be reduced. Congress should override any existing state laws that force home sellers to pay for real estate services they neither want nor need.

- To help increase the pool of home buyers, Congress should also override a number of state laws that prevent home buyers from receiving real estate commission rebates. In some cases those rebates can amount to as much as 2% of the selling price. Many prospective buyers who are just short of a down payment could become homeowners if these laws were repealed. The repeal would help not only the home buyers but many times more home sellers (including many in trouble with subprime loans), since an entry level home purchase often makes possible three purchase/sales higher up the food chain.
- Congress should also permanently extend the private mortgage insurance tax deduction for home buyers with $100,000 in income. This deduction, passed late last year, expires at the end of 2007.
- Mortgage interest rates have now increased for the fourth straight week. The Federal Reserve Board and other government entities should be encouraged to take any steps that will keep mortgage rates low.
- A number of other constructive and innovative proposals have been suggested to help keep mortgage interest rates down, reduce the cost of home ownership and/or help maintain home values. We urge the committee to consider any that make sense and which can be enacted in the narrow window of opportunity for legislative action.

There are also some steps that Congress should not consider as part of the fast track crisis avoidance effort:

- Suitability standards, while well intentioned, cannot realistically be applied sensibly by someone who has had little or no training in mortgage finance. Homeowners should not be subjected to a regime in which such an unqualified person gets to decide whether or not they will get a mortgage. Even if legislation to raise professional/educational standards of lenders' sales staff substantially is passed immediately, it will be some years before the professional ability of mortgage sales representatives rises to the level appropriate to provide sound consumer counseling. In addition the concept of a suitability standard is both elusive and subjective. Suitability standards are bound to lead to the denial of mortgage financing to some who could afford the mortgages. Their inherent subjective nature will also encourage lawsuits. With a number of new, pending, and proposed regulations that include specific and objective requirements for better disclosures and sound underwriting practices, subjective suitability standards may not be needed. In any event suitability standards are not a short term solution, and considerable thought and study should be undertaken before they are adopted as part of a long-term solution.

Congress , federal and state regulatory agencies and mortgage lenders have made much progress towards the prevention of future underwriting amnesia. Before Congress now is an immediate crisis that will affect the lives and futures of a large number of homeowners, and could also have far broader economic impact. We thank the committee for its recognition of this crisis, and urge speedy introduction and legislative action on any and all measures that might avert or reduce the impact of this crisis.

VANTAGESCORE

Testimony of Barrett Burns

On behalf of

VantageScore Solutions, LLC

"Possible Responses to Rising Mortgage Foreclosures"

Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

April 17, 2007

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Chairman Frank and Members of the Financial Services Committee, my name is Barrett Burns. On behalf of VantageScore Solutions, LLC, I commend you for convening today's hearing to consider possible responses to the alarming rise in residential mortgage foreclosure rates, particularly within the subprime market.

While it will take Herculean efforts to safeguard the American Dream of many families who today find their homes at risk, there is a clear opportunity for those who shape public policy and those in the private sector who extend home mortgage credit to substantially reduce the likelihood of future homeowners suffering that same misfortune. VantageScore Solutions, LLC, has a unique perspective on these issues, and I respectfully request that this statement be included in the official hearing record.

My testimony is based not only from the perspective of my current position as CEO of VantageScore Solutions, LLC, but also on the expertise and insight gleaned over the course of a career spanning more than three decades as a senior executive within the risk and credit management functions at several of the nation's most prestigious financial services companies, including U.S. Trust, Ford Motor Credit, Bank One, and Citibank.

VantageScore Solutions, LLC, is an independently managed company that maintains the intellectual property rights to VantageScore, a consumer credit scoring system that was launched last year by the nation's three largest credit reporting companies: Equifax, Experian and TransUnion. The model's underlying algorithms were developed specifically to enable accurate and predictive credit scoring of so-called "thin file" consumers – individuals whose insufficient documented credit histories have rendered them largely unscorable under other commercial credit scoring models. This sizeable economic subgroup, which includes subprime borrowers, often faces tremendous difficulty obtaining credit at reasonable terms or pricing despite the fact that a great many of them are creditworthy.

As rightfully concerned regulators, legislators, and members of the lending and consumer advocacy communities convene here and in other forums to find meaningful solutions to thwart a repeat of the current foreclosure crisis and protect future borrowers from being victimized by duplicitous or usurious lending activities, it is extremely important that we remain diligent about distinguishing between subprime lending and predatory lending. They are not interchangeable terms.

While the subprime market may serve as the "feeding ground" for predatory lenders, not all subprime loans are the work of unscrupulous lenders. And, despite the commonly held misperception, subprime borrowers are not all living paycheck to paycheck, nor can they all be characterized as irresponsible borrowers. Quite the opposite. They frequently are young adults just starting their careers, newly arrived

immigrants, recently divorced individuals – people of all backgrounds who shun the traditional banking system or prefer to manage their finances on a cash-only basis. That being the case, any response to the foreclosure crisis clearly needs to maintain access to credit for all deserving consumers – including subprime consumers.

In the majority of cases, recipients of subprime loans are low-risk, creditworthy individuals who are effectively being penalized by the lending process for their previous lack of adequate participation in the credit markets. Lenders rely heavily on automated credit scoring systems to facilitate the decision-making process about whether to extend credit and, if so, at what terms and pricing. Indeed, credit scores are the bedrock of the credit approval process. However, reliable credit scores can only be compiled on individuals with a documented history of credit usage. Individuals who lack such records, referred to in the industry as "thin file" consumers, cannot be readily scored.

While exact statistics are difficult to obtain, the general industry consensus is that there are as many as 50 to 70 million residents who do not fill the "paper trail" mold of most credit scoring systems. That does not make them undeserving of credit or even unscorable; it simply makes them unscorable *under those models*. Unfortunately for thin file consumers, however, those models are the ones that most lenders currently use.

The good news is that there are scoring models that allow for the scoring of more thin file consumers with the same reliability and predictiveness that regulators and credit risk managers demand. Such innovation is the result of the models' ability to leverage credit-related information not typically considered under familiar, older credit scoring models. Energy utility, telecommunications, and rent payment histories would be examples.

If the lending industry were to adopt these more data-intensive models, it is expected that millions of Americans who are now routinely categorized as subprime borrowers would be appropriately identified as having risk profiles that mirror those of mainstream borrowers, which would make them eligible for less risky products and repayment terms.

What is the greatest challenge to the adoption of these more comprehensive models? For the most part it is institutional resistance to change, to doing something different than how it has been done in the past. Public policy makers in Congress and in the regulatory community would do borrowers a great service by encouraging credit grantors, rating agencies, and the securitization market to embrace these newer models and, more generally, facilitate increased competition in the credit scoring marketplace.

It is worth noting that the findings of a joint study published recently by the Political and Economic Research Council and The Brookings Institution's Urban

Markets Initiative serve to further support this call for increased competition in the credit scoring marketplace. Released late last year, the study entitled *Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data* [1] makes a compelling case for increasing thin file consumers' access to affordable mainstream credit using the aforementioned more comprehensive data sources.

Among the study's most notable conclusions:

1. Lenders can accurately score more thin file consumers without relaxing their risk standards simply to accommodate their unique financial behaviors;

2. Those outside the credit mainstream have similar risk profiles as those in the mainstream when including nontraditional data in credit assessments;

3. Minorities and the poor benefit more than expected from inclusion of nontraditional data sources;

4. More comprehensive data can improve the performance of scoring models; and

5. Including more data can reduce bad loans, thus making more capital available, and improving margins as well as capital adequacy and provisioning requirements.

The study's conclusions on the impact of including nontraditional trade lines on poorly performing loans were equally compelling. Brookings found that including fully reported energy utility and telecommunications trade lines in traditional consumer credit reports measurably improves the performance of loans for a target acceptance rate. For example, by integrating fully reported energy utility data, a lender's default rate declines 29 percent, given a 60 percent target acceptance rate. Similarly, adding telecommunications data reduces the default rate by 27 percent. This reduction in bad loans translates into making more capital available and improving margins as well as capital adequacy and provisioning requirements.

One of the study's primary conclusions is that: "... alternative data, if widely incorporated into credit reporting, can bridge the information gap on financial risk for millions of Americans."

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[1] *Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data* by Michael A. Turner, Alyssa Stewart Lee, Ann Schnare, Robin Varghese, and Patrick D. Walker, December 2006 (http://www.brookings.edu/metro/umi/pubs/20061218_givecredit.htm).

As the Members of the House Financial Services Committee and your colleagues in Congress search for meaningful responses to the alarming rise in residential mortgage foreclosure rates – particularly within the subprime market – we urge you not to overlook but rather embrace more data-intensive credit scoring models. Such action could be implemented immediately with no change in law or regulation. It's immediate impact: millions of borrowers who now are routinely categorized as subprime would be recognized as having risk profiles very similar if not identical to those of mainstream borrowers, thus making them eligible for less risky loan products and more favorable repayment terms.

If substandard lending practices at the loan origination level are at the heart of the current foreclosure crisis, then meaningful responses seeking to strengthen this process need to incorporate improvements in the credit scoring process as well, since that is the foundation upon which lending decisions are made. There are underutilized resources available to lenders today that can provide desperately needed remediation, and I strongly encourage the Members of this Committee to ask the lending community, rating agencies, and securitization market to embrace them.

I would like to thank you, Mr. Chairman, and all of the Members of the House Financial Services Committee for the opportunity to share these views with you. Please do not hesitate to contact me should you, your colleagues on the Committee, or your staff wish to discuss these comments further.